

THE BATTLE OVER TAXING OFFSHORE ACCOUNTS^{*}

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ABSTRACT

The international tax system is in the midst of a contest between automatic information reporting and anonymous withholding models for ensuring that nations have the ability to tax offshore accounts. At stake is the extent of many countries' capacity to tax investment income of individuals and profits of closely held businesses through an income tax in an increasingly financially integrated world.

Four incongruent initiatives of the European Union, the Organisation for Economic Cooperation and Development (OECD), Switzerland, and the United States together represent an emerging international regime in which financial institutions act to facilitate countries' ability to tax their residents' offshore accounts. The growing consensus that financial institutions should act as tax intermediaries cross-border represents a remarkable shift in international norms that has yet to be recognized in the academic literature.

The remaining debate is about how financial institutions should serve as tax intermediaries cross-border, and for which countries. Different outcomes in this contest portend starkly different futures for the extent of cross-border tax administrative assistance available to most countries. The eventual triumph of an information reporting model over an anonymous withholding model is key to (1) allowing for the taxation of principal, (2) ensuring that most countries are included in the benefit of financial institutions serving as tax intermediaries cross-border, and (3) encouraging taxpayer engagement with the polity and supporting sovereign policy flexibility, especially in emerging and developing economies. This Article closes with proposals to help reconcile the emerging automatic information exchange approaches in order to produce an effective multilateral system.

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INTRODUCTION

Approximately \$7.8 trillion, representing more than 6 percent of all global wealth, is managed through offshore accounts.¹ Beginning in 2008, well-publicized cross-border tax evasion scandals focused political attention on offshore tax evasion in the world's major economies. One of the major scandals involved the United Bank of Switzerland (UBS), one of Europe's largest banks. Another involved LGT, a bank controlled by the royal family of Liechtenstein. The details read like a thriller. Bankers smuggled toothpaste tubes full of

1. BOSTON CONSULTING GROUP, GLOBAL WEALTH 2011: SHAPING A NEW TOMORROW 13 (2011), available at <http://www.bcg.com.pl/documents/file77766.pdf> [hereinafter BCG, GLOBAL WEALTH]. For the purposes of this Article, wealth managed through offshore accounts means “assets under management booked in a country where the investor has no legal residence or tax domicile.” *Id.*

diamonds across borders, while governments bought stolen disks that identified tax evaders and handed new identities to the informants.²

In the midst of the financial crisis, with its attendant budgetary pressures, the political response to the offshore tax evasion scandals was swift. Presidents and finance ministers insisted on improved transparency to combat offshore tax abuses. Recognizing its vulnerability to demands for transparency, Switzerland developed its own proposal: comprehensive anonymous cross-border tax withholding in lieu of an information reporting scheme that would promote transparency.

Thus began a global contest between automatic information reporting and anonymous withholding models for ensuring that states have the ability to tax offshore accounts. The latest moves as of this writing came in February, April, and June of 2012.³ In February the governments of six large developed economies, including the United States, issued a joint statement contemplating a shared commitment to developing a common model for the automatic exchange of tax information. In April treaty protocols entered into by Germany and the United Kingdom with Switzerland and a new agreement between Austria and Switzerland affirmed those countries' interest in anonymous withholding by the Swiss.⁴ Finally, in June Switzerland

2. L. Browning, *Ex-UBS Banker Pleads Guilty in Tax Evasion*, N.Y. TIMES, June 20, 2008, at C8; Carter Dougherty & Mark Landler, *Tax Scandal in Germany Fans Claims of Inequity*, N.Y. TIMES, Feb. 18, 2008, at C8; *Liechtenstein Tax Evasion Scandal: Informant in German Investigation 'Fears' for His Life*, SPIEGEL ONLINE INT'L, Mar. 3, 2008, <http://www.spiegel.de/international/business/0,1518,540283,00.html> (last visited Feb. 2, 2012).

3. This Article will not appear in print until November, 2012. However, the editorial process is such that the author will not be able to make substantive changes after July. Thus, readers should view the draft as taking into account events before July 1, 2012. The author recognizes that further developments after this date are likely, but this Article will not address such developments.

4. Press Release, U.S. Dep't of Treasury, Joint Statement From the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA (Feb. 7, 2012), available at <http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf> [hereinafter Joint Statement I]; Protokoll zur Änderung des am 21. September 2011 in Berlin

and the United States issued a joint statement that defused the direct confrontation between them over U.S. legislation commonly known as FATCA,⁵ while allowing the broader contest between anonymous withholding and automatic information exchange to play out.

The outcome of the debate over whether automatic information reporting or anonymous withholding should prevail will affect states' ability to tax income of their wealthiest residents.

unterzeichneten Abkommens zwischen der Bundesrepublik Deutschland und der Schweizerischen Eidgenossenschaft über Zusammenarbeit in den Bereichen Steuern und Finanzmarkt [Protocol Amending the Agreement between the Federal Republic of Germany and the Swiss Confederation on Cooperation in the Area of Taxation and Financial Markets signed in Berlin September 21, 2011], Ger.-Switz., Apr. 5, 2012 (Ger.), *available at* http://www.bundesfinanzministerium.de/nm_74882/DE/Wirtschaft_und_Verwaltung/Steuern/Aktuell/05-04-2012-Schweiz-Protokoll,templateId=raw,property=publicationFile.pdf [hereinafter Ger.-Switz. Protocol Amendment]; Protocol Amending the Agreement Between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on Cooperation in the Area of Taxation, U.K.-Switz., Oct. 6, 2011, *available at* <http://www.hmrc.gov.uk/taxtreaties/protocol-amend-ukswiss-agree.pdf> [hereinafter U.K.-Switz. Protocol Amendment]; Abkommen zwischen der Schweizerischen Eidgenossenschaft und der Republik Österreich über die Zusammenarbeit in den Bereichen Steuern und Finanzmarkt [Agreement between the Swiss Confederation and Austria on Cooperation in the Area of Taxation and Financial Markets], Austria-Switz., Apr. 13, 2012 (Ger.), *available at* <http://www.news.admin.ch/NSBSubscriber/message/attachments/26559.pdf> [hereinafter Austria-Switz. Cooperation Agreement]. As of late July 2012, the latest update is development of reciprocal and nonreciprocal model intergovernmental agreements. *See also* MODEL INTERGOVERNMENTAL AGREEMENT TO IMPROVE TAX COMPLIANCE AND TO IMPLEMENT FATCA (July 26, 2012), *available at* <http://www.treasury.gov/press-center/press-releases/Pages/tg1653.aspx>.

5. Press Release, U.S. & Switz., Joint Statement From the United States and Switzerland Regarding a Framework for Cooperation to Facilitate the Implementation of FATCA (June 21, 2012), *available at* <http://www.treasury.gov/press-center/press-releases/Documents/FATCA%20Joint%20Statement%20US-Switzerland.pdf> [hereinafter Joint Statement II].

The capacity to make, hold, and manage investments through offshore financial institutions⁶ has increased dramatically in recent years, while the cost of such services has plummeted.⁷ Individuals now find it substantially easier to underreport or fail to report investment earnings through the use of offshore accounts, and experience suggests that such accounts may also be used to help evade tax on income earned domestically by closely held businesses. Consequently, the principal held in offshore accounts as well as the investment earnings generated through such accounts may go untaxed.

Under either an automatic information reporting or an anonymous withholding model for cross-border tax administrative assistance, global financial institutions are co-opted by governments as cross-border tax intermediaries. In this important respect the two models are variants of a single emerging regime. However, the contest between information reporting and anonymous withholding models for how financial institutions will provide cross-border tax administrative assistance implicates broad questions about the future of tax sovereignty in a globalized economy and about the treatment of the wealthiest vis-à-vis other taxpayers. Whereas anonymous withholding delegates the collection of tax to a foreign entity, automatic information reporting shores up a government's capacity to tax its own citizens.

The stakes in the battle between automatic information exchange and anonymous withholding are particularly high for many emerging and developing economies. For these countries, the question is not whether their wealthy taxpayers' access to offshore accounts will weaken enforcement, but whether, given such access, taxes on capital income can be enforced at all. In many such economies, the bulk of the individual income tax base is often comprised of a

6. I use the term "offshore financial institution" to refer to any financial institution outside the jurisdiction of legal residence or tax domicile of a given investor. In this way, my use of the term "offshore financial institution" differs from much of the literature regarding "offshore financial centers." That literature tends to categorize individual jurisdictions as "onshore" and "offshore" centers. In contrast, I view a financial institution in the United Kingdom serving an Indian investor as an "offshore financial institution" with respect to that Indian investor.

7. Maintaining the capacity for large, developed economies to tax capital income under such circumstances has been a subject of scholarly concern for many years. *See, e.g.,* Vito Tanzi, *Globalization, Technological Developments, and the Work of Fiscal Termites*, 26 BROOK. J. INT'L L. 1261, 1262, 1274–75 (2001).

concentrated group of well-off individuals. Domestic financial institutions are also often relatively undeveloped. Thus, it is commonplace for the wealthy to hold investments through offshore accounts.⁸ Without proper support mechanisms for the overstretched tax administrators of these countries, it is difficult to constrain their citizens from evading domestic tax liability on capital income and closely held business income by using offshore accounts and offshore entities.

In April 2009 leaders of the G20 countries⁹ declared that “[t]he era of banking secrecy is over,” and emphasized the importance of including developing countries in what they said would be “a new cooperative international tax environment.”¹⁰ Since that time, a growing number of governments¹¹ and NGOs¹² have called for automatic exchange of tax information to address the taxation of offshore accounts. Financial institutions have expressed interest in providing governments with automatic information on cross-border investors and their investment income, at least when promised relief from withholding tax for such investors. The European Union’s

8. See *infra* notes 42–43 and accompanying text.

9. The G20 is comprised on 19 member countries and the European Union. The members are: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Republic of Korea, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States, and the European Union. *Members*, G20, <http://www.g20.org/index.php/en/members> (last visited Sept. 13, 2012).

10. Group of Twenty, *Declaration on Strengthening the Financial System*, G-20 (Apr. 2, 2009), <http://www.g20.utoronto.ca/2009/2009ifi.pdf> [hereinafter April 2009 London Communiqué].

11. One of the strongest statements came from Indian Prime Minister Manmohan Singh, who suggested that the “G-20 countries should take the lead in agreeing to automatic exchange of tax related information with each other . . . in the spirit of our London Summit [declaration] that ‘the era of bank secrecy is over.’” *PM Sends Strong Message to Stop Tax Evasion*, IBN LIVE, <http://ibnlive.in.com/news/send-strong-message-on-tax-evasion-pm-to-g20/198996-2.html> (last updated Nov. 3, 2011).

12. The Tax Justice Network has been particularly active and effective in encouraging civil society to focus on the issue of automatic exchange of tax information. TAX JUSTICE NETWORK, http://www.taxjustice.net/cms/front_content.php?idcatart=2&lang=1 (last visited May 28, 2012).

Savings Directive resulted in a limited form of automatic information exchange among most EU countries, and proposals of the last few years would expand its scope. FATCA, legislation enacted by the United States in 2010, will eventually require foreign financial institutions to report financial information about accounts held by specified U.S. persons or to be subject to a punitive withholding tax. Finally, the recently revised Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) creates a potential legal platform for multilateral automatic information exchange.

In August 2011, however, both Germany and the United Kingdom signed treaties with Switzerland that reject automatic information exchange and substitute anonymous cross-border tax withholding.¹³ A similar agreement followed with Austria in April 2012.¹⁴ Under these agreements, Swiss financial institutions will impose withholding tax on behalf of a foreign government and the Swiss government will remit that tax anonymously to the countries of

13. See generally Agreement Between the Swiss Confederation and the United Kingdom of Great Britain and Northern Ireland on Cooperation in the Area of Taxation, U.K.-Switz., Oct. 6, 2011, *available at* <http://www.hmrc.gov.uk/taxtreaties/swiss.pdf> [hereinafter U.K.-Switz. Cooperation Agreement]; U.K.-Switz. Protocol Amendment, *supra* note 4; Mutual Agreement Implementing Article XVIII of the Protocol Signed on 20 March 2012, Amending the Agreement Between the Swiss Confederation and the United Kingdom of Great Britain and Northern Ireland on Cooperation in the Area of Taxation, U.K.-Switz., Apr. 18, 2012, *available at* <http://www.hmrc.gov.uk/taxtreaties/swiss-uk-letters.pdf> (increasing the minimum rate payable from 19 percent to 21 percent and increasing the rate payable on £7 million or more to 41 percent) [hereinafter U.K.-Switz. Protocol Letters]. See also Abkommen zwischen der Bundesrepublik Deutschland und der Schweizerischen Eidgenossenschaft über Zusammenarbeit in den Bereichen Steuern und Finanzmarkt [Agreement between the Federal Republic of Germany and the Swiss Confederation on Cooperation in the Area of Taxation and Financial Markets], Ger.-Switz., Sept. 21, 2011 (Ger.) [hereinafter Ger.-Switz. Cooperation Agreement]; Ger.-Switz. Protocol Amendment, *supra* note 4; Austria-Switz. Cooperation Agreement, *supra* note 4. Additionally, it was announced on June 12, 2012, that Italy and Switzerland are working to revise their double taxation agreement. See Swiss Fed. Dep't of Fin., *Switzerland-Italy Tax Dossier*, June 12, 2012, *available at* <http://www.news.admin.ch/NSBSubscriber/message/attachments/27146.pdf>.

14. See Austria-Switz. Cooperation Agreement, *supra* note 4.

residence of the investors, without revealing the names or other information regarding the account holders whose investment earnings give rise to these payments. The Swiss agreements are important because more than 25 percent of the world's offshore wealth is managed from Switzerland, while approximately another 25 percent of the world's offshore wealth is managed from the United Kingdom and its dependencies.¹⁵ Switzerland often acts as a leader for offshore asset management centers, while Germany and the United Kingdom are among the few economic and financial centers with sufficient leverage to exert pressure on governments that are home to important offshore asset managers. The Swiss agreements, particularly if ratified, represent a major blow to multilateral automatic information reporting. Bilateral anonymous withholding agreements are incompatible with a broadly multilateral automatic information exchange system.

Together, the moves by governments and financial institutions toward automatic information exchange and anonymous cross-border withholding represent an important shift for the international tax system. Yet academic discourse has hardly addressed the emerging approaches for cross-border tax intermediation.¹⁶ Professional authors and the press generally

15. BCG, GLOBAL WEALTH, *supra* note 1, at 13.

16. The only article of which I am aware that addresses the differences between all of the emerging information reporting models in any detail is Stafford Smiley, *Qualified Intermediaries, The EU Savings Directives, Trace—What Does FATCA Really Add?*, CORP. TAX'N, Sept–Oct. 2011, at 20. Although I disagree with certain of that article's conclusions, and it does not consider the clash with anonymous withholding, Smiley makes an important contribution to the literature. Recently, Susan Morse wrote a piece comparing FATCA's approach to routing information reporting with the approach to routing information taken by the European Union's Savings Directive, and recommended simplifying FATCA diligence and reporting, making side payments to participating countries, and seeking inter-governmental cooperation by offering reciprocity. Susan C. Morse, *Ask for Help, Uncle Sam: The Future of Global Tax Reporting*, 57 VILL. L. REV. (forthcoming 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1999101. Richard Harvey wrote an article focused on the implementation of FATCA, but it does not discuss the international context or other emerging approaches. J. Richard Harvey, Jr., *Offshore Accounts: Insider's Summary of FATCA and Its Potential Future*, 57 VILL. L. REV. (forthcoming 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1969123.

focus on a single emerging approach, or occasionally note that automatic information exchange and anonymous withholding are in conflict with one another. The commonality between these systems is, however, as important as their differences: the emergence of the EU, Organisation for Economic Cooperation and Development (OECD), Swiss, and U.S. approaches to cross-border tax administrative assistance has shifted the discourse of international tax cooperation from a dispute about whether financial institutions should function as cross-border tax intermediaries to a dispute about how financial institutions should perform that role.

This Article makes three key contributions. First, it highlights the commonality between automatic information exchange and anonymous withholding, and argues that we are witnessing the birth of a new international regime in which financial institutions act as cross-border tax intermediaries with respect to offshore accounts.¹⁷ Second, it explains why automatic information reporting solutions are preferable to anonymous withholding solutions.¹⁸ Finally,

In late 2009 Jefferson VanderWolk wrote an insightful and prescient short article suggesting that the change in international norms with respect to information exchange upon request was likely to be an initial stage in a process that would eventually result in broader and more automatic exchanges of information between tax authorities. *See generally* Jefferson P. VanderWolk, *The New World of Tax Information Exchange*, 13 ASIA-PAC. J. TAX’N [redacted] (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1582452. An early paper emphasizing that “multilateral coordination has become necessary to achieve the effective international information exchanges required for residence-based taxation of foreign portfolio income,” and that “the threat of coordinated multilateral defensive measures may coerce tax havens into entering into information exchange agreements with OECD [Organisation for Economic Cooperation and Development] countries,” is Michael J. Graetz & Itai Grinberg, *Taxing International Portfolio Income*, 56 TAX. L. REV. 537, 579–80 (2003).

17. By an “international regime” I mean to employ Stephen Krasner’s classic definition: “implicit or explicit principles, norms, rules and decision-making procedures around which actors’ expectations converge in a given area of international relations.” Stephen D. Krasner, *Structural Causes and Regime Consequences: Regimes as Intervening Variables*, 36 INT’L ORG. 185, 186 (1982).

18. From the perspective of a tax administrator, this comparison is between two second-best alternatives. The ideal compliance system would provide for both non-anonymous

this Article begins to address how to reconcile the emerging and incongruent proposals for automatic information reporting in a manner that will promote the emergence of a multilateral automatic information reporting system.

Part I of this Article introduces the events that catalyzed the present evolutionary moment in cross-border tax cooperation, and describes why the push for greater transparency to address offshore tax evasion may be even more important to emerging and developing economies than it is to developed economies. Part II describes the nascent approaches to cross-border tax cooperation being developed by the European Union, the OECD, Switzerland, and the United States. It argues that all of these approaches build on the premise that financial institutions should be cross-border tax intermediaries. The fact that both government and private sector expectations are converging around this premise marks the emergence of a new regime.

Part III argues that the automatic information reporting model is superior to the anonymous withholding model. Automatic information reporting solutions can address concerns regarding the accretion of untaxed principal, whereas anonymous withholding solutions cannot. Automatic information reporting also undergirds voluntary compliance by preserving tax morale, maintains expressive values associated with the taxation of capital income, and supports government policy flexibility, particularly outside the large developed economies.¹⁹ Finally, unlike anonymous withholding, an automatic information reporting solution has the capacity to develop into a broadly multilateral regime.

However, the development of the new regime is likely to be path dependent, and bilateral anonymous withholding along with limited use of automatic information exchange may be the most likely default. A critical mass of anonymous withholding agreements would likely produce

withholding and information reporting. This Article does not address that possibility because it is not presently under consideration internationally.

19. Some might query whether the degree to which the tax and development literature supports progressive personal income taxation and challenge the recommendations of this Article on those grounds. *See generally* Richard M. Bird & Eric M. Zolt, *Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries*, 52 UCLA L. REV. 1627 (2005). However, if administration were less of a concern due to improved global cooperation, then scholars with concerns regarding administrability might be more likely to endorse schedular income taxation of capital income by developing countries, at least at the top of the income distribution, as one part of a broader strategy to address inequality. *See id.* at 1659–60, 1689–92.

a suboptimal equilibrium that would allow only a limited group of countries to reap benefits from financial institutions functioning as cross-border tax intermediaries. Thus, the emergence of a multilateral automatic information reporting system requires progress in the near to medium term before an anonymous withholding system becomes ensconced.

At present it remains unclear whether the world is on the path toward automatic information exchange, anonymous withholding, or some combination thereof. Part IV provides proposals as to how the emerging information reporting models could be harmonized to encourage the development of a multilateral automatic information exchange system. It also proposes safeguards to address concerns that information exchanged automatically might be misused in some countries.²⁰

I. THE BEGINNING OF EVOLUTIONARY CHANGE IN CROSS-BORDER TAX ADMINISTRATIVE ASSISTANCE

A. Achieving Information Exchange Upon Request, and Its Inadequacy

Most governments of major developed countries agree that access to information from other countries is vital to the full and fair enforcement of their tax laws.²¹ Consequently, bilateral tax

20. As a study of a particular problem in international tax diplomacy and regime conflict, this Article is also responsive to Diane Ring's observation that the international tax literature lacks such scholarship, and could greatly benefit from it. Diane Ring, *International Tax Relations: Theory and Implications*, 60 TAX L. REV. 83 (2007).

21. For example, over the years the International Tax Counsel of the United States has consistently testified before the Senate Foreign Relations Committee that access to information from other countries is critically important to the enforcement of U.S. tax laws. *See, e.g., Tax Convention With the United Kingdom (T.Doc. 107-19) and Protocols Amending Tax Conventions With Australia (T. Doc. 107-19) and Mexico (T. Doc. 108-3): Hearing Before the Committee on Foreign Relations*, 108th Cong. 9 (2003) (statement of Barbara M. Angus, Int'l Tax Counsel, U.S. Dep't of Treasury) ("Because access to information from other countries is critically important to the full and fair enforcement of the U.S. tax laws, information exchange is a priority for the United States in its tax treaty program. If a country has bank secrecy rules that would prevent or seriously inhibit the appropriate exchange of information under a tax treaty, we will not conclude a treaty with that country. [I]t is one of a very few matters that we consider non-negotiable."); *Treaty Doc. 112-01: Protocol Amending Tax Convention With Swiss*

treaties generally provide for the exchange of information between tax authorities. Such provisions have appeared in tax treaties since at least World War II.²² However, the OECD Model Tax Convention (OECD Model Treaty), the world's dominant model tax treaty, only requires information exchange upon request, while permitting but not requiring automatic information exchange.²³ The OECD's standards do not permit "fishing expeditions" in a request for information from one country to another. Historically, that limitation was understood to allow only requests about specific taxpayers, identified by name, in circumstances where the

Confederation; Treaty Doc. 111-08: Protocol Amending Tax Convention With Luxembourg; Treaty Doc. 111-07: Tax Convention With Hungary; Treaty Doc. 110-23: Investment Treaty With Rwanda; Treaty Doc. 111-06: Mutual Legal Assistance Treaty With Bermuda: Hearing Before the S. Comm. on Foreign Relations, 111th Cong. (2011) (statement of Manal Corwin, Int'l Tax Counsel, U.S. Dep't of Treasury).

22. Steven Dean, *The Incomplete Global Market for Tax Information*, 49 B.C. L. REV. 605, 648–53 (2008) (describing bilateral tax information exchange upon request as a barter system that allows pairs of governments to barter with one another for information that each can use to enforce their own taxes, and exploring the possibility of a market for cross-border tax information in which governments could buy and sell taxpayer information for consideration other than reciprocity).

23. ORG. FOR ECON. COOPERATION & DEV., Articles of the Model Convention With Respect to Taxes on Income and on Capital art. 26 (2008) [hereinafter OECD Model Convention]. The OECD's Model Convention and Model Tax Information Exchange Agreement (for countries wishing to agree to tax information exchange without a broader tax treaty) require exchange of information *upon request* where: (1) it is "foreseeably relevant" to the administration and enforcement of the domestic laws of the treaty partner; (2) there are no restrictions on exchange caused by bank secrecy or domestic tax interest requirements; (3) there is availability of reliable information and powers to obtain it; (4) respect is given for taxpayers' rights; and (5) information that is exchanged remains strictly confidential. ORG. FOR ECON. COOPERATION & DEV., OVERVIEW OF THE OECD'S WORK ON COUNTERING INTERNATIONAL TAX EVASION (2009). These standards were eventually endorsed by the G8, the G20, and the (United Nations) UN, leading the OECD to describe the results as representing international standards for transparency and exchange of tax information.

requesting government could explain why it had reason to suspect it needed information about that taxpayer's affairs.²⁴

Prior to 2009, the major developed economies and the OECD were hamstrung in their efforts to achieve comprehensive information exchange upon request. The chief obstacle was the fact that four OECD member states—Austria, Belgium, Luxembourg, and Switzerland—were committed to bank secrecy as a bar to tax information exchange upon request.²⁵ One of these countries, Switzerland, is the location of more than 25 percent of the global offshore wealth

24. See Article 26 of the OECD Model Tax Convention on Income and on Capital and its Commentary (Jul. 6, 2010). *But see* OECD, Update to Article 26 of the OECD Model Tax Convention and its Commentary, at ¶ 5.2, available at [http://www.oecd.org/ctp/exchangeofinformation/latestdocuments/120718_Article%2026-ENG_no%20cover%20\(2\).pdf](http://www.oecd.org/ctp/exchangeofinformation/latestdocuments/120718_Article%2026-ENG_no%20cover%20(2).pdf). Under the revised commentary to Article 26 of the OECD Model Convention released on July 17, 2012, a request for information relating to a group of unidentified taxpayers will be viewed as a “fishing expedition,” i.e., random and speculative, unless the requesting State can provide the following to the requested State: (1) a detailed description of the group; (2) the specific facts and circumstances underlying the request; (3) explanation of the applicable law, and, (4) “why there is reason to believe that the taxpayers in the group for whom information is requested have been non-compliant with that law supported by a clear factual basis.” Furthermore, the requesting State must show that the requested information “would assist” in determining whether the taxpayers in the group complied with the tax law.

25. Historically, the OECD had pressured nonmembers to conform to high standards regarding tax information exchange but, given its consensus-based system for agreement among member countries, found it difficult to pressure its own four bank secrecy jurisdictions. Statements regarding the importance of information exchange and compliance with international standards could not hide the fact that there was no true consensus among developed governments as to how to manage their own outliers (such as Austria and Switzerland) on this issue. The unwillingness or inability of the major developed economies to confront fellow OECD members sparked understandable calls of hypocrisy from other offshore financial centers during the late 1990s, in the course of the OECD's efforts to combat so-called harmful tax competition. Those outcries were effective in limiting pressure on jurisdictions opposed to liberal global tax information exchange rules.

management industry as measured by assets under management,²⁶ and the others also have important histories as offshore banking centers. Significant non-OECD financial centers (such as Hong Kong, Liechtenstein, Panama, and Singapore) felt comfortable following the lead of Switzerland and the other OECD bank secrecy jurisdictions in rejecting exchange upon request of bank information.

In 2008, however, the issue of offshore tax evasion moved high on the global political agenda, largely as a result of two notable scandals. The first of these scandals resulted in prosecutions for tax evasion through accounts held at LGT bank in Liechtenstein, primarily against residents of Germany and other large European countries.²⁷ The second scandal led the United States to act against UBS for conspiring to defraud the United States by helping U.S. customers conceal their ownership of, or beneficial interest in, income and assets held through offshore accounts in Switzerland and other jurisdictions.²⁸ Responding to a widespread understanding that LGT and UBS were merely exemplars of a much broader problem, world leaders at the April 2009 G20 London Summit stated that they “stand ready to take agreed action against those jurisdictions which do not meet international standards in relation to tax transparency.”²⁹ The G20 called attention to a document the OECD published on the same day as the London Summit that listed countries that had not committed to or substantially

26. Switzerland manages more than 25 percent of the world’s offshore wealth. *See* BCG, GLOBAL WEALTH, *supra* note 1, at 13. BOSTON CONSULTING GROUP, GLOBAL WEALTH 2010: REGAINING LOST GROUND 13 (June 2010), *available at* http://www.trigoncapital.com/upload/wealth_managment/TWM/BCG_Regaining_Lost_Ground_Jun_10.pdf [hereinafter BCG, GLOBAL WEALTH 2010].

27. L. Browning, *Banking Scandal Unfolds Like a Thriller*, N.Y. TIMES, Aug. 15, 2008, at C8; *Liechtenstein Tax Evasion Scandal: Informant in German Investigation ‘Fears’ for His Life*, *supra* note 2; *Investigators Find ‘Immense’ Evasion: Over 160 Tax Dodgers Confess in Liechtenstein Probe*, SPIEGEL ONLINE INT’L (Feb. 26, 2008), <http://www.spiegel.de/international/business/0,1518,537839,00.html>.

28. DOJ Announces Deferred Prosecution Agreement With UBS, TAX NOTES TODAY 31–32 (Feb. 19, 2009).

29. April 2009 London Communiqué, *supra* note 10, at 4.

implemented international standards for tax transparency. For the first time, such an OECD list included the bank secrecy countries that were OECD members.³⁰

The April 2009 G20 Summit and OECD list catalyzed the present evolutionary moment in cross-border administrative assistance for tax purposes.³¹ Within a few years of being threatened with sanctions by the G20, those jurisdictions previously unwilling to exchange information upon request in accordance with OECD standards changed their position and began to comply with this new global norm. However, information exchange on request is, on its own, inadequate to combat offshore tax evasion. The ability to request information regardless of bank secrecy does have some chilling effect on tax evasion because evaders cannot rely on bank secrecy to conceal their activities. At the same time, in order to receive information upon request, a tax administration was traditionally required to name the taxpayer, to know which jurisdiction to ask for information, to know at which financial institution a taxpayer may hold her account, and to have a credible suspicion of tax evasion. Otherwise, the request could be denied as a fishing expedition. A requirement that a requesting tax administration have such specific and detailed information limits the effectiveness of information exchange upon request as a means to systematically combat offshore tax evasion.³²

Recent actions by legislatures, tax administrations, and prosecutors of the world's major developed economies demonstrate their belief that information exchange upon request is inadequate to fight offshore tax evasion. Various G7 governments have purchased account data

30. *Id.* at 4.

31. Following the release of the G20 communiqué, previously recalcitrant jurisdictions made formal commitments to the OECD information exchange upon request standard and shortly thereafter began passing legislation to implement their stated commitments. *See, e.g.*, David Crawford & Jesse Drucker, *Swiss to Relax Bank Secrecy Laws*, WALL ST. J., Mar. 14, 2009, <http://online.wsj.com/article/SB123694252262918343.html>.

32. *See* John Christensen & David Spencer, *Stop This Timidity in Ending Tax Haven Abuse*, FIN. TIMES, Mar. 4, 2008, <http://www.ft.com/intl/cms/s/0/63cdb642-ea03-11dc-b3c9-0000779fd2ac.html#axzz1hJI1DvU3>. *But see* OECD, Update to Article 26 of the OECD Model Tax Convention and its Commentary, *supra* note 24, at ¶ 5.2 (changes to the Commentary to Article 26 of the OECD Model Convention to explicitly authorize requests relating to a group of unidentified taxpayers in certain circumstances).

stolen by insiders from banks,³³ shared stolen information among themselves and used it to prosecute tax evaders,³⁴ required foreign banks to report on or close their residents' accounts,³⁵ opened up investigations of and prosecuted financial institutions with large offshore asset management businesses,³⁶ entered agreements to require anonymous withholding on their residents' offshore accounts,³⁷ demanded automatic information reporting,³⁸ and linked enhanced penalties for offshore tax evasion by their citizens to the tax transparency of the territory in

33. Carter Dougherty & Mark Landler, *Tax Scandal in Germany Fans Complaints of Inequality*, N.Y. TIMES, Feb. 18, 2008, <http://www.nytimes.com/2008/02/18/business/worldbusiness/18tax.html>.

34. H. Arnold Sherman, *The War on Offshore Tax Evasion*, STEP J., Sept. 2010, http://www.stepjournal.org/journal_archive/2010/step_journal_september_2010/the_war_on_offshore_tax.aspx (noting that the French, German, and American tax authorities have all used stolen information purchased from employees of foreign banks to prosecute taxpayers evading domestic tax obligations).

35. Joint Declaration by the Government of the Principality of Liechtenstein and Her Majesty's Revenue and Customs Concerning the Memorandum of Understanding Relating to Cooperation in Tax Matters, Liech.-U.K., Aug. 11, 2009, *available at* <http://www.hmrc.gov.uk/international/joint-declaration-lich.pdf>. The United Kingdom entered into a treaty in which Liechtenstein, under pressure, agreed that financial intermediaries in Liechtenstein will identify persons that may be liable to tax in the United Kingdom, and either obtain certification that such person is compliant with their U.K. tax obligations or close the account. Somewhat similarly, the U.S. FATCA legislation requires foreign financial institutions to report on, withhold on, or close U.S. accounts.

36. Randall Jackson, *U.S. Offers 11 Swiss Banks Deals to End Tax Evasion Investigation*, 134 TAX NOTES 71 (2012).

37. U.K.-Switz. Cooperation Agreement, *supra* note 13; Ger.-Switz. Cooperation Agreement, *supra* note 13.

38. *See, e.g.*, Hiring Incentives to Restore Employment Act of 2010 (HIRE Act), Pub. L. No. 111-47, § 501-35, 124 Stat. 71, 97-115 (2010) (foreign account tax compliance title); Council Directive 2011/16/EU, Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC, 2011 O.J. (L 64) 1 [hereinafter the February Directive]. *See also* Singh, *supra* note 11.

which the income or gain arises.³⁹ These unilateral techniques, while somewhat effective, often are not available to less powerful countries looking to address their own offshore tax evasion concerns.

B. Emerging and Developing Economies Are Most Exposed

The best available data suggests that compliance concerns over tax evasion through offshore accounts are likely to be greater for emerging and developing economies than for developed economies. Meanwhile, the emerging and developing economies' lower administrative capacity reduces the efficacy of information exchange upon request as a tool with which they can combat offshore tax evasion. They often lack the audit and investigative skills to determine which country to ask about which resident taxpayer.

Offshore wealth represents 6.4 percent of the more than \$120 trillion of global wealth.⁴⁰ However, the extent to which taxpayers' assets are managed offshore is not uniform across regions of the world. Boston Consulting Group (BCG) estimates that less than 2 percent of North American wealth and less than 8 percent of European wealth is held offshore.⁴¹ In contrast, more than 25 percent of all Latin American household wealth, representing \$900 billion, and almost 33 percent of all Middle Eastern and African wealth, representing \$1.4 trillion, is held offshore.⁴² Households outside the major developed economies hold

39. See, e.g., Finance Act, 2010, c. 13, § 35, sch. 10 (U.K.).

40. BCG, GLOBAL WEALTH, *supra* note 1, at 13. For the purposes of this Article, offshore wealth is "assets under management booked in a country where the investor has no legal residence or tax domicile." *Id.*

41. In all, \$0.7 trillion of \$38.2 trillion in North American wealth is held offshore, representing 2 percent of North American wealth. Three trillion dollars in European wealth is held offshore, representing 8 percent of European wealth. *Id.* at 7, 13.

42. BCG estimates that global wealth at the end of 2010 stood at \$121.8 trillion. Households outside the major developed economies hold approximately 25 percent of global wealth, with \$21.7 trillion in wealth held by households in Asia-Pacific ex-Japan, \$4.5 trillion in the Middle East and Africa, and \$3.5 trillion in Latin America (defined to include Mexico). Global wealth for this purpose includes all assets under management across all households worldwide, including worldwide cash deposits, money market funds, and listed securities held directly or indirectly through managed investments, and includes all onshore and offshore assets.

approximately 25 percent of global wealth (including \$21.7 trillion in wealth for households in Asia-Pacific ex-Japan).⁴³ Wealth is also much more concentrated⁴⁴ and growing at a significantly faster rate outside North America, Japan, and Western Europe, with experts expecting that trend to continue.⁴⁵ Thus, the taxation of offshore wealth should be of greater relative importance to Latin America, the Middle East, and Africa than to the United States and Canada or the major European economies. Data on actual revenues lost by developing countries and emerging economies overall from offshore tax evasion is unreliable. However, OECD officials have stated that revenue losses, only a portion of which are attributed to the use of offshore accounts by resident individuals, may be of a magnitude that approximates all official development assistance worldwide (totaling \$120 billion per year).⁴⁶

It excludes wealth attributed to individuals' own businesses, residences, or luxury goods. The major developed economies are Canada, Europe, Japan, and the United States. *Id.* at 5, 7, 7 n.3.

43. *Id.* at 7.

44. In Europe, for example, 1.1 percent of households held more than \$1 million in assets under management, representing in total 26 percent of European wealth. *Id.* at 8. In contrast, in Latin America, 0.24 percent of households held more than \$1 million in assets under management, representing 36 percent of total Latin American wealth, and in the Middle East and Africa, 0.3 percent of households held more than \$1 million in assets under management, representing 45 percent of total Middle Eastern and African wealth. *Id.*

45. *See id.* at 10. *See also* MERRILL LYNCH & CAP GEMINI, WORLD WEALTH REPORT 6 (2011).

46. Remarks of Jeffrey Owens, then-director of the Committee on Fiscal Affairs, Meeting of the OECD's Informal Task Force on Tax and Development (May 10–11, 2010) (author's notes and discussions with attendees) (suggesting that revenue losses may equal the sum spent official development assistance worldwide); OECD Development Assistance Comm., *Investing in Development: A Common Cause in a Changing World*, 3 (2009), available at <http://www.oecd.org/dataoecd/14/1/43854787.pdf> (noting that official development assistance totaled \$120 billion in 2008). A number of commentators estimate that offshore tax evasion in the developing world is much more extensive. *See, e.g.*, DEV KAR & DEVON CARTWRIGHT-SMITH, GLOBAL FIN. INTEGRITY, ILLICIT FINANCIAL FLOWS FROM DEVELOPING COUNTRIES 2002–2006 (2009) (illicit financial flows out of developing countries estimated at \$850 billion to \$1 trillion a year). However, Clemens Fuest and Nadine Riedel are skeptical of the higher figures and

Nor are emerging economies' concerns with offshore tax evasion limited to revenue loss. As in the developed world, an inability to collect tax on income and wealth held through offshore accounts and entities may undermine tax morale and threaten the broader administration of the domestic tax system. Moreover, in administrative regimes characterized by limited competence, widespread awareness of evasion through offshore accounts by the wealthy or privileged may undermine the authority and effectiveness of the state. The Indian Supreme Court, which handled a series of cases associated with corruption and tax evasion in recent years, described the problem:

Unaccounted monies, especially large sums held by nationals and entities with a legal presence in the nation, in banks abroad . . . would also indicate a substantial weakness in the capacity of the State in collection of taxes on incomes generated by individuals and other legal entities within the country. The generation of such revenues is essential for the State to undertake the various public goods and services that it is constitutionally mandated, and normatively expected by its citizenry, to provide. A substantial degree of incapacity, in the above respect, would be an indicia of the degree of failure of the State; and beyond a particular point, the State may spin into a vicious cycle of declining moral authority, thereby causing the incidence of unlawful activities in which wealth is sought to be generated, as well as instances of tax evasion, to increase in volume and in intensity.⁴⁷

II. BEYOND INFORMATION EXCHANGE UPON REQUEST

At the start of the twenty-first century, outside of information exchange upon request, there were few mechanisms in place by which governments or financial institutions automatically provided effective assistance to a foreign sovereign attempting to tax assets held offshore by the

further conclude that “most existing estimates of tax revenue losses in developing countries due to evasion and avoidance are not based on reliable methods and data.” Clemens Fuest & Nadine Riedel, *Tax Evasion, Tax Avoidance and Tax Expenditures in Developing Countries: A Review of the Literature* VI (Oxford University Centre for Business Taxation, Working Paper 2009) (emphasis removed).

47. Ram Jethmalani & Ors v. Union of India & Ors, (2011) 8 S.C.C. 1, 7–8 (India).

foreign sovereign's residents.⁴⁸ This situation persisted despite the fact that financial institutions had served as tax intermediaries domestically in almost all major developed economies for decades, and despite large, wealthy economies' concern over evasion of domestic tax burdens through offshore accounts during that entire period.⁴⁹ Even within the European Union, a sui generis pooling of sovereignty with significant inter-state cooperation, debates about routine

48. For example, Australia, now an international leader in unilaterally and automatically supplying other jurisdictions with usable resident taxpayer information, engaged in its first automatic exchange of information in 2000. *See* AUSTRALIAN NATIONAL AUDIT OFFICE, THE MANAGEMENT AND USE OF DOUBLE TAXATION AGREEMENT INFORMATION COLLECTED THROUGH AUTOMATIC EXCHANGE, AUDIT REPORT NO. 34 2009–2010, 37 (2000), *available at* http://www.anao.gov.au/uploads/documents/2009-10_Audit_Report%20_34.pdf [hereinafter ANAO REPORT]. One noteworthy exception was U.S. bank deposit interest reporting to Canada and reciprocal Canadian reporting to the U.S. with respect to financial payments made to any person disclosing a permanent U.S. address. Treas. Reg. § 1.6049-8 (as amended in 1997). There were also certain other routine information exchanges relating to certain passive income flows, often providing bulk data that was not attributable to any given taxpayer or was otherwise unusable.

49. At least as early as 1970, the U.S. Congress was concerned about the issue, as it noted in a congressional report accompanying the passage of the Bank Secrecy Act of 1970, which stated: “[T]hese days when the citizens of this country are crying out for tax reform and relief, it is grossly unfair to leave the secret foreign bank account open as a convenient avenue of tax evasion.” *Cal. Bankers Ass’n v. Shultz*, 416 U.S. 21, 29 (1974) (quoting H.R. Rep. No. 91-975, at 4 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394, 4397). *See also* Thomas Rixen & Peter Schwarz, *How Effective is the European Union’s Savings Tax Directive?: Evidence From Four EU Member States*, 50 J. COMMON MARKET STUD. 151, 152 (2012) (arguing that agreement on the EU Savings Directive in 2003 was the product of thirty-five years of negotiations). Indeed, French concerns with tax evasion through Swiss banks pre-date World War II. *Journal Officiel de la République Française, Débats Parlementaires, Chambre des Députés, Séance du 10 novembre 1932*, p. 2997 et seq. Note that the OECD developed the first paper-based protocol for automatic information exchange in 1981. OECD, *Recommendation of the Council Concerning a Standardised Form for Automatic Exchanges of Information Under International Tax Agreements*, OECD Doc. C(81)39/FINAL (May 5, 1981).

cooperation on the taxation of a single category of income—interest—did not progress for decades.⁵⁰ Germany, the European Union’s most powerful government, was forced to change its regime for taxing capital income when its citizens found it too easy and tempting to evade German taxes by holding assets through a foreign account in another EU jurisdiction.⁵¹

Some discussions in the late 1990s suggested small steps toward improving the availability of bank information for cross-border tax purposes,⁵² but progress in this direction was limited.⁵³ In the early years of the twenty-first century, hopes of grander collective steps proved largely illusory. The most important nascent example of automatic cooperation with respect to bank information was the European Union’s Savings Directive (EUSD). That directive became effective in 2005, and requires financial institutions in a specific subset of jurisdictions to report information on certain interest income (and only interest income) paid to EU residents who

50. See, e.g., Charles-Henry Courtois, *The Impact of the European Commission on the Council of Ministers’ Decisions in the Field of European Taxation: The Case of the European Savings Directive*, 2 INT’L PUB. POL’Y REV. 26, 30 (2006); Alex Easson, *The Tax Competition Controversy*, 18 TAX NOTES INT’L 171, 371 (1999) (describing how a 1989 EU Commission predecessor proposal to the Savings Directive was “quickly dropped”).

51. Germany saw a major outflow of domestic capital to Luxembourg and other European states after imposing a withholding tax on domestic interest income, and was forced to repeal that tax to staunch the losses. See Courtois, *supra* note 50. See also Claudio M. Radaelli, *Harmful Tax Competition in the EU: Policy Narratives and Advocacy Coalitions*, 37 J. COMMON MKT. STUD. 661 (1999).

52. See OECD, IMPROVING ACCESS TO BANK INFORMATION FOR TAX PURPOSES (2000), available at <http://www.oecd.org/dataoecd/3/7/2497487.pdf>; OECD, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE (1998), available at <http://www.oecd.org/dataoecd/33/0/1904176.pdf>.

53. See, e.g., Angel Gurría, Secretary-General, Org. for Econ. Cooperation and Dev., Address at the Parliamentary Assembly Session of the Council of Europe (Oct. 6, 2010) (“[W]e have achieved important breakthroughs in combating tax evasion. This includes the exchange of information for tax purposes, where we have made more progress in the past two years than in the previous ten.”) (transcript available at <http://hub.coe.int/parliamentary-assembly-sessions/all-session-news-october-2010/statement-by-angel-gurria>).

reside cross-border.⁵⁴ Scholars believed that it could be a forerunner of broader international cooperation, but that hope had not yet been realized.⁵⁵

In the last few years, the global landscape has changed radically. Interest in systematic automatic information exchange grew in parallel to the mounting universal acceptance of information exchange upon request as a global norm. The OECD's work on creating standard transmission formats created a progressively more effective technical platform for automatic information exchange that is increasingly being used by governments in ad hoc bilateral exchanges, and an update of the Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) created a viable legal framework for multilateral information exchange.⁵⁶ Meanwhile, since 2007, three concrete models for automatic information exchange have emerged: the OECD's authorized intermediary project, the European Union's Directive on Administrative Cooperation in the Field of Taxation and proposed revision of the EUSD, and the United States' FATCA legislation. These models demonstrate how information on investment

54. A European Union directive is a non-self-executing legislative act of the Institutions of the European Union that European Union member states must implement, whether by national legislation or regulatory action. Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community art. 249, Dec. 17, 2007, O.J. (C 306).

55. See Graetz & Grinberg, *supra* note 16, at 585.

56. See, e.g., OECD, *Recommendation of the Council on the Use of Tax Identification Numbers in an International Context*, OECD Doc. C(97)29/FINAL (Mar. 13, 1997); OECD, *Recommendation of the Council on the Use of the Revised OECD Standard Magnetic Format for Automatic Exchange of Information*, OECD Doc. C(97)30/FINAL (Mar. 13, 1997); OECD, *Recommendation of the Council on the Use of the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes*, OECD Doc. C(2001)28/FINAL (Mar. 22, 2001); *Tool Kit on Automatic Exchange of Information*, OECD, http://www.oecd.org/document/18/0,3746,en_2649_33767_40499474_1_1_1_1,00.html (last visited July 15, 2012). A number of bilateral electronic automatic information exchange relationships were established beginning in the first few years of the twenty-first century, but the types of data exchanged were highly variable and the ability to match the data to taxpayer records was initially quite poor. The last few years have seen an increase in both the number of automatic information exchange relationships and the quality of taxpayer matching for automatically exchanged information. See, e.g., ANAO REPORT, *supra* note 48, at 93–95.

income earned through offshore accounts⁵⁷ could flow automatically from financial institutions to residence country governments, thereby facilitating enforcement of residence country tax burdens on income earned through offshore accounts.

The only academic commentator who compares the three emerging models for systematic automatic information exchange describes the models as competing with one another.⁵⁸ A fourth model, the Swiss anonymous withholding model, presents an even sharper contrast. Instead of offering an information reporting solution, this approach emphasizes anonymity in combination with a withholding regime for collecting revenue from nonresident account holders.

However, focusing on the inconsistencies and conflicts between the emerging systems obscures their commonality, which is more important than their differences. All four models share a key feature that the literature has yet to recognize: each requires domestic financial institutions to routinely provide cross-border administrative assistance to a sovereign outside the country in which the financial institution is located, and to thereby serve as cross-border tax intermediaries. This alone is a critically important achievement. For years, financial institutions have acted as domestic tax intermediaries by providing information reporting on their domestic payees to the tax administration of their country of residence, or withholding from such payees and remitting the withheld amounts to the domestic tax administration, or both. But even five years ago, no one would have claimed that financial institutions were obligated to act as cross-border tax intermediaries or that there was an emerging consensus that they do so. Countries are now agreeing to a higher level of international tax cooperation and demanding that multinational financial institutions play an additional role in tax collection. In some sense this may be a reclamation of sovereign authority over cross-border asset management, and in another sense it is an acknowledgement that multinational financial institutions are a necessary part of the mechanics of tax collection in a globalized economy.

57. I use the term “offshore account” to refer to any account through which investments are intermediated on behalf of an individual who is not a tax resident of the jurisdiction in which the institution that provides the financial intermediation services (or the relevant subsidiary or branch of such institution) resides.

58. See Smiley, *supra* note 16.

A. Background: Source Country Taxation and Financial Intermediation

This Section introduces nomenclature used throughout the Article, and describes the United States' qualified intermediary system (QI). The Section begins with a simplified example of how modern financial intermediation of cross-border portfolio investment works. The example is intended to help readers understand the details of the various emerging information exchange approaches discussed in Part II.B and thereafter. This Section then addresses QI, which began operating in 2001 and was primarily intended to ensure that non-U.S. persons making portfolio investments in the United States were being properly taxed by the United States on income from those investments. QI was therefore directed at taxation of U.S. source income received by foreigners (source country taxation), rather than at the problem of taxing U.S. citizens and residents on investments made through foreign financial institutions (a part of "residence country taxation"). In this sense, QI is not a precursor to the emerging approaches to cross-border administrative assistance, each of which addresses residence country concerns with respect to cross-border tax evasion. Still, the QI system is relevant historically because: (1) it marked the first time financial institutions routinely acted as cross-border tax intermediaries; (2) it provided one of the seeds of the anonymous withholding approach currently being promoted by Switzerland as a means to address residence country tax concerns; and (3) the OECD's authorized intermediary project, discussed in Part II.B, started with a QI model, although it ultimately developed an approach that is more responsive to residence country tax enforcement concerns.

1. Cross-Border Portfolio Investment and Source Country Taxation

Host country tax on nonresidents who make portfolio investments in securities⁵⁹ issued by an entity in that country (the "source country") is usually assessed by means of a tax that a domestic payor is required to withhold from gross payments made to foreign investors ("withholding taxes"). Like most countries, the United States imposes a withholding tax on portfolio dividends (30 percent under U.S. law⁶⁰) and then reduces that tax rate under bilateral treaties, but only when a qualifying resident of the treaty country beneficially owns the

59. These portfolio investments include small investments in debt and equity securities by noninstitutional investors.

60. I.R.C. § 871 (2010).

dividend.⁶¹ As a result, different rates of withholding tax apply to different foreign investors depending on where they reside and whether they are eligible for the benefits of a treaty.

This administrative challenge is exacerbated by the highly intermediated nature of modern cross-border portfolio investment. A simplified example both illustrates the problem and introduces key terminology for the remainder of the Article. A typical investment made by an Indian national in a U.S. company can involve the Indian national providing funds to Singapore Bank A, which in turn provides those funds to Singapore Bank B, which in turn provides the funds to U.S. Bank C, which then makes the investment in the U.S. company by holding shares through a central securities depository, a type of clearinghouse for securities transactions (U.S. Clearinghouse). Income from those investments will generally flow from the U.S. company to its paying agent, then on to the U.S. Clearinghouse, then to U.S. Bank C, on to Singapore Bank B, and from Singapore Bank B to Singapore Bank A, which will credit the relevant funds to the Indian national's account. In this example, India is the country of residence of the investor (residence country), the United States is the country of the source of the income (source country), and Singapore is the country from which the assets are being managed (asset management country).⁶²

Absent some mechanism to provide more detailed information, only Singapore Bank A knows on which client's behalf the given investment was made. At every other stage in the process, the investment is generally made through so-called omnibus accounts that identify the financial institution from which the investment is received rather than the investor on whose behalf the investment is made. No private or public institution in either the residence country or

61. See Press Release, Dep't of Treasury, Treasury Issues New Versions of the U.S. Model Income Tax Convention and Model Technical Explanation supp. at 16–17 (Nov. 15, 2006) (U.S. Model Income Tax Convention of Nov. 15, 2006) [hereinafter United States Model Income Tax Convention].

62. To generalize more broadly, “[i]ncome payments arising from securities typically will flow from the issuer to its paying agent and from the paying agent through [multiple] intermediaries to the end investors.” OECD, REPORT OF THE INFORMAL CONSULTATIVE GROUP ON THE TAXATION OF COLLECTIVE INVESTMENT VEHICLES AND PROCEDURES FOR TAX RELIEF FOR CROSS-BORDER INVESTORS ON POSSIBLE IMPROVEMENTS TO PROCEDURES FOR TAX RELIEF FOR CROSS-BORDER INVESTORS 8 (2009), [hereinafter ICG Report], *available at* <http://www.oecd.org/dataoecd/34/19/41974569.pdf>.

the source country need know the identity of the client who is the beneficial owner of the investment.

In this example, determining the tax rate that the United States should impose on the income resulting from the investment is an aspect of source country taxation. The question is whether the ultimate investor, the Indian national, is eligible for a reduction in withholding pursuant to a treaty between the United States and India, and how that information is taken into account by the U.S. payor that is responsible for imposing the proper withholding tax on a dividend payment it makes to Singapore Bank B. It is important to note that the residence country taxation question—how India, the residence country, will effectively administer its tax on the earnings from this investment by an Indian national, which will be earned through an account at Singapore Bank A—is entirely separate from the question of how the source country administers its withholding tax.

2. The Qualified Intermediary System

In the 1990s, the United States began to grapple with taxing growing flows of cross-border portfolio investments, including small investments in U.S. debt and equity securities by large numbers of noninstitutional investors.⁶³ QI represented a bargain between the United States and non-U.S. financial institutions through which the United States addressed this challenge and ensured that the tax it imposes on nonresident portfolio investors is properly enforced.⁶⁴ Under QI, non-U.S. financial institutions agree to collect information from their customers investing in the United States as to whether those customers are U.S. persons or non-U.S. persons, and which of the non-U.S. persons are entitled to reduced rates of withholding tax.⁶⁵ Before QI, there was

63. See, e.g., William L. Burke, *Tax Information Reporting and Compliance in the Cross-Border Context*, 27 VA. TAX REV. 399, 403–04, 403 n.11, 407–08, 408 n.22 (2007).

64. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-99, TAX COMPLIANCE: QUALIFIED INTERMEDIARY PROGRAM PROVIDES SOME ASSURANCE THAT TAXES ON FOREIGN INVESTORS ARE WITHHELD AND REPORTED, BUT CAN BE IMPROVED 12 (2008) [hereinafter GAO, QUALIFIED INTERMEDIARY PROGRAM].

65. These reduced rates may be available under a tax treaty or a U.S. statutory rule. For a thorough discussion of the QI rules as originally promulgated, see generally Carol Doran Klein & Diane L. Renfroe et al., *The Final Withholding Regulations: A Rube Goldberg Contraption—Will it Work?*, 27 TAX MGMT. INT'L J. 67 (1998).

no practical regime in place by which the Internal Revenue Service (IRS) or U.S. withholding agents could make these determinations.⁶⁶ The United States provided non-U.S. financial institutions three inducements to cooperate with the new regime: (1) nonresident client anonymity from U.S. financial institutions (thus protecting their clients' identities from their competitors), (2) anonymity from the IRS (thus ensuring that the IRS would not provide information to the tax administration of the investor's country of residence), and (3) accurate and timely treaty benefits for non-U.S. persons.

The QI rules were of particular importance to private banks engaged in asset management because a QI was able to conceal the identity of its non-U.S. customers from both competitor institutions and the IRS. As a result, a QI could ensure that other financial institutions in the chain of intermediation would not be able to steal its customers, and could assure its customers that the IRS would not provide information to their home country tax authority. After imposition of the QI rules, these benefits generally existed for QI institutions but not for non-QI institutions. In the example, if Singapore Bank A is a QI, it determines the rate of U.S. withholding that should apply to the Indian national, and informs Singapore Bank B as to the rate of withholding that should apply with respect to a pool of investments it is making on behalf of its customers through Singapore Bank B (including the Indian national's investment). It does not, however, provide Singapore Bank B with the identity of the Indian national. Singapore Bank B then forwards the pooled information on to U.S. Bank C, which uses that information to impose withholding tax. On the other hand, if Singapore Bank A did not agree to become a QI, new U.S. rules imposed at the same time as the QI system required the bank to collect information from its non-U.S. customers who sought reduced withholding, and to send that information up the chain of financial institutions and potentially all the way to the IRS. As one group of prominent practitioners wrote in the late 1990s, "because of the relative secrecy benefits provided to non-U.S. citizens or residents, the failure of a private bank to qualify as a QI would put that bank in a competitive disadvantage in the marketplace."⁶⁷

66. See Stephen E. Shay et al., "What's Source Got to Do With It?" *Source Rules and U.S. International Taxation*, 56 TAX. L. REV. 81, 122 (2002).

67. Thomas A. O'Donnell, Philip Marcovici & Marnin J. Michaels, *The New U.S. Withholding Tax Regime: To Be or Not to Be a "Qualified Intermediary,"* 27 TAX PLANNING INT'L REV. 3, 4 (2000).

QI effectively became the first major operational example of a cross-border anonymous withholding regime. Ten years after QI came into operation, however, the UBS scandal demonstrated the extent to which QI could be abused to facilitate U.S. residence country tax evasion by U.S. persons,⁶⁸ even as it provided the IRS some assurance that source country taxation of nonresidents was being collected.⁶⁹ The compromises made to launch the QI program and the consequent UBS scandal together laid the groundwork for the most recent U.S. legislation intended to address offshore tax evasion by U.S. persons.

B. Emerging Approaches to Automatic Residence-Based Tax Information Exchange

Cross-border information reporting models that are substantially focused on residence country taxation are emerging from the European Union, the OECD, and the United States. This Section describes these models and their histories, highlighting that the new regime for financial institutions to serve as cross-border tax intermediaries emerged only in the last few years. Three of the key features that distinguish these information reporting approaches from one another are: (1) what information they require to be reported cross-border (reporting), (2) how they route

68. The United States Justice Department showed that United Bank of Switzerland (UBS) used (qualified intermediary) QI status to suggest to U.S. clients that it was a more secure institution through which U.S. citizens could evade U.S. tax. *See* Press Release, Dep't of Justice, UBS Enters Into Deferred Prosecution Agreement supp. (Feb. 18, 2009) (Deferred Prosecution Agreement) [hereinafter UBS Deferred Prosecution Agreement]. UBS then helped U.S. residents set up entity structures to avoid the reporting and withholding nominally required by QI with respect to U.S. persons' investments back into the United States, thereby allowing them to achieve the anonymity with respect to U.S. investments that was supposed to be provided only to nonresident investors. *See id.* at 2–4 (“Acceptance of Responsibility for Violation of Law”). Hearings and investigations in Congress highlighted the inadequacy of the QI system as a backstop for U.S. residence country taxation. *See generally Tax Haven Banks and U.S. Tax Compliance: Hearing Before the S. Permanent Subcomm. on Investigations*, 110th Cong. (2008). Sadly, the design features that produced these inadequacies were widely commented upon and accepted by U.S. government officials as part of the bargain made with foreign financial intermediaries to improve U.S. source country nonresident taxation. *See, e.g.,* Shay et al., *supra* note 66, at 125–26.

69. GAO, QUALIFIED INTERMEDIARY PROGRAM, *supra* note 64, at 6–11.

information from financial institutions to residence country governments (routing), and (3) what mechanisms they use to encourage financial institutions and governments to participate (incentives and mandates). Understanding the alternative ways that the emerging information reporting models address reporting, routing, and incentives is necessary in order to understand the comparison of information reporting to anonymous withholding in Part III.

Part IV, which provides some observations about the bases for a multilateral information reporting system, discusses how to reconcile the different reporting, routing, and incentives features in the emerging information exchange approaches. It also considers three further design features: (4) which financial institutions are included in the system (scope), (5) how the systems identify taxpayers and their country of residence (identification), and (6) how the systems ensure financial institutions comply with the systems' rules (verification). Together, identification, reporting, verification, scope, routing, and incentives constitute the six key features of any cross-border information reporting regime.

1. The European Union

In 1998 the EU Commission proposed a directive intended to ensure that a minimum effective tax rate was imposed on interest income earned through accounts held by a resident taxpayer in a foreign country that was a EU member.⁷⁰ After a few years of bitter debate between EU member states supporting bank secrecy and EU member states supporting information exchange, and a series of failed compromises, a proposal emerged. Under the proposal, information exchange was treated as the preferred mechanism for reducing evasion of tax on interest income by EU residents, but EU jurisdictions were allowed to impose a

70. Having failed miserably with a 1989 suggestion to impose a single 15 percent withholding tax on interest income across the European Union, in 1998 the Commission tried to focus exclusively on tax evasion associated with interest income. Proposal for a Council Directive on a common system of withholding tax on interest income, COM (89) 60 final, 1989 O.J. (C 141) (1989 proposal for a Council Directive on a common system of withholding taxes levied upon interest at a 15 percent rate within the European Economic Community). The Commission described its 1998 proposal narrowly, as a mechanism to address perceived economic distortions arising from nontaxation of cross-border interest payments made to individuals. *Id.*; see also Courtois, *supra* note 50, at 31 (interviewing Commission staff on the history of the European Union Savings Directive).

withholding tax during a so-called transitional period. However, the European Union's bank secrecy jurisdictions (Austria, Belgium,⁷¹ and Luxembourg) took the firm position that they would only agree to the proposal if both small banking centers like Liechtenstein and the Channel Islands, and major non-EU financial centers like Switzerland and the United States, agreed to adopt equivalent measures.⁷²

Non-EU financial centers were not amenable to the EU bank secrecy jurisdictions' demand. Switzerland objected to any information exchange or withholding. Meanwhile, the Clinton administration objected to the "implicit assumption that a withholding tax would be an adequate substitute for the exchange of information."⁷³ Then, in 2002 Glenn Hubbard, the chairman of the White House Council of Economic Advisers in the Bush administration, announced definitively that the United States would not agree to EU requests for across-the-board sharing of information

71. In 2010, Belgium began to exchange information rather than impose a withholding tax on interest income subject to the EUSD. See European Commission, *Rules Applicable*, http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/rules_applicable/index_en.htm (last visited July 11, 2012).

72. In June 2000 Luxembourg Prime Minister and Finance Minister Jean-Claude Juncker epitomized the EU bank secrecy jurisdictions' unflinching opposition to cooperating in the absence of non-EU member cooperation by stating that "there would be blood on the table if certain other delegations do not change their point of view." George P. Gilligan, *Whither or With the European Savings Tax Directive? A Case Study in the Political Economy of Taxation*, 11 J. FIN. CRIME 56, 59 (2003).

73. Albertina Fernandez & Thomas Field, *Canadian Tax Foundation Holds First World Tax Conference*, 20 TAX NOTES INT'L 1056, 1056 (2000) (quoting Phillip West, then International Tax Counsel of the United States, at the World Tax Conference, "Taxes Without Borders," held in Tampa Bay, Florida, Feb. 26–Mar. 1, 2000). The public record suggests that significant discussions between the United States and the European Union regarding cross-border administrative assistance may have occurred during this period. It is possible that some U.S. officials at the time may have been prepared to contemplate reciprocity if the European Union moved to an information reporting system rather than an anonymous withholding system or a system that accepted either anonymous withholding or automatic information reporting. Whatever policymakers' intentions, no progress was made.

on U.S. savings accounts held by EU residents.⁷⁴ By that point, the continuing EUSD debate was mostly about the parameters of an ever-closer European Union.⁷⁵ Broader acceptance of financial institutions as cross-border tax intermediaries did not appear to be forthcoming.

In mid-2003 the European Union agreed to forge ahead internally on a version of the EUSD that would apply after 2005 and was intended to meet the relatively narrow goal of ensuring information reporting or withholding on interest payments earned by EU residents holding, in their own name as individuals, accounts earning interest at financial institutions within Europe.⁷⁶ If an EU country exchanges information under the EUSD, financial institutions in that country report information to the tax administration of the EU member state where the financial

74. Edward Alden et al., *US Opposes Sharing Information on Savings*, FIN. TIMES, Sept. 26, 2002. In August of 2002 the Bush administration withdrew proposed regulations issued in the dying days of the Clinton administration, *Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens*, 66 Fed. Reg. 3925 (proposed Jan. 17, 2001), that would have required U.S. banks to collect and report to the Internal Revenue Service (IRS) information generally of the type needed to join the Savings Directive. *See* 67 Fed. Reg. 50386 (Aug. 2, 2002) (withdrawing and re-proposing the bank deposit interest regulations). Initially, those regulations were replaced with proposed regulations that would have required the collection of bank deposit interest information for nonresident alien individuals that were residents of certain designated countries, including some (but not all) members of the European Union. The Bush administration did not finalize the revised proposed regulations and they never came into effect.

75. The other question was the relationship of European Free Trade Association countries like Liechtenstein and Switzerland to the European Union.

76. The European Union Savings Directive (EUSD) was agreed among EU member states on June 3, 2003, and came into force on January 1, 2005. Council Directive 2003/48/EC, of 3 June 2000 on Taxation of Savings Income in the Form of Interest Payments, 2003 O.J. (L157) 38, 38, 45 [hereinafter EUSD]. EU member states agreed that for the Directive to apply and be meaningful as an enforcement measure for offshore accounts it was necessary that at least six non-EU countries (Switzerland, Liechtenstein, Andorra, Monaco, San Marino, and the United States) also comply with the EUSD. Nevertheless, they made the Directive effective beginning in 2005, provided that Switzerland, Liechtenstein, Andorra, Monaco, and San Marino, but not the United States, met certain conditions. *Id.* at 45.

institution is resident, and then relevant information is routed from that tax administration to the tax administration of the member state where an account holder is resident.⁷⁷

The EUSD mandates only that member states either exchange information with one another or impose a withholding tax to be deducted from interest income, for so long as an indefinite “transitional period” continues.⁷⁸ Most countries within the European Union adopted the information exchange regime. The three EU member bank secrecy states adopted the withholding tax system, as did many of the dependent territories of the United Kingdom and the Netherlands, including the Channel Islands.⁷⁹ Switzerland agreed to cooperate with the directive

77. The information exchange component of the EUSD built on foundational work done at the OECD that was intended to create a toolkit for tax administrators to adopt automatic information exchange. *See* OECD Model Convention, *supra* note 23, at art. 26.

78. Jurisdictions opting for the so-called transitional withholding tax system share the revenue with the country of residence (handing over 75 percent of receipts and keeping 25 percent of receipts). EUSD, *supra* note 76, at 44. The withholding tax option initially was assessed at a rate of 15 percent, with a schedule that increased the rate to 35 percent after June 30, 2011. *Id.* at 43. Whenever the transitional period is deemed to end, all EU member states must move to the information reporting system. *See id.* at 43 (mandating that the residual EU member states of Belgium, Luxembourg, and Austria will have to apply the information reporting system at the end of the transitional period). Technically, under the terms of the EUSD, the transition period ends whenever (1) there is an agreement between the European Community and the last of Switzerland, Liechtenstein, San Marino, Monaco, and Andorra to exchange information upon request on interest payments consistent with international standards (as they were then embodied in the so-called OECD Model Agreement on Exchange of Information on Tax Matters), (2) the United States commits to exchange of information upon request at the same international standards, and (3) the European Council unanimously agrees that conditions (1) and (2) have been met. *Id.* Practically speaking (although perhaps not technically) conditions (1) and (2) have already been met. The real barrier is the European Council’s inability to unanimously agree that the transition period is over.

79. *Id.* at 43, 45. In contrast to the arrangements with five non-EU sovereigns, discussed *infra* at note 86 and accompanying text, the dependent or associated territories of the United Kingdom and the Netherlands (including the Channel Islands and various Caribbean islands) that did not agree to exchange information automatically are required to participate in the EUSD as

due to a combination of substantial coercive pressure and important financial incentives (notably, Swiss companies were granted the benefits of the EU Parent-Subsidiary Directive, thereby exempting from cross-border withholding taxes dividends paid by an EU subsidiary of a Swiss company to its Swiss parent). Four smaller non-EU European offshore banking centers (Andorra, Liechtenstein, Monaco, San Marino) followed Switzerland's lead.⁸⁰ Their bilateral agreements with the EU adopted the withholding system of the EUSD, but explicitly permitted Switzerland, Liechtenstein, and the rest to maintain a withholding tax indefinitely in place of information exchange.⁸¹ The indefinite transitional period for EU member bank secrecy jurisdictions, and the European Union's agreement to permanent anonymous withholding by Switzerland and other European offshore banking centers, created an uneasy truce between information reporting and anonymous withholding models for tax administrative assistance regarding interest income within Europe.

At one point in the current evolutionary period in cross-border administrative assistance, this truce appeared to be ending. In February 2011 the European Union adopted a roadmap to automatic information exchange among EU member states for categories of income other than interest.⁸² Unlike the EUSD, the Directive on Administrative Cooperation in the Field of

withholding jurisdictions and to move to automatic information exchange at such time as the transitional period ends. *Id.*

80. See, e.g., Agreement Between the European Community and the Principality of Monaco Providing for Measures Equivalent to Those Laid Down in Council Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments, Eur. Union-Mon., Jan. 21, 2005), 2005 O.K. (L 19).

81. See, e.g., Agreement Between the European Community and the Swiss Confederation Providing for Measures Equivalent to Those Laid Down in Council Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments, Eur. Union-Switz., Dec. 29, 2004, 2004 O.J. (L 385) 30. See also EUSD, *supra* note 76, at 45.

82. Council Directive 2011/16/EU of 15 February 2011 on Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC, 2011 O.J. (L 64) 10 [hereinafter the February Directive]. The February Directive generally requires that, beginning January 1, 2014, the competent authority of each member state automatically reports to other member states whatever information the communicating member state has available regarding income from employment, director's fees, pension income, life insurance products not covered by other EU

Taxation does not mandate a given EU member state to participate in broader automatic information exchange within the European Union, let alone provide incentives to encourage any country outside the European Union to participate. However, it does provide that the European Commission must submit proposals to the European Council before July 1, 2017, regarding the categories of capital and income that member states should be mandated to report to one another, with one aim being to extend that list to include capital gains, dividends, and royalties.⁸³ If the European Council were to decide to require mandatory information reporting on these categories of income, in addition to interest reported through the Savings Directive, EU information reporting would generally overlap with the income reporting, but not the asset reporting, required under new U.S. legislation known as FATCA.

2. The OECD

In 2006, the Committee on Fiscal Affairs of the OECD (CFA), which brings together the senior international tax official of each OECD member state government, agreed to work with many of the major global cross-border financial institutions on a project to improve the process by which portfolio investors may claim reduced source country withholding tax rates under tax

legal instruments on exchange of information and other such measures, as well as income from immovable property. *Id.* at 6. Under the February Directive, member states that do not wish to receive information can opt out (for now) of both reporting and receiving information. *Id.* The February Directive also provides that limitations on the application of European Union Directive 95/46/EC (“Data Protection Directive,” related to European data protection laws) are necessary and proportionate in the case of tax information exchange and cooperation in view of the potential loss of revenue for member states and the crucial importance of the February Directive in the effectiveness of the fight against fraud. *Id.* 11–12. Thus, an EU data subject’s right to information about the use of his or her personal data, access to that data, and judicial remedy for breach of his or her rights under the Data Protection Directive is restricted for purposes of obtaining information exchange among the member states. *Id.* The potential conflict between EU data protection law and the crucial needs of non-EU tax authorities in a globalized economy is beyond the scope of this Article.

83. *Id.* at 6.

treaties.⁸⁴ Conceptually, the substantive objective was to recommend for countries to develop systems akin to the QI system.⁸⁵

The 2008 tax evasion scandals and the consequent shift in the focus of OECD tax administrations from source country taxation to residence country taxation of offshore assets rocked the foundations of the OECD's project. The resulting report of the Informal Consultative Group (the ICG Report) addressed one of QI's major perceived shortcomings: that it bottles up customer-specific information about the beneficial owner of any given payment at the level of the financial institution closest to the customer such that source countries never receive that information and therefore can never provide it to residence countries.

The ICG Report recommended that OECD countries develop systems similar to QI.⁸⁶ Taking the example provided in Part II.A as a starting point, under the system proposed in the report Singapore Bank A would inform Singapore Bank B as to what tax rate should apply to the earnings on the Indian national's investment in the United States (without revealing that person's identity). However, unlike under the QI system, Singapore Bank B would also route information directly to the IRS regarding the Indian national's identity and return on investment (as long as the investment was of a type that benefitted from a reduced rate of withholding under the system). The IRS could then, in principle, route this information on to India. The additional reporting therefore represents a pro-residence-country-compliance modification of the QI system, and abandons the anonymous withholding component of QI.⁸⁷ Financial institutions from Asia, Europe, and North America strongly endorsed the ICG Report, making clear their willingness and ability to serve as tax intermediaries cross-border.

The ICG System was developed based on the principle of consensus between governments and financial institutions. The resulting approach relied exclusively on incentives rather than

84. The Committee on Fiscal Affairs of the OECD (CFA) is the world's leading multilateral body in international tax policy.

85. The CFA's project also included a component intended to facilitate claiming tax treaty benefits for income earned by collective investment vehicles. That portion of the project was brought to a successful conclusion in 2009.

86. ICG Report, *supra* note 62, at 2–3. Like QI, these systems would allow authorized financial institutions to contract with governments to make tax treaty withholding relief claims on behalf of their customers on a pooled basis.

87. *See id.*

penalties for financial institution participation. The ICG System could ask only so much of financial institutions in exchange for these incentives. The focus on reporting in exchange for benefits for investors limited the potential reporting benefit to residence countries to information on those kinds of payments, like dividends, that benefit from a reduced rate of tax withholding. Many kinds of cross-border investment income, such as capital gains and certain interest income, generally are not subject to source country taxation and therefore withholding. This means they are not implicated by, or reported in, a QI-like system. While recognizing the limitations of the ICG System as a means to address residence country concerns, senior international tax officials of the OECD governments decided to further develop the ICG System through an initiative known as the Treaty Relief and Compliance Enhancement (TRACE) project.

Alongside the TRACE project, the OECD continues its ongoing work to create information technology standards for automatic information exchange between governments to support residence-based taxation. This OECD effort includes well-developed standards for capturing, exchanging, and processing information in an automatic matching system. As a result of the OECD's technical standards, a variety of jurisdictions have made advances in recent years toward automatic exchange of information between governments on an electronic basis that can be matched against resident taxpayer records.

The OECD was also instrumental in facilitating the 2010 revision of the Multilateral Convention. The Multilateral Convention's stated objective is to enable each party to the convention to counter international tax evasion and better enforce its national tax laws, while simultaneously respecting the rights of taxpayers. In 1988 the convention was opened for signature by the fifty-four countries that are members of either the Council of Europe or the OECD, or both. The 1988 convention proved to be of limited applicability and no practical import.⁸⁸ However, in 2010, based on a request of the 2009 G20 summit,⁸⁹ the Multilateral

88. OECD AND COUNCIL OF EUROPE (2011), THE MULTILATERAL CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS: AMENDED BY THE 2010 PROTOCOL, (OECD Publishing, May 27, 2010), *available at* <http://dx.doi.org/10.1787/9789264115606-en> (acknowledging that the Multilateral Convention appeared to be a novel step forward in multilateral tax cooperation when agreed in the 1980s, but was thereafter disregarded and left almost entirely unused even by its signatories).

89. *The Convention on Mutual Administrative Assistance in Tax Matters-Background*, OECD, June 4, 2010,

Convention was amended to incorporate OECD Model Tax Convention standards for tax information exchange, and membership was opened up to all countries, with particular emphasis placed on including developing economies so that they might benefit from a “new cooperative international tax environment.”⁹⁰ The convention now provides a general legal framework under which automatic cross-border tax information exchange could in principle be established among a broad range of sovereign participants.

3. FATCA

In 2010, following the UBS scandal and President Obama’s campaign commitment to crack down on offshore tax evasion,⁹¹ the U.S. Congress enacted sections 1471 to 1474 (generally known as FATCA⁹²) of the Internal Revenue Code. Under FATCA, foreign financial institutions are generally required to report information on financial accounts of U.S. persons and foreign entities with significant U.S. ownership (U.S. accounts) directly to the IRS beginning in 2014.⁹³

http://www.oecd.org/document/2/0,3746,en_2649_33767_44886082_1_1_1_1,00.html. U.K. Prime Minister Gordon Brown, as chair of the G20, indicated in a letter to the OECD that “it would be helpful, in this regard, if an effective multilateral mechanism could be developed”. *Id.*

90. April 2009 London Communiqué, *supra* note 10, at 5.

91. *Id.*

92. Sections 1471 to 1474 of the Internal Revenue Code (Code) were enacted in the Foreign Account Tax Compliance title (Title V) of the Hiring Incentives to Restore Employment Act of 2010 (HIRE Act). Hiring Incentives to Restore Employment Act of 2010, Pub. L. No. 111-147, § 501-35, 124 Stat. 71, 97–115 (2010) [hereinafter HIRE Act]. An earlier version of the Foreign Account Tax Compliance title of the HIRE Act was introduced in Congress as the Foreign Account Tax Compliance Act. The acronym FATCA stuck with these provisions.

93. The statutory effective date is January 1, 2013, but regulatory guidance has effectively delayed implementation of FATCA by one year. Chapter 4 Implementation Notice 2011-53, 2011-32 I.R.B. 124, 2011 WL 2741154 (2011). U.S. accounts are technically defined as financial accounts that are held by specified U.S. persons or U.S.-owned foreign entities. I.R.C. § 1471(d)(1)(A) (2010). Financial accounts are broadly defined by the statute in a manner that is intended to pull in interests in hedge funds, private equity funds, and other investment arrangements.

Foreign financial institutions must report the account balance or value of each U.S. account,⁹⁴ and the amount of dividends, interest, other income, and gross proceeds from the sale of property credited to a U.S. account.⁹⁵ The rules are intended to provide reporting both on accounts held directly by individuals and on interests in accounts held by shell entities for the benefit of U.S. individuals.

Congress explained that in enacting FATCA, the legislative intent was to “force foreign financial institutions to disclose their U.S. account holders or pay a steep penalty for nondisclosure.”⁹⁶ Accordingly, FATCA imposes a withholding “tax”⁹⁷ on the gross amount of certain payments from U.S. sources and the proceeds from disposing of certain U.S. investments (withholdable payments) on foreign financial institutions that do not comply and become a “participating foreign financial institution.”⁹⁸ This withholding tax also applies to certain other payments to the extent the funding for those payments may be attributed to withholdable payments (passthru payments).⁹⁹ Importantly, this withholding tax is not limited to payments to

94. I.R.C. § 1471(c)(1)(C).

95. See Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities, 77 Fed. Reg. 9022 (Feb. 15, 2012) (to be codified at 26 C.F.R. pt. 1, 301).

96. HIRE ACT, 156 Cong. Rec. S1745, S1745.

97. In a conventional withholding tax, withholding on a given payment is associated with the U.S. income tax liability or potential U.S. income tax liability of a given taxpayer in connection with the payment with respect to which withholding is imposed. FATCA is not a conventional withholding tax. Although nominally labeled a “tax,” it is better understood as a penalty regime intended to force foreign financial institutions to disclose information to the IRS.

98. More technically, withholdable payments are (generally) any payment of fixed or determinable annual or periodical income, if such payments are from sources within the United States, and gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends from sources within the United States. I.R.C. § 1473(1)(A).

99. As part of the foreign financial institution (FFI) Agreement, Section 1471 requires participating FFIs to deduct and withhold a tax equal to 30 percent of any passthru payment that is made by the participating FFI to a recalcitrant account holder or a nonparticipating FFI. I.R.C. § 1471(b)(1)(D)(i). The statute defines recalcitrant account holders as those account holders that fail to comply with reasonable requests for information by a participating FFI in order for it to

U.S. persons. In other words, if foreign financial institutions will not agree to report to the United States on income earned by U.S. individuals through accounts at those institutions, FATCA requires withholding on a wide range of payments from the United States to those same financial institutions, regardless of whether the payments are beneficially owned by U.S. persons on which the IRS wants reporting, non-U.S. customers of the institution, or the institution itself. Section 1471 also requires participating foreign financial institutions to withhold on payments to nonparticipating foreign financial institutions. It thus is intended to (1) induce foreign financial institutions that are investing in or through participating financial institutions, but that are not investing in the United States, to also agree to participate in FATCA,¹⁰⁰ and (2) disincline participating foreign financial institutions from doing business with nonparticipating financial institutions, because business between participating and nonparticipating financial institutions may require withholding under U.S. law. Through the passthru payment mechanism, FATCA tried to use the combined weight of U.S. financial markets and financial institutions that must, as a practical matter, do business in the U.S. marketplace as leverage with other foreign financial institutions to ensure near-comprehensive participation in FATCA's cross-border information reporting.¹⁰¹ It is doubtful at best, however, that the United States could either implement passthru payment withholding or achieve near-comprehensive financial institution participation through unilateral measures alone.

meet its reporting obligations under an FFI Agreement, or that fail to provide a waiver in any case in which any foreign law would (but for such waiver) prevent the reporting of any information an FFI is required to report under its FFI Agreement. I.R.C. § 1471(d)(6).

100. When an FFI is not acting as a custodian or nominee and is not a tax transparent entity receiving payments on behalf of its members, payments that FFI makes to account holders (including investors in its equity or debt instruments) would be treated under generally applicable U.S. tax principles as non-U.S. source income of those account holders, and therefore would not be “withholdable payments.” Thus, in the absence of a passthru payment concept, the many FFIs that do not do business directly in U.S. securities, and their account holders, would generally fall outside the scope of FATCA.

101. The coercive force of FATCA's withholding mechanism is also important as a vehicle to bring in nontraditional financial institutions such as private equity funds, hedge funds, and insurance companies.

A related difficulty is that as legislated FATCA's reporting is also unilateral; it benefits the United States alone while putting significant burdens on foreign financial institutions. Furthermore, FATCA as legislated routes information reporting directly to the U.S. government, and can require closure of certain account holders' accounts and/or withholding on payments made by a foreign financial institution to account holders and other foreign financial institutions. As a result, compliance with FATCA may require foreign financial institutions in many jurisdictions to violate contractual relationships as well as data protection, bank secrecy, or other laws of the jurisdiction in which they are located.¹⁰² Beginning with her first major public address on these issues on December 16, 2011, Acting Assistant Secretary Emily McMahon acknowledged the difficulties associated with FATCA's unilateral approach. She stated that the United States could not ask foreign financial institutions to routinely report to the United States if the United States did not routinely collect certain information on nonresidents from domestic financial institutions that it could provide to cooperating foreign sovereigns.¹⁰³ She went on to suggest that the United States was committed to entering into bilateral and multilateral agreements that would allow financial institutions to comply with FATCA without violating

102. See, e.g., Letter From Faye M. Polayes, Tax Counsel, HSBC N. Am., to Manal Corwin, Int'l Tax Counsel, U.S. Dep't of the Treasury, Michael Danilack, Deputy Comm'r (Int'l), Internal Revenue Serv., and Steve Musher, Assoc. Chief Counsel, Internal Revenue Serv., (June 7, 2011), (available at http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_HSBC_060711_WithCopyright_062311.pdf).

103. Emily McMahon, Acting Assistant Sec'y, U.S. Treasury, Keynote Address at the George Washington University Law School & I.R.S. Conference: Current Issues in International Taxation (Dec. 16, 2011) (author's notes from speech at a conference widely viewed as one of the premier annual gatherings of U.S. international tax practitioners and government tax officials, with over 700 international tax lawyers in attendance). The Obama administration in 2011 proposed regulations that would require U.S. financial institutions to collect and report to the IRS bank deposit interest information for all nonresident alien individuals, whatever their country of residence.

local law.¹⁰⁴ Finally, McMahon described FATCA as a vehicle to achieve a transition to a multilateral system.¹⁰⁵

Then in February 2012 the Treasury Department issued a joint statement with France, Germany, Italy, Spain, and the United Kingdom providing for an intergovernmental approach to FATCA implementation (Joint Statement I).¹⁰⁶ The joint statement acknowledged that FATCA “has raised a number of issues,” including that financial institutions in the European joint statement countries “may not be able to comply with the reporting, withholding and account closure requirements because of legal restrictions.” The framework adopted in the joint statement is accordingly based on reporting by financial institutions to the tax authority of the country in which they are located, followed by reciprocal automatic information exchange between governments.¹⁰⁷ Thus, non-U.S. financial institutions would report information on U.S. persons to the country in which the institution resides, and then have the information transferred to the United States by the foreign sovereign, and vice versa. That routing mechanism, in contrast to FATCA’s statutory direct, one-way reporting to the IRS, would resolve the conflict of law issues largely by bringing the United States into line with the routing mechanism of the EUSD.

Joint Statement I also suggested that the six governments would develop a shared approach to incentives and mandates, reporting, and customer identification. For example, with respect to incentives and mandates the joint statement provides that the framework for an intergovernmental approach would also include a practical and effective alternative approach to achieving the policy objective of passthru payment withholding.¹⁰⁸ As described above, that policy purpose is to ensure near-comprehensive participation by financial institutions in an automatic information reporting system by means of coercion. Joint Statement I thus suggested

104. Allison Bennett, *U.S. Open to Intergovernmental Approach To FATCA Information Sharing*, *Official Says*, 243 DAILY TAX REPORT, at G-11 (Dec. 19, 2011).

105. See McMahon, *supra* note 103; see also John Herzfeld, *Financial Institutions: FATCA Rules in Final Review Stages; McMahon Notes Billions in Offshore Yields*, 15 DAILY TAX REPORT, at G-4 (Jan. 25, 2012) (reporting McMahon making same point and observing that FATCA “cannot be the end of the story”).

106. Joint Statement I, *supra* note 4.

107. *Id.*

108. *Id.*

that a shared approach to incentives and mandates (which could also be described as “defensive measures”) was under consideration to ensure that other countries and institutions join an automatic information exchange system. The joint statement similarly provided for the development of common “reporting and due diligence standards.”¹⁰⁹ Joint Statement I and the Treasury’s public statements represented a substantial multilateral turn for FATCA implementation, given that the statute itself adopts a distinctly unilateral approach.

Then, in June of 2012, the United States and Switzerland issued a joint statement (Joint Statement II)¹¹⁰ that generally provided for reporting of consenting U.S. accountholders directly by Swiss financial institutions to the IRS and nonconsenting U.S. accountholders on an aggregate basis consistent with FATCA rules. Switzerland then agreed to provide information exchange upon request with respect to such ascertainable groups. Unlike the anonymous withholding agreements with countries like Germany and the United Kingdom, the Swiss-U.S. agreement will not provide the United States with information on the jurisdictions to which U.S. accountholders most commonly choose to move those untaxed assets in advance of the FATCA effective date. Joint Statement II represents a victory for the United States alone in that Switzerland accepted a modified form of FATCA compliance. On the other hand, Joint Statement II may represent an effective Swiss rearguard action against multilateral automatic information exchange in that it (1) continues to reject automatic information exchange in principle, (2) largely defuses the coercive force of FATCA withholding as a source of pressure that might help obtain automatic information exchange from Switzerland for other jurisdictions,

109. *Id.*

110. Joint Statement II, *supra* note 5. On the same date, the United States issued a similar joint statement with Japan. Press Release, U.S. Treasury Department, Joint Statement From the United States and Japan Regarding a Framework for Intergovernmental Cooperation to Facilitate the Implementation of FATCA and Improve International Tax Compliance (June 21, 2012), *available at* <http://www.treasury.gov/press-center/press-releases/Documents/FATCA%20Joint%20Statement%20US-Japan.pdf>. Like Joint Statement II, the joint statement with Japan creates a mechanism for Japanese financial institutions to provide information about U.S. accountholders to the IRS in order to comply with FATCA, without necessarily committing the Japanese government to developing more extensive mechanisms for cooperation with the IRS that might facilitate broader automatic information exchange. *Id.*

and (3) allows Switzerland to continue promoting an anonymous withholding alternative to other countries that are able to pressure it for enhanced cooperation.

The OECD, EU, and U.S. approaches to cross-border tax information exchange are challenging to reconcile because they inconsistently address identification, reporting, scope, verification, routing, and incentive issues, while also presenting different models of inter-nation cooperation. Part IV of this Article returns to these inconsistencies and makes some observations on how they can be reconciled. The key point at this juncture is that the shared commitment to information exchange sets TRACE, the EUSD, and FATCA apart from the anonymous withholding alternative being aggressively promoted by the Swiss government.

C. Anonymous Withholding: The Swiss Approach

Switzerland's substitute for the tax information reporting models provided by the OECD, the European Union, and the United States has gained significant traction. The approach was developed largely by Swiss financial institutions and was subsequently adopted by the Swiss government.¹¹¹ It provides for anonymous withholding and regularization of untaxed assets for residents of key Swiss trading partners, is intended to substitute for automatic tax information exchange cross-border with respect to non-Swiss residents holding Swiss accounts, and is justified as a means to protect the financial privacy of account holders.¹¹² Its fundamental

111. See *infra* note 137 and accompanying text. In February 2011 the CEO of the Swiss Bankers Association (SBA) reported with satisfaction that the Swiss government had adopted the SBA's strategy and was efficiently implementing that strategy. Claude-Alain Margelisch, *Foreward to SWISS BANKERS ASS'N, WEALTH MANAGEMENT IN SWITZERLAND: STATUS REPORT AND TRENDS* (Feb. 2011), available at <http://www.swissbanking.ch/en/20110107-bro-vermoegensverwaltungsgeschaeftrva.pdf>.

112. Arguments around client privacy are not a focus of this Article. However, those who claim that financial institutions should not report information cross-border to the government of a country in which a client resides for financial privacy reasons must argue either (1) that bank secrecy vis-à-vis tax administrations is part and parcel of a basic right to privacy, and that the information reporting/information availability model for tax enforcement in almost every major developed economy is thus unjust, (2) that individuals who have the wherewithal and sophistication to bank internationally should have access to elective bank secrecy, or (3) that bank secrecy needs to be preserved vis-à-vis authoritarian and corrupt regimes. The first of these

objective is to ensure that automatic tax information exchange does not take hold as a global system.

Austria, Germany, and the United Kingdom (each a “Partner Country”) recently signed treaties with Switzerland based on this approach.¹¹³ Further, Greece and Italy are reported to be negotiating such agreements with Switzerland.¹¹⁴ At one point the French parliament also asked the French finance ministry to study such an agreement.¹¹⁵ Such agreements are important

arguments rejects long-standing legal and policy notions in every major developed economy that tax administration access to resident taxpayer financial information is consistent with a taxpayer’s reasonable expectations of privacy. The second argument is entirely untenable; there is no credible basis for arguing that having sufficient wealth or sophistication to access offshore banking should give an individual the right to bank secrecy. The third argument conflates the idea that the benefits of a multilateral information exchange system should not be extended to all governments with the proposition that any individual, regardless of whether he or she resides in a just or unjust, democratic or undemocratic, or morally legitimate or illegitimate state, should have the option to individually elect to securely evade his or her taxes.

113. See generally Austria-Switz. Cooperation Agreement, *supra* note 4; U.K.-Switz. Cooperation Agreement, *supra* note 13; Ger.-Switz. Cooperation Agreement, *supra* note 13.

114. *Greece Seeks Withholding Tax Agreement With Swiss*, STEP J. (Oct. 31, 2011), http://www.stepjournal.org/news/news/secondary_news/greece_seeks_withholding_tax_a.aspx; see also Christiane Schlötzer, *Die Spur der Scheine* [The Track of the Bills], SÜDDEUTSCHE.DE (Apr. 28, 2012) (Ger.), <http://www.sueddeutsche.de/wirtschaft/steuerabkommen-zwischen-schweiz-und-griechenland-die-spur-der-scheine-1.1344218>; Giuseppe Fonte, *Italy Senate Urges Swiss-Italy Tax Deal*, REUTERS (Sept. 16, 2011), <http://www.reuters.com/article/2011/09/16/italy-tax-idUSL5E7KG2VH20110916>. Italy’s Prime Minister declared the possibility of negotiating a similar agreement with Switzerland if certain conditions are met. Armando Mombelli, *Segnali di disgelo nella vertenza fiscale* [Signs of Thaw in Tax Dispute], SWISSINFO.CH (May 3, 2012) (It.), http://www.swissinfo.ch/ita/politica/Segnali_di_disgelo_nella_vertenza_fiscale_.html?cid=32616442.

115. As of late November 2011 French Budget Minister, Valérie Pécresse, opposed a similar agreement with Switzerland. *France Has a “Choice” on Tax Says Calmy-Rey*, SWISSINFO.CH (Nov. 25, 2011, 9:11 AM),

because Switzerland is the world's most important offshore asset management center (managing approximately 27 percent of the world's offshore wealth),¹¹⁶ and is also the headquarters for certain systemically important global financial institutions. Switzerland also has the power to lead other offshore asset management jurisdictions by its example, and has done so in the past. The agreements therefore have dealt a significant blow to the emergence of automatic cross-border information reporting, and will deliver a further blow if they are ratified.¹¹⁷ The agreements provide that investment income and capital gains of Austrian, German, and U.K. residents (Partner Country Residents) with Swiss deposits or accounts will be taxed by Switzerland at agreed rates that vary by country and category of income, with the proceeds remitted anonymously to the Partner Country.¹¹⁸ The agreements specify that once the

http://www.swissinfo.ch/eng/politics/France_has_a_choice_on_tax_says_Calmy-Rey.html?cid=31636338.

116. BCG, GLOBAL WEALTH 2010, *supra* note 26, at 13.

117. *But see* Matthew Allen, *Rubik Tax Treaties Face Serious Hurdle*, SWISSINFO.CH (Nov. 25, 2011, 1:33 PM), *available at* http://www.swissinfo.ch/eng/Specials/Rebuilding_the_financial_sector/Spotlight_on_banking_secrecy/Rubik_tax_treaties_face_serious_hurdle.html?cid=31638262 (noting that France has “closed the door” on an anonymous withholding agreement and describing EU Commission legal objection to anonymous withholding); *Steuerabkommen mit der Schweiz?—Italien winkt (noch) ab*, SCHWEIZER FERNSEHEN (Dec. 8, 2011, 12:58 AM), <http://www.tagesschau.sf.tv/Nachrichten/Archiv/2011/12/08/Schweiz/Steuerabkommen-mit-der-Schweiz-Italien-winkt-noch-ab> (Prime Minister Monti previously suggested that the Italian government did not intend to enter into a tax agreement with Switzerland on the model of Bern's agreements with Germany and the United Kingdom).

118. The German and Austrian agreements specify that the Swiss will impose the same tax rate applicable to investment income and capital gains earned by German/Austrian residents through any institution that does not impose anonymous withholding, while the U.K. agreement provides for rates slightly below the regular U.K. rates on the relevant categories of income. Thus, the Swiss-U.K. agreement provides that future investment income and capital gains of U.K. residents with Swiss deposits or accounts will be taxed by Switzerland at a rate of 40 percent on dividend income, 48 percent on interest income and other investment income, and 27 percent on capital gains. *See* U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 19(1);

withholding tax is imposed by Swiss financial institutions, the investor's tax obligation to the Partner Country will be fulfilled.¹¹⁹ Partner Country Residents with Swiss bank accounts will not have any tax liability or information reporting obligation to the Partner Country on income or capital gains with respect to which the anonymous withholding tax is imposed.¹²⁰

Partner Country Residents that held Swiss accounts in the past and choose to keep those accounts after May of the year the agreement enters into force will generally be charged a one-time lump-sum by the Swiss institutions that hold their accounts, and be subject to anonymous withholding on future dividends, interest, and capital gains.¹²¹ The one-time charge on existing assets of account holders resident in the Partner Country varies from between 15 percent to 41 percent of the assets in question.¹²² This one-time charge is intended as a rough proxy to

U.K.-Switz. Protocol Amendment, *supra* note 4, at art. 8 (note that for interest income governed by art. 19(3), the Protocol has changed the rate from 48 percent to 50 percent). The German-Swiss agreement specifies a tax rate of 26.375 percent for investment income and capital gains, in line with the 25 percent German tax rate, plus the 'solidarity surcharge.' Press Release, Swiss Fed. Dep't of Fin., Switzerland and Germany Initial Tax Agreement (Aug. 10, 2011), *available at*

<http://www.efd.admin.ch/dokumentation/medieninformationen/00467/index.html?lang=en&msg-id=40533>. The Austrian-Swiss agreement foresees a 25 percent tax rate. Press Release, Swiss Fed. Dep't of Fin., Switzerland and Austria Sign Withholding Tax Agreement (Apr. 13, 2012), *available at* <http://www.news.admin.ch/message/index.html?lang=en&msg-id=44130>.

119. See U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 9(7),-9(12),-9(13),-19(5); Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 7(6),-18(4); Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 7(6),-17(3).

120. *Id.*

121. U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 9; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 7; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 7.

122. The one-time tax rate on assets varies based on a formula that takes into account the duration of the client's relationship with the withholding financial institution as well as the initial and final amount of the capital in the account over the period assessed under the agreements. Press Release, Swiss Fed. Dep't of Fin., Switzerland and Germany Initial Tax Agreement, *supra* note 118; U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 9; Ger.-Switz. Cooperation

compensate for past tax evasion. A one-time charge to address the past should be separated conceptually from the issues associated with an anonymous withholding system for taxing future dividends, interest, and capital gains.¹²³

Under the agreements, if Partner Country Residents move their Swiss accounts out of Switzerland prior to May 31 of the year the agreement enters into force, potentially opening replacement accounts in other offshore financial centers (including non-Swiss branches of Swiss banks) they avoid the lump-sum payment, future withholding, and disclosure of their accounts.¹²⁴ Thus, under the agreements, Partner Country Residents can evade both taxation and disclosure if they wish. Swiss banks have agreed to guarantee Germany at least EUR 2 billion in revenue and to guarantee the United Kingdom at least CHF 500 million, regardless of how much withholding is actually assessed under the one-off assessments imposed by the agreements.¹²⁵

Switzerland will report to the Partner Country the ten jurisdictions to which Partner Country Residents who close their accounts transfer the largest volume of assets.¹²⁶ Switzerland will also tell the Partner Country how many of its residents moved funds out of Switzerland to those

Agreement, *supra* note 13, at art. 7; U.K.-Switz. Protocol Letters, *supra* note 13; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 7.

123. One could imagine a one-time charge to resolve past tax evasion combined with an automatic information reporting regime for the future. The agreements themselves in effect acknowledge that addressing the past and providing for the future are separate issues. U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 10; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 9; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 9. This Article does not take a position on the question of whether amnesty for the past (as opposed to compliance in the future) should require disclosure.

124. See U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 7(1); Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 5(1); Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 5(1).

125. See U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 17(2); Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 15(2). The agreement with Austria does not include an upfront payment.

126. See U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 18; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 16; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 15.

various ten jurisdictions, but will not identify those people.¹²⁷ These arrangements simultaneously maintain client anonymity and encourage the Partner Country to pressure the jurisdictions where Partner Country Residents move their money to provide anonymous withholding, thereby helping to further spread the Swiss approach.

The Swiss agreements assert that this bilateral system achieves “a level of cooperation which has, with regard to taxation in respect of income and gains on relevant assets an enduring effect equivalent to the outcome that would be achieved through an agreement to exchange information about such individuals on an automatic basis.”¹²⁸ Ratification of this declaration by major financial centers would achieve a central aim and key political goal of Swiss policy: gaining acceptance of the idea that anonymous withholding is equivalent to automatic information exchange.¹²⁹ For this reason, the Swiss press almost universally described the agreements as a major coup in Switzerland’s rearguard effort to defend bank secrecy.¹³⁰

D. A New International Regime?

It is easy to see the OECD, EU, U.S., and Swiss approaches to cross-border tax administrative assistance as four competing systems. Yet doing so obscures a more fundamental point. At the start of the twenty-first century, neither governments nor financial institutions believed the institutions had a systematic role in quelling offshore tax evasion. Today, all the

127. See U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 18; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 16; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 15.

128. See U.K.-Switz. Cooperation Agreement, *supra* note 13, at art. 1; Ger.-Switz. Cooperation Agreement, *supra* note 13, at art. 1; Austria-Switz. Cooperation Agreement, *supra* note 4, at art. 1.

129. See, e.g., Press Release, Swiss Federal Department of Finance, Switzerland and the UK Initial Tax Agreement, *available at* <http://www.sif.admin.ch/00488/index.html?lang=en&msg-id=40731>.

130. See, e.g., Matthew Allen, *Ist das Schweizer Bankgeheimnis gerettet?*, SWISSINFO.CH (Oct. 29, 2011, 3:16 PM), http://www.swissinfo.ch/ger/Wirtschaft/Finanzsektor_im_Umbruch/Bankgeheimnis_im_Rampenlicht/Ist_das_Schweizer_Bankgeheimnis_gerettet.html?cid=28660632 (last visited May 29, 2012).

emerging systems for cross-border tax cooperation assume financial institutions will function as cross-border tax agents, whether as withholding agents or as information reporting agents. Despite the differences among these proposed systems, the fact remains that the United States, the European Union, the OECD, and Switzerland have all coalesced around this conclusion. That consensus represents a remarkable shift in global understandings. It has allowed the discourse of international tax cooperation to shift from a dispute about whether financial intermediaries should function as tax intermediaries cross-border to a dispute about how financial intermediaries should perform that role.

Financial institutions themselves appear to have accepted the inevitability of this new international regime. Whereas only a few years ago these same institutions eschewed any meaningful role in global efforts to police cross-border tax evasion, they now seek to shape the role they will play. For example, in response to FATCA, the U.S. Treasury has received hundreds of detailed submissions with comments from a variety of non-U.S. financial intermediaries, including traditional banks as well as pension funds, insurance companies, hedge funds, bond traders, and trust vehicles, and also industry associations and national chambers of commerce. The submissions consistently accept, either explicitly or implicitly, that the time has come for financial intermediaries to be tax intermediaries cross-border.¹³¹ Financial institutions are embracing a multilateral approach, if only to best manage their compliance costs as tax intermediaries cross-border.

Thus, the British Bankers Association (BBA), although scathingly critical of FATCA in a series of comments letters to the U.S. Treasury, noted that although FATCA is intended to combat U.S. tax evasion, the problem is a global one that can only be solved with participation

131. Some might describe industry endorsement of a global system as financial institutions trying to prolong the time before they will need to comply with any regime and simultaneously making lemonade out of lemons by ensuring they face only one regime. Such purported motives (which may or may not accurately reflect the motives of any given institution) do not change the basic decision to endorse a multilateral regime. *See, e.g.,* Alternative Investment Management Association, *Foreign Account Tax Compliance ('FATCA')*, Letter to Steven Musher, Assoc. Chief Counsel, Int'l, IRS, and Manal Corwin, Int'l Tax Counsel, U.S. Dep't of the Treasury (June 29, 2010), *available at* <http://www.bsmlegal.com/PDFs/AIMASubmissiontoUSTreasuryandIRSreFATCA29June.pdf>. *See also infra* notes 132–133 and accompanying text.

by financial institutions. In a moment of shocking clarity regarding policy by the standard of financial industry submissions to tax regulatory processes, the BBA suggested that “[i]n the longer term, we urge the U.S. and other nations to work toward an alternative global multilateral solution, where there would be reciprocal arrangements for all jurisdictions, and where information could be collected and exchanged between governments. We propose that consideration of a multilateral solution be an agenda item for upcoming meetings of the G20 since this is clearly an issue of international concern that requires a coordinated response.”¹³² This proposal came from the leading association for banking and financial services in the United Kingdom, which represents banking organizations headquartered not only in the United Kingdom but also around the world. A series of other industry groups and national banking associations expressed similar sentiments about the importance of developing a coordinated multilateral approach for financial institutions to serve as cross-border tax intermediaries.¹³³

132. BRITISH BANKERS’ ASS’N, NOTICE 2010-60, NOTICE AND REQUEST FOR COMMENTS REGARDING IMPLEMENTATION OF INFORMATION REPORTING AND WITHHOLDING UNDER CHAPTER 4 OF THE CODE (‘THE NOTICE’) (Oct. 29, 2010), *available at* http://www.bsmlegal.com/PDFs/FATCA_BBA_20101029.pdf. *See also* BRITISH BANKERS’ ASS’N, NOTICE 2011-34, SUPPLEMENTAL NOTICE TO NOTICE 2010-60 PROVIDING FURTHER GUIDANCE AND REQUESTING COMMENTS ON CERTAIN PRIORITY ISSUES UNDER CHAPTER 4 OF SUBTITLE A OF THE CODE (‘THE NOTICE’) (June 7, 2011), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_British_Bankers_Ass_06072011_061611.pdf.

133. *See, e.g.*, Letter From Int’l Council of Sec. Ass’ns to Timothy Geithner, Sec’y U.S. Dep’t of the Treasury and Douglas H. Shulman, Comm’r Internal Revenue Serv., Re: Implication of the Foreign Account Tax Compliance Act (FATCA) (June 28, 2011), *available at* http://www.icsa.bz/img/letter_pdf/ICSA-FATCA-Letter-Jun-2011.pdf (“Rather than the unilateral approach taken by FATCA, we suggest that a more appropriate approach would be the development of a global framework that would allow the U.S. and other governments to obtain information regarding income paid to citizens of their countries by foreign financial institutions which is in harmony with each jurisdiction’s existing laws and does not create an excessive compliance burden for financial institutions.”); Letter From the Dutch Banking Ass’n to Stephen E. Shay, Deputy Assistant Sec’y, U.S. Treasury, et al., Re: Comments of the Dutch Banking

Financial sector commentary regarding the OECD's TRACE project highlights the same convergence around the idea of financial institutions as tax intermediaries cross-border. Consider the submission of the Capital Markets Tax Committee of Asia (CMTCA) to the OECD's work. CMTCA is a financial services industry body consisting of major commercial banks, investment banks, securities firms, and other diversified financial services institutions operating in Asia. In its submission to the OECD, the CMTCA suggests that "cross-border information gathering and information exchange represents the new reality of the global economy."¹³⁴ It does not object to rules requiring its members to make customer and account information available to tax administrators on a routine basis for the purpose of cross-border information exchange.¹³⁵ Indeed, the CMTCA writes that "because of their unique position in the global economy, it is inevitable that financial institutions will be increasingly called upon to make such information available to tax administrators."¹³⁶ The CMTCA's submission is remarkable because it demonstrates that a leading tax-related association of major financial institutions operating in Hong Kong and Singapore—the two most important financial centers popularly understood to be resistant to cross-border tax intermediation by financial institutions—has at least resigned itself to this new regime.

Association on the Foreign Account Tax Compliance Act, as well as Notice 2010-60 and Notice 2011-34 (June 9, 2011), *available at* http://www.deloitte.com/view/en_US/us/Services/tax/40f3486234d42310VgnVCM2000001b56f00aRCRD.htm ("[The Dutch Banking Association] would suggest a coordinated approach of states similar to what has been done in the area of transfer pricing, where through development of common concepts compliance efforts have been limited to a manageable position for taxpayers."); Letter From Eur. Banking Fed'n & Inst. of Int'l Bankers to Stephen E. Shay, Deputy Assistant Sec'y for Int'l Tax Affairs, U.S. Dep't of the Treasury, et al., Re: Comments on Notice 2010-60 Providing Preliminary Guidance on FATCA (Nov. 12, 2010), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_EBF_IIB_FATCA_Comment_Letter_No v12_121010.pdf (making similar comments).

134. Letter From Capital Markets Tax Committee of Asia to Jeffrey Owens, Director, CTPA, OECD (Aug. 18, 2010), *available at* <http://www.oecd.org/dataoecd/40/60/46019879.pdf>.

135. *Id.*

136. *Id.*

Finally, and as described earlier, Swiss financial institutions have not only consented to the anonymous withholding approach—they are in fact its originators. As the Swiss Banking Association pointed out in its 2009–2010 Annual Report, “[t]he flat rate tax project represents an important element of both the Swiss Bankers Association’s 2015 Financial Centre Strategy and the financial market strategy of the Swiss federal government, published in December 2009. The flat rate tax project proposal was developed in a body constituted by the Swiss banks.”¹³⁷

Together the United States, the European Union and its member states’ dependencies, and the other OECD economies (including Switzerland) represent 59 percent of global gross domestic product (GDP),¹³⁸ and the management location for well more than 80 percent of global financial assets.¹³⁹ The comments on the EU, OECD, and U.S. systems that endorse some form of automatic multilateral tax information exchange come from associations that represent much of the global financial industry.

The views of both private and public sector actors are thus converging around new principles and norms wherein financial institutions act as tax agents for governments cross-border. We are witnessing the birth of a new international regime for cross-border tax administrative assistance with respect to income and assets held through offshore accounts. The most basic contour of the emerging regime—financial institutions as tax intermediaries cross-border—is already established. Two other key elements remain to be determined: the nature of the cooperation required by the regime (anonymous withholding or information reporting), and the scope of beneficiaries of the regime (major financial centers and states politically bound to

137. SWISS BANKERS ASS’N, TÄTIGKEITSBERICHT 2009/2010 [2009–2010 ANNUAL REPORT] (2010), <http://www.swissbanking.org/en/taetigkeitsbericht-2010.pdf> [hereinafter SBA ANNUAL REPORT 2009/2010].

138. U.S. Dep’t of State, *What is the OECD?*, U.S. MISSION TO THE OECD, <http://usoecd.usmission.gov/mission/overview.html> (last visited May 30, 2012).

139. Eighty-two percent of financial assets globally (managed both domestically and offshore) are managed from the United States, the United Kingdom, Switzerland, France, Germany, or Japan. The remaining 18 percent of assets consists in significant measure of assets of a resident of one of the other OECD economies managed from within that OECD economy. SWISS BANKERS ASS’N, WEALTH MANAGEMENT IN SWITZERLAND 7 (2009), *available at* [http://www.finanzplatz-zuerich.ch/portals/1/Documents/DE/Studien/Wealthmanagement2009_sbvg_0109\[1\].pdf](http://www.finanzplatz-zuerich.ch/portals/1/Documents/DE/Studien/Wealthmanagement2009_sbvg_0109[1].pdf).

those financial centers, or the greater part of the world). Anonymous withholding available to a limited number of states is the more likely default result, but a broadly multilateral automatic information exchange system is the normatively preferable answer.

III. ANONYMOUS WITHHOLDING VS. AUTOMATIC INFORMATION REPORTING

Automatic information reporting systems and cross-border anonymous withholding systems both clearly break from past practice, and move toward a global norm of financial institutions serving as tax agents for governments cross-border. Neither system represents the most comprehensive solution to address offshore accounts, which would involve nonanonymous cross-border withholding in combination with information reporting.¹⁴⁰ However, between the two models presently under consideration internationally, an information reporting model is superior to an anonymous withholding model. Information reporting is substantively superior because it is able to address concerns regarding the accretion of untaxed principal, whereas withholding solutions are not. Furthermore, contrary to some conventional wisdom, anonymous withholding is not significantly cheaper, simpler, or more administrable than information reporting.

Just as importantly, cross-border anonymous withholding institutionalizes differentiated treatment of the most sophisticated taxpayers from the rest of society. In doing so, it undermines tax morale and the role that taxation can play in helping to define citizenship in a democratic polity. In contrast, information reporting can empower the tax system to act as a building block of liberal democracy. Where anonymous withholding has the effect of reducing policy flexibility and sovereign authority, information reporting preserves sovereign policy autonomy. Particularly outside the largest developed economies, these differences favor automatic information reporting.

140. Cf. MICHAEL KEEN AND JENNY E. LIGTHART, INFORMATION SHARING AND INTERNATIONAL TAXATION, TILBERG UNIV. DISCUSSION PAPER NO. 2004-117, at 3 (Nov. 2004), available at <http://arno.uvt.nl/show.cgi?fid=12179> (suggesting that information sharing “may now be the last hope of the residence principle,” observing that other policy responses to offshore tax evasion may be a step too far in terms of being perceived as intrusions on national sovereignty, and treating anonymous withholding and information reporting as substitutes for rather than complements to each other as a practical matter).

Finally, politically speaking, anonymous withholding will not be accepted globally, whereas automatic information reporting has the capacity to develop into a global regime. Information reporting regimes could conceivably grow to serve a wide range of states, whereas anonymous withholding regimes will, at best, only serve the interests of the wealthiest states with the most influential financial centers. Despite the superiority of information reporting, if a crucial subset of major financial centers accepts anonymous withholding, the suboptimal result represented by anonymous withholding for a limited number of countries may become a stable equilibrium. This dynamic makes the outcomes of the current evolutionary moment crucial to the development of cross-border administrative assistance.

A. Effectiveness and Administration

1. Reaching Untaxed Principal

Automatic information reporting has the capacity to address concerns regarding the accretion of untaxed principal. Anonymous withholding is triggered only when interest, dividends, or capital gains are earned in a foreign account, whereas automatic information reporting can be structured both to report on income and gains and to measure the growth of principal in a foreign account. Untaxed principal is a significant concern for tax administrators. While scholarly discussions of tax evasion often focus on tax revenues lost because of untaxed investment income,¹⁴¹ discussions with policymakers reveal that government officials have focused equally on the use of offshore structures to evade taxation on domestic business income of closely held businesses, with the proceeds from that evasion then being invested through offshore accounts so as to evade tax on the resulting investment income.¹⁴² For instance, the hearings of the Permanent Subcommittee on Investigations (PSI), which served as a catalyst for recent U.S. efforts to crack down on offshore tax evasion, focused intently on exactly this kind of

141. See JANE G. GRAVELLE, CONG. RESEARCH SERV., R40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION (2009), available at http://assets.opencrs.com/rpts/R40623_20090709.pdf; Joseph Guttentag & Reuven Avi-Yonah, *Closing the International Tax Gap*, in BRIDGING THE TAX GAP: ADDRESSING THE CRISIS IN FEDERAL TAX ADMINISTRATION 99 (Max B. Sawicky ed., 2005).

142. Discussions between author and current and former government officials from Australia, Denmark, France, Germany, India, and the United States.

tax evasion.¹⁴³ U.S. Department of Justice prosecutions have similarly reflected the concern that taxpayers are evading tax by fraudulently shifting domestic taxable income offshore.¹⁴⁴ These same concerns are shared by tax administrators outside the United States, as demonstrated by their discussions in global forums.¹⁴⁵

Understanding the prevalence of concerns regarding the fraudulent use of offshore structures to evade domestic business income tax is imperative to a cogent evaluation of anonymous withholding. Even if an anonymous withholding system were adopted by all countries, it would not address or deter the use of offshore structures and specious transactions to evade domestic

143. *Tax Haven Abuses: The Enablers, the Tools and Secrecy: Hearing Before the Permanent Subcomm. on Investigations of the Comm. on Homeland Sec. & Gov't Affairs*, 109th Cong. 33, 45 (2006).

144. *See, e.g.*, Barton Massey, *Convicted Bank Chairman is Key to Dozens of New Tax Haven Cases*, 19 TAX NOTES INT'L 959, 959–60 (Sept. 13, 1999); GAO, QUALIFIED INTERMEDIARY PROGRAM, *supra* note 64, at 23 (describing 2007 indictment of adult entertainment mogul for using offshore companies that he owned to overstate business and personal expenses, while concealing his ownership of those companies); Statement by Defendant in Advance of Plea of Guilty, *United States v. Taylor*, No. 2:08-CR-00064-TC (D. Utah Jan. 24, 2008); Statement by Defendant in Advance of Plea of Guilty, *United States v. Petersen*, No. 2:05-CR-00805-TC-DN (D. Utah Jan. 18, 2008). *See also Tax Haven Banks and U.S. Tax Compliance*, *supra* note 68, at 17–18.

145. *See* OECD, SEOUL DECLARATION, THIRD MEETING OF THE OECD FORUM ON TAX ADMINISTRATION (Sept. 15, 2006) (thirty-five tax commissioners and deputy tax commissioners from OECD and non-OECD economies express concern regarding outright fraud to conceal income and assets using offshore business entities). *See also, e.g.*, FIN. COMM'N, NAT. ASSEMBLY OF FR., INFORMATION REPORT NO. 1902, at 147–56 (Sept. 10, 2009), *available at* <http://www.assemblee-nationale.fr/13/pdf/rap-info/i1902.pdf>; Gesetz zur Bekämpfung der Steuerhinterziehung (Steuerhinterziehungsbekämpfungsgesetz) [Act to Fight Against Tax Evasion (Tax Evasion Act)], July 29, 2009, BGBl I at 2302, *available at* http://www.bundesfinanzministerium.de/nr_4146/DE/BMF__Startseite/Aktuelles/Aktuelle__Gesetze/Gesetze__Verordnungen/040__SteuerhinterziehungsbekG__anl,templateId=raw,property=publicationFile.pdf (increasing reporting requirements for business transactions with entities in jurisdictions lacking tax transparency).

taxation. Withholding in any anonymous withholding system only applies to investment income, not contributions to principal. Thus, the Swiss agreements use a one-time charge as a proxy to acknowledge past untaxed principal, but have no mechanism to help address the evasion of domestic business income tax through offshore accounts on a forward-going basis. Furthermore, anonymous withholding exists to limit exchange of information, and thus such a regime runs counter to the extensive cross-border administrative assistance necessary to ferret out tax evasion on principal. Conversely, an appropriately structured system of information exchange can call attention to the existence of assets of a domestic taxpayer that may be funded from income, profits, or gains that evaded taxation. The U.S. FATCA regime, for instance, requires annual asset reporting, including assets held by shell entities, as well as income reporting. This reporting attempts to deter and identify patterns suggestive of the use of offshore accounts to evade tax on domestic income earned by closely held businesses.

Agreements between the United States and Switzerland over more than a decade demonstrate that nontaxation of principal is an important concern for U.S. tax administrators. Normally, the United States insists that tax treaties provide unfettered information exchange upon request,¹⁴⁶ but until 2010, Switzerland refused to provide information exchange upon request to any country with which it entered into tax treaties. The compromise agreed to in 1996 was that the Swiss would provide information to the United States in situations of tax fraud, rather than mere tax evasion (run-of-the-mill tax evasion is not a crime under Swiss law). One difficulty with this compromise was that it forced the two states to define the term “tax fraud” for purposes of the treaty.¹⁴⁷ The United States pressed the Swiss on this issue repeatedly, which resulted in three sequential agreements, the substance of which sheds light on U.S. tax administrators’ offshore tax abuse concerns during the Clinton and Bush administrations. The

146. United States Model Income Tax Convention, *supra* note 61, at art. 26(1).

147. The history suggests that U.S. officials were not pleased with Swiss officials’ initial (narrow) interpretation of the meaning of the term “tax fraud,” which was defined in paragraph 10 of the protocol accompanying the 1996 Convention treaty to mean “fraudulent conduct that causes or is intended to cause an illegal and substantial reduction in the amount of tax paid to a Contracting State.” Protocol Amending the Convention for the Avoidance of Double Taxation With Respect to Taxes on Income ¶ 10, U.S.-Switz., Oct. 2, 1996, 27 U.S.T. 1996, *available at* <http://www.irs.gov/pub/irs-trty/swiss.pdf>.

agreements focused heavily on issues likely to arise through the fraudulent use of offshore structures to evade taxes on domestic business income.¹⁴⁸

The most recent agreement, in 2003, highlighted U.S. Treasury concerns by outlining fourteen examples of offshore tax evasion abuses that would be treated as tax fraud. Each example involved evasion of tax on domestic-source income through the use of offshore accounts. One representative example involved an individual that operates a domestic business, forms a third-country corporation of which he is the disguised owner, and maintains an offshore bank account in the corporate name. The business enters into a contract with the corporation under which the corporation agrees to perform services for the business. Such services are never performed, but the business pays substantial fees for the service, and the fees are deposited into the offshore bank account of the corporation. The business then records the fees as expenses on the business books and records, and because those books and records are used to prepare the individual's income tax return, his reported domestic taxable income is substantially understated.

Concern about similar abuses led the U.K. Treasury to emphasize the distinction between information reporting regimes and anonymous withholding regimes in deterring tax evasion on domestic business income when it championed information exchange over anonymous

148. The initial protocol to the 1996 Convention emphasized that “[f]raudulent conduct is assumed in situations where a taxpayer uses, or has the intention to use, a forged or falsified document such as a double set of books, a false invoice, an incorrect balance sheet or profit and loss statement, or a fictitious order or, in general, a false piece of documentary evidence.” Protocol Amending the Convention for the Avoidance of Double Taxation With Respect to Taxes on Income ¶ 10, U.S.-Switz., Oct. 2, 1996, 27 U.S.T. 1996. The conduct defined as fraudulent is primarily relevant in relation to evasion of tax on business income, rather than investment income. The protocol then dwells on how a state should determine “whether tax fraud exists in a case involving the active conduct of a profession or business (including a profession or business conducted through a sole proprietorship, partnership or similar enterprise).” *Id.* In 2003 the definition of “tax fraud” for purposes of the convention was clarified again, and again focused in substantial measure on examples of issues that would most likely arise in connection with evasion of domestic business income through the fraudulent use of offshore structures. Mutual Agreement Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996, U.S.-Switz., Jan. 23, 2003 [2003 U.S.-Switz. Agreement].

withholding in the early debates over the EUSD at the turn of the twenty-first century. The United Kingdom noted that an information exchange system can deter taxpayers from concealing business income through offshore structures, while “[e]ven if withholding arrangements were adopted by all countries globally, this would not provide an effective solution to evasion,” because such systems would not “deter and detect the ‘laundering’ of the proceeds of tax evasion through investment abroad.”¹⁴⁹

2. Administrability

Another argument made in favor of anonymous withholding is that even if automatic information reporting is a substantively preferable system, anonymous withholding is less costly and more administrable. This claim is grossly overstated. Anonymous withholding and automatic information reporting share almost all of the same operational challenges. A multilateral anonymous withholding system along the lines of the Swiss model must (1) determine how to identify taxpayers’ country of residence, (2) collect information about amounts of interest, dividends, capital gains, and other income in order to impose the right withholding rates, (3) determine which financial institutions are included in the withholding system, (4) ensure financial institutions comply with the requirements to identify taxpayers with a country of residence and withhold appropriate amounts on identified types of income, and (5) determine how to encourage widespread multilateral participation. The only important aspect of information reporting that is more burdensome than anonymous withholding is its requirement for taxpayer identification numbers (TINs). On the other hand, an anonymous withholding system is more burdensome than information reporting along other dimensions. In an anonymous withholding system, a financial institution must keep track of tax rates and rate changes in different categories of income for every country in the world for which it applies

149. See HM TREASURY, UNITED KINGDOM, EXCHANGE OF INFORMATION AND THE DRAFT DIRECTIVE ON TAXATION OF SAVINGS ¶ 3 (Feb. 2000), <http://archive.treasury.gov.uk/docs/2000/eoi.html> (last visited Feb. 2, 2012) [hereinafter HM TREASURY, EXCHANGE OF INFORMATION]. Note that unlike the Labor government in place in 2000, the current U.K. government appears to be prepared to accept anonymous withholding. Perhaps the change of perspective is because of the United Kingdom’s growing role as a major offshore asset manager.

withholding and then must in fact withhold, instead of simply tracking income and gross proceeds and reporting these amounts.

The only important element of a regime for cross-border administrative assistance that an information reporting system must develop more thoroughly than an anonymous withholding regime is a mechanism to transmit information from the asset management jurisdiction to the residence country in a form that tax administrations can match against residents' tax returns.¹⁵⁰ Assuming that a financial institution were to arrange its information technology (IT) systems to collect the necessary information to impose a withholding tax, the rate of which varies by type of income and country of residence of the customer, providing automatic information reporting instead of withholding requires adding only two pieces to the system: TINs and information technology that allows secure transfer of the requisite information in a mutually intelligible format. Solving the former problem requires every residence country interested in benefitting from automatic information exchange to issue its taxpayers TINs if it has not done so. It also requires every financial institution with offshore accounts to collect those numbers from nonresident account holders.¹⁵¹ Solving the latter problem involves significant but feasible investment in IT development and allowing time to implement the new technology. That much has already been demonstrated by the successful operation of the EUSD,¹⁵² as well as the work of expert groups at the OECD.¹⁵³

150. Anonymous withholding as proposed in the Swiss agreements still requires financial institutions to be prepared to report on individual account holders (at their request), but the scale of that reporting may be small enough that it can be done manually.

151. See OECD, RECOMMENDATION OF THE COUNCIL ON THE USE OF TAX IDENTIFICATION NUMBERS IN AN INTERNATIONAL CONTEXT, (Mar. 13, 1997), *available at* [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C\(97\)29/FINAL&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C(97)29/FINAL&docLanguage=En); see also David E. Spencer, *OECD Information Exchange Recommendations are a Significant First Step in Resolving Tax Evasion*, 8 J. INT'L TAX'N 353 (1997); MODEL INTERGOVERNMENTAL AGREEMENT TO IMPROVE TAX COMPLIANCE AND TO IMPLEMENT FATCA, *supra* note 4, at Art. 6(3) (reciprocal commitment to collect TINs—agreed to approximately six months after a version of this Article, entitled “Beyond FATCA: An Evolutionary Moment for the International Tax System” first appeared on the Social Science Research Network).

152. See COMM'N OF THE EUR. CMTYS., REPORT FROM THE COMMISSION TO THE COUNCIL IN ACCORDANCE WITH ARTICLE 18 OF COUNCIL DIRECTIVE 2003/48/EC ON TAXATION OF

The Swiss Banking Association estimates the compliance cost for Swiss anonymous withholding for all financial institutions throughout Switzerland will be between CHF 300 and 500 million.¹⁵⁴ Further, it implies that this one-time fixed cost does not increase substantially with the number of jurisdictions for which Swiss financial institutions search for nonresident account holders. CHF 300 to 500 hundred million diffused across the industry is an expensive but manageable cost. Although the additional cost of collecting TINs and building the IT system for fully automatic routine information reporting may be significant, it is unlikely to vastly exceed the costs, common to automatic information exchange and anonymous withholding, of (1) identifying taxpayers and their country of residence, (2) collecting information about interest, dividends, capital gains, and other income earned by nonresident taxpayers, and (3) ensuring financial institution compliance.¹⁵⁵

Advocates of anonymous withholding often suggest that it is more administrable and less costly than information reporting by comparing the Swiss model to FATCA and noting that anonymous withholding does not require withholding on any entity, or on passthru payments, as does FATCA. These arguments are not on point. The withholding imposed by FATCA on

SAVINGS INCOME IN THE FORM OF INTEREST PAYMENTS, 2 (Sept. 15, 2008) (emphasizing the need for taxpayer identification numbers (TINs), and with that caveat suggesting exchange is workable through preexisting channels of communication established among EU member states).

153. See, e.g., Spencer, *supra* note 151.

154. SBA ANNUAL REPORT 2009/2010, *supra* note 137, at 17. But see Swiss Banking Association, *FATCA Notice 2011: Submission of the Swiss Bankers Association*, Letter to Manal Corwin, Deputy Assistant Secretary Tax Policy (Int'l), U.S. Dep't of the Treasury, Michael Danilack, and Steve Musher, IRS (June 10, 2011), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_SBA_061011_NOCOPYRIGHTNEEDED_062311.pdf (last visited Dec. 22, 2011) (complaining about the excessive cost of FATCA account identification, due diligence, and verification procedures as proposed in Notice 2010-60 and Notice 2011-34).

155. It is of course possible that the estimated costs of the Swiss system are low because it does not do enough to identify tax evaders or otherwise ferret out evasion. The most important point is simply that there will not be a monumental cost differential in an apples-to-apples comparison of automatic information exchange and anonymous withholding systems.

financial institutions for noncompliance is not a cost of the information reporting system. Rather, it is simply the stick chosen by the United States to try to encourage global compliance. Any system with global aspirations needs a combination of carrots and sticks if it is to drive the vast majority of institutions and governments into the system. FATCA attempts to create a global regime to improve cross-border administrative assistance in the face of resistance from certain foreign sovereigns and financial institutions. It therefore requires means of coercion without which various financial institutions and sovereigns would not comply. Swiss anonymous withholding, in contrast, is intentionally characterized by contracting. It requires no coercive measures because Switzerland is not attempting to globalize the regime. Indeed, Switzerland would likely prefer to establish anonymous withholding with only as few countries as necessary to stop the spread of automatic information reporting. Coercion inevitably imposes greater compliance and political costs than contracting, even if the results from coercion are justified.¹⁵⁶

It is inappropriate to think of the cost of mechanisms used to encourage widespread multilateral participation among financial institutions and governments as a cost of an information reporting system rather than an anonymous withholding system. That cost is simply the cost of trying to create a multilateral system. The United States can appropriately be criticized for coercing by withholding 30 percent on a wide range of payments arising in or indirectly attributable to the United States for the sake of a regime that addresses a global problem in a way that benefits only the United States. If such costs were imposed to ensure that automatic information reporting was available from most financial institutions in the world to most jurisdictions that complied with relevant international standards, however, the calculus regarding the cost of coercion would change. Nothing about that calculus is inherent to the choice between information reporting and anonymous withholding.

B. Governance Concerns

Tax administration plays a central role in developing national institutions. Robust tax administrations are important for national institutions more generally because they usually provide the lifeblood of a country's government. Setting aside aid-dependent and rentier states, tax administrations fund all other national institutions and, as the practical expression of tax policy, represent an important component of a country's economic policy. Tax administrations

156. See STEPHEN D. KRASNER, SOVEREIGNTY: ORGANIZED HYPOCRISY 33–40 (1999).

also mediate more regularly between many private citizens and government than any single other government institution. The tax administration embodies and asserts a government's exclusive authority to tax, and demonstrates a government's effective level of control (or lack thereof) in performing its sovereign task of gathering resources for the state.¹⁵⁷ For these reasons, from a state-building perspective it matters not only how much revenue a government raises, but also how it raises that revenue.¹⁵⁸

Even if anonymous withholding could be globalized (which I argue it cannot be), most countries, especially emerging economies, should prefer automatic information reporting for governance-related reasons. This claim may be controversial because anonymous cross-border withholding could theoretically provide revenue to emerging economy government fiscs without those governments needing to build an effective tax administration in order to collect that revenue. However, anonymous cross-border withholding on capital income threatens domestic tax morale, tends to undermine the expressive role of taxation as a building block of liberal democracy, and erodes sovereign policy flexibility. Meanwhile cross-border information reporting undergirds voluntary tax compliance and strengthens the capacity to govern.

1. Tax Morale

Compliance with domestic tax policy is quasi-voluntary; tax collection is significantly less costly and more effective if it is motivated by a voluntary willingness to cooperate ("tax morale") even while backed by coercive authority. Evidence from experimental studies and survey data suggests that tax morale is affected by factors such as citizens' perceptions of other citizens' compliance, and by perceptions of the trustworthiness and competence of the government.¹⁵⁹ This research is consistent with broader empirical research suggesting that

157. Cf. Kyle Bagwell & Robert W. Staiger, *National Sovereignty in an Interdependent World* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 10249, 2004), available at <http://www.nber.org/papers/w10249.pdf> (arguing that the capacities to exercise unilateral control over policy instruments and to operate without outside influence in internal affairs are the key features of sovereignty).

158. See Bird & Zolt, *supra* note 19, at 1631 ("A country's tax system is thus both an important and a highly visible symbol of its fundamental political and philosophical choices.").

159. James Alm & Benno Torgler, *Culture Differences and Tax Morale in the United States and in Europe*, 27 J. ECON. PSYCHOL. 224, 228 (2006) ("[T]ax morale is likely to be

individuals' willingness to contribute to public goods depends on whether they trust others to do the same.¹⁶⁰ Recent work further suggests that tax measures that increase the transparency of tax matters may help build a culture of tax compliance, and thus help maximize revenue while minimizing political and enforcement-related conflict.¹⁶¹ In contrast, cross-border anonymous withholding provides opacity that prevents governments from receiving the data that would suggest that tax is being collected equitably. It singles out an elite class of potential nonpayers who have the sophistication to utilize foreign institutions and provides them with special treatment. A belief in equitable treatment and enforcement appears to be crucial to tax morale.

Tax compliance research also suggests that the government's level of commitment to enforcing the tax law has an important effect on voluntary compliance and tax morale.¹⁶² If there is a widespread perception that the government is not willing to detect and penalize tax evaders, then tax evasion may be socially legitimized and tax morale tends to fall.¹⁶³ In countries like

influenced by such factors as perceptions of fairness, trust in the institutions of government, the nature of the fiscal exchange between taxpayers and government, and a range of individual characteristics.”); Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1477 (2003) (“[T]he development of a sense that others are contributing is likely an important factor in tax compliance.”).

160. See, e.g., Dan M. Kahan, *Trust, Collective Action, and Law*, 81 B.U. L. REV. 333 (2001) (discussing this research). Put another way, reciprocity hinges on contributors' perception that they are not being taken advantage of. See Lederman, *supra* note 159, at 1477; see also Eric Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1784–85 (2000).

161. See Richard M. Bird, Jorge Martinez-Vazquez & Benno Torgler, *Societal Institutions and Tax Effort in Developing Countries* (Ctr. for Research, Econ. Mgmt., & the Arts Working Paper No. 2004-21, 2004), available at <http://ssrn.com/abstract=662081>.

162. See Ronald G. Cummings et al., *Tax Morale Affects Tax Compliance: Evidence From Surveys and an Artefactual Field Experiment*, 70 J. ECON. BEHAV. & ORG. 447 (2009).

163. James Alm & Jorge Martinez-Vazquez, *Institutions, Paradigms, and Tax Evasion in Developing and Transition Countries*, in PUBLIC FINANCE IN DEVELOPING AND TRANSITIONAL COUNTRIES 146, 151 (Jorge Martinez-Vazquez & James Alm eds., 2003); see also Bruno S. Frey & Benno Torgler, *Tax Morale and Conditional Cooperation*, 35 J. COMP. ECON. 136 (2007)

Greece, Italy, or the Philippines, weak tax administrations lacking vigorous enforcement programs have contributed to tax evasion carrying very little moral opprobrium.

Cross-border anonymous withholding arguably represents the tax administration forswearing any independent effort to collect tax that is due. It thus may legitimize nondeclaration and tax evasion with respect to income earned not only through offshore accounts, but also more broadly. Thus, when the U.K. Treasury evaluated the anonymous withholding component of the late 1990s so-called coexistence model for the EUSD, a model that treated withholding and reporting as equally satisfactory systems, the U.K. Treasury noted that “exchange of information encourages compliance with the tax system. It provides a deterrent to the nondeclaration or under-declaration of income. In contrast a [cross-border anonymous] withholding system, without exchange of information, might appear to give the impression of legitimising tax evasion since it fails to deter nondeclaration.”¹⁶⁴

2. Other Political Economy Concerns and Consequences

Even in major developed economies, cross-border anonymous withholding raises concerns about the taxpayer’s engagement with the polity and the equality of citizens in the face of the taxing authority.¹⁶⁵ These concerns have even greater salience in many emerging and developing economies, where tax evasion is frequently characterized as systemic, and the taxation of elites is often a source of special concern.¹⁶⁶ In contrast to anonymous withholding, information reporting, like identified withholding, allows the income taxation of elites to be sufficiently

(arguing that noncompliance by other taxpayers tends to decrease a taxpayer’s tax morale and compliance).

164. HM TREASURY, EXCHANGE OF INFORMATION, *supra* note 149, at ¶ 3.4.

165. Michael Backhaus & Angelika Hellemann, *Sigmar Gabriel: Und Wir Sollten die Bürger Darüber Abstimmen Lassen* pt. 2, BILD (Sept. 25, 2011, 12:16 AM), <http://www.bild.de/politik/inland/sigmar-gabriel/wir-muessen-die-eu-reformieren-die-buerger-abstimmen-lassen-teil-2-20134564.bild.html>; *see also supra* notes 149–150 and accompanying text.

166. Alm & Martinez-Vazquez, *supra* note 163, at 151; Clive S. Gray, *Enhancing Transparency in Tax Administration in Madagascar and Tanzania* (Afr. Econ. Policy Discussion Paper No. 77, 2001), available at http://pdf.usaid.gov/pdf_docs/PNACM656.pdf.

visible that it may help support the legitimacy of the governance structure in the eyes of all citizens.

When taxpayers feel they are subject to generally applicable taxes imposed by the sovereign, scholarship suggests that they are more likely to collectively insist on meaningful representation.¹⁶⁷ A generation of economists, economic historians, sociologists, and political scientists has been influenced by the idea that relatively broad-based and transparent taxation, especially of mobile assets, generally tends to produce more representative government.¹⁶⁸ On

167. For instance, some historians explain the contrast between English liberty and French absolutism for three hundred years in part with reference to the prevalence of tax exemptions for French nobles, as compared to a transparent direct tax burden borne relatively uniformly by the English nobility. The argument is that in England, elites were motivated to ensure a robust national assembly with meaningful authority and rule of law that constrained the executive, whereas in France, those incentives were lacking. Aristide R. Zolberg, *Strategic Interactions and the Formation of Modern States: France and England*, 32 INT'L SOC. SCI. J. 687 (1980).

168. See generally Robert H. Bates & Da-Hsiang Donald Lien, *A Note on Taxation, Development, and Representative Government*, 14 POL. & SOC'Y 53 (1985); Robert H. Bates, *The Economics of Transitions to Democracy*, 24 P.S.: POL. SCI. & POL. 24 (1991); NIALL FERGUSON, *THE CASH NEXUS: MONEY AND POWER IN THE MODERN WORLD, 1700–2000*, at 81–106 (2001); MARGARET LEVI, *OF RULE AND REVENUE* (1988) [hereinafter LEVI, *OF RULE AND REVENUE*]. See also DOUGLASS C. NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE* 49 (1990); Mancur Olson, *Dictatorship, Democracy, and Development*, 87 AM. POL. SCI. REV. 567 (1993); Martin C. McGuire & Mancur Olson, Jr., *The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force*, 34 J. ECON. LITERATURE 72 (1996); CHARLES TILLY, *COERCION, CAPITAL AND EUROPEAN STATES, AD 990–1990*, at 96–114 (1990); James E. Mahon, Jr., *Liberal States and Fiscal Contracts: Aspects of the Political Economy of Public Finance* (Ann. Meeting of the Am. Pol. Sci. Ass'n, Conference Paper, 2005), available at http://citation.allacademic.com/meta/p_mla_apa_research_citation/0/4/0/1/1/pages40115/p40115-1.php; Michael L. Ross, *Does Taxation Lead to Representation?*, 34 BRIT. J. POL. SCI. 229 (2004) (showing regressions consistent with the hypothesis that higher taxes relative to total government services make states more democratic, but inconsistent with the hypothesis that higher taxes relative to income lead to democratization).

the other hand, some of these scholars suggest that external funding allowed third-world client regimes during the Cold War to avoid entering into implicit or explicit social fiscal contracts with their citizenry in which they exchanged law and representation for resources.¹⁶⁹ Others argue that oil wealth hinders liberal democracy because it allows oil-rich governments to avoid taxation of domestic residents and the societal bargains that come with such taxation.¹⁷⁰ In both examples, external funding allowed autocrats to avoid liberal democracy.

Similarly, in an anonymous withholding regime, tax collected abroad may be more akin to a source of external funding than to funding provided by citizens in a transparent relationship with their government. When domestic authorities handle tax compliance, governments are under pressure to respond to citizen demands in order to enhance tax compliance and sustain state revenues.¹⁷¹ Cross-border anonymous withholding obviates the need to strengthen governance institutions in order to collect revenue, as it presupposes collection and remittance by a foreign financial institution under the regulatory authority of a foreign sovereign. Furthermore, relying on foreign financial institutions for routine tax collection, rather than on domestic withholding, information reporting, and/or quasi-voluntary self-assessment, may reduce the capacity of compliant and visible taxpayers to bargain for law and representation in exchange for tax revenues.¹⁷² In contrast, automatic information exchange may strengthen domestic governance

169. TILLY, *supra* note 168, at 207–22.

170. See Michael L. Ross, *Does Oil Hinder Democracy?*, 53 WORLD POL. 325 (2001); Hazem Beblawi, *The Rentier State in the Arab World*, in THE ARAB STATE 85–98 (Giacomo Luciani ed., 1990); Giacomo Luciani, *The Oil Rent, the Fiscal Crisis of the State and Democratization*, in DEMOCRACY WITHOUT DEMOCRATS? THE RENEWAL OF POLITICS IN THE MUSLIM WORLD 130–55 (Ghassan Salamé ed., 1994); see also Thomas L. Friedman, Op-Ed., *Drowning Freedom in Oil*, N.Y. TIMES, Aug. 25, 2002, <http://www.nytimes.com/2002/08/25/opinion/drowning-freedom-in-oil.html>.

171. See, e.g., Mick Moore, *How Does Taxation Affect the Quality of Governance?* (Inst. of Dev. Studies Working Paper No. 280, 2007), available at <http://www2.ids.ac.uk/gdr/cfs/pdfs/Wp280.pdf>; LEVI, OF RULE AND REVENUE, *supra* note 168.

172. It is precisely because automatic information exchange will never be perfect that government will tend to heed the concerns of taxpayers and attempt to achieve quasi-voluntary compliance in an information reporting system.

institutions both by improving the capacity of domestic authorities to handle tax compliance and forcing an interaction between government and taxpayers in order for tax to be collected.¹⁷³

A cross-border anonymous withholding system also may undermine the role that taxation of capital income can play in providing a sense of fairness within a liberal democracy. Information reporting provides some assurance to the entire society that tax on capital income is in fact being collected from wealthy taxpayers. A government can, for example, provide reports showing distributional breakdowns of the tax burden. In contrast, cross-border anonymous withholding can undermine the perceived legitimacy of the government by eroding the citizenry's confidence that the government is raising funds in an equitable manner.¹⁷⁴ In this regard, it is important to recognize that the value anonymous withholding purports to uphold, financial privacy vis-à-vis one's own government in matters of taxation, rejects the basic information reporting/information availability model for tax enforcement in almost every major developed economy.¹⁷⁵ Perhaps for these reasons, in discussing cross-border anonymous withholding, Sigmar Gabriel, chairman of Germany's Social Democratic Party, has suggested that the Swiss-German anonymous withholding agreement is "destroying people's sense of justice," and sending a message that

173. Even when tax is enforced domestically via withholding by domestic financial institutions, domestic tax authorities must regulate the process by which withholding is imposed, which forces them to develop the capacity to oversee such withholding.

174. For instance, if anonymous withholding were commonplace it would not be possible to accurately show what part of the income tax was paid by the top 1 percent of income earners. See Margaret Levi & Audrey Sacks, *Achieving Good Government—and, Maybe, Legitimacy* (Dec. 12–15, 2005), available at <http://siteresources.worldbank.org/INTRANETSOCIALDEVELOPMENT/Resources/ACHIEVINGGOODGOVERNMENT.pdf> (arguing that the legitimacy of what we might consider a good government requires a belief by the citizenry that the government is raising funds in an equitable manner in addition to serving the public good).

175. Against this background, concerns regarding the potential for instances of misuse of exchanged information by tax administrators in some countries cannot serve as a justification for favoring anonymous withholding over information reporting for cross-border activities generally. See *supra* note 112. Such concerns do, however, suggest the importance of safeguards to prevent and penalize misuse of taxpayer information. See *infra* notes 223–222.

“whoever is rich can buy themselves free from punishment.”¹⁷⁶ If the transparency of taxation has any role to play in constituting the democratic experience, then moving to an anonymous withholding system to collect those taxes most likely to be associated with privilege undermines that role.

Some scholars suggest that visible, progressive taxation of capital income and closely held business income at the top of the income distribution is a necessary symbol of the commitment to fairness in a liberal democracy.¹⁷⁷ Others suggest that imposing taxes on mobile assets in a transparent manner encourages collective bargaining with the sovereign and thus results in the emergence of more representative and classically liberal government.¹⁷⁸ An automatic

176. Backhaus & Hellemann, *supra* note 165, at pt. 2.

177. See, e.g., Maureen B. Cavanaugh, *Democracy, Equality, and Taxes*, 54 ALA. L. REV. 415 (2003); Bird & Zolt, *supra* note 19, at 1683 (noting that “symbols matter” and that in the developing world “[a] progressive income tax, whatever its defects in practice, may be an important and sometimes critical symbol of concern with the distributive outcomes of the market system”); see also MICHAEL J. GRAETZ, 100 MILLION UNNECESSARY RETURNS: A SIMPLE, FAIR, AND COMPETITIVE TAX PLAN FOR THE UNITED STATES 54 (2008) (noting that even schoolchildren conclude that fairness in a democracy involves some degree of progressive taxation based on ability to pay). Some scholars claim that without visibly progressive taxation, public support for growth-inducing policies like free trade may fray, and economic populism may become a more pronounced feature of government. See, e.g., ROGER C. ALTMAN ET AL., BROOKINGS INST., PATH TO PROSPERITY: AN ECONOMIC STRATEGY TO ACHIEVE MORE BROADLY SHARED GROWTH 7 (2008), available at http://www.brookings.edu/~media/research/files/papers/2008/11/path%20to%20prosperity/11_path_to_prosperity; Kenneth M. Scheve & Matthew J. Slaughter, *A New Deal for Globalization*, 86 FOREIGN AFF., July–Aug. 2007, at 34.

178. See Bates & Lien, *supra* note 168; LEVI, OF RULE AND REVENUE, *supra* note 168. Niall Ferguson suggests that direct taxes on elites are positively associated with the growth of representative institutions. FERGUSON, *supra* note 168, at 81; see also Wilson Prichard, *Taxation and State Building: Towards a Governance Focused Tax Reform Agenda*, 24 (Inst. of Dev. Studies Working Paper No. 341, 2010), available at <http://www2.ids.ac.uk/gdr/cfs/pdfs/Wp341%20web.pdf> (“The greatest challenge in improving enforcement equity, and thus strengthening the basis for collective tax bargaining, lies in

information reporting system that identifies prosperous individual taxpayers and requires them to participate in the act of paying taxes (and perhaps encourages them to lobby to reduce those taxes) achieves both of these ends. In contrast, anonymous cross-border withholding of income tax on capital income may change the taxing relationship between the citizen and the state. At minimum it reduces the taxpayer's awareness of a domestic fiscal process and any consequent likelihood to engage the polity to demand accountability. Beyond that, cross-border anonymous withholding may shake all citizens' confidence that the government is raising funds equitably.¹⁷⁹ In the context of major developed economies, the pressures on liberal democracy from anonymous withholding may be significantly less relevant. But in the context of emerging and developing economies still working to achieve robust democratic governance, these same pressures should not be underestimated.¹⁸⁰

3. Maintaining Policy Flexibility

In contrast to automatic information reporting, anonymous withholding substantially reduces sovereign authority and policy flexibility, especially for less powerful states, by permanently outsourcing tax collection on capital income to foreign sovereigns and removing unilateral control over tax policy instruments. Anonymous withholding thus threatens the organization and effectiveness of domestic administrative and political authority, as well as sovereign autonomy, understood as the capacity to exclude external actors from domestic policy decisions.

The Swiss agreements show hints of each of these problems. Under the terms of those agreements, if a Partner Country adjusts its tax rates on income or gains after the agreements are signed, withholding tax imposed by Switzerland is amended by the same number of percentage points that the statutory rates are amended, unless the competent authority of Switzerland decides

improving taxation of elites. The poor enforcement of personal income taxes is in some respects the defining feature of developing country tax systems, with implications for revenue and legitimacy.”).

179. See generally Levi & Sacks, *supra* note 174. In contrast, cross-border information reporting can provide a tool to preserve the role of the state as the ultimate enforcer of tax assessments.

180. See generally Bird, Martinez-Vazquez & Torgler, *supra* note 161.

that it will not adjust the applicable tax rates.¹⁸¹ Furthermore, the treaties lock in a particular definition of income, dividends, other income, and capital gain that cannot be changed without bilateral agreement.¹⁸² The agreements thus cede to Switzerland a measure of final authority over whether the income and gains of the Partner Country Residents will be taxed according to law of the Partner Country. From a practical standpoint, it is difficult to imagine Switzerland refusing to adjust withholding rates consistent with German or British policy decisions in the medium term; Switzerland would likely refrain from such action out of fear of retaliation and a desire to see the Swiss approach accepted internationally. But when generalized to other countries, the fact that the Swiss retain even a nominal right to overrule Partner Country tax

181. U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 20(2); Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 19(2); Austria-Switz. Cooperation Agreement, *supra* note 4, art. 18(2). The United Kingdom, Germany, and Austria may change their tax rates applicable to income and gain, and in such instances they must inform Switzerland without delay. At that point, Switzerland has thirty days to inform the countries as to whether it refuses to adjust the rates at which it withholds anonymously by the same percentage as the rates have changed under Austrian, U.K., or German law. U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 20(2); Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 19(2); Austria-Switz. Cooperation Agreement, *supra* note 4, art. 18(2). Under the agreements, Austria, the United Kingdom, and Germany are allowed to terminate the agreement with six months' notice if Switzerland does not adjust its withholding rate to correspond with a domestic U.K. rate change. U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 44(3)-(4); Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 43(3)-(4); Austria-Switz. Cooperation Agreement, *supra* note 4, art. 40(3)-(4). This is more flexible than the general termination rules under the agreement, which are intended to lock both jurisdictions into the agreement by requiring at least two years' notice to terminate. U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 44(2); Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 43(2); Austria-Switz. Cooperation Agreement, *supra* note 4, art. 40(2).

182. U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 25-28; Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 24-27; Austria-Switz. Cooperation Agreement, *supra* note 4, art. 23-26. Note that the general two-year termination period would apply if a government chose to abandon the agreement out of concern regarding the definition of a category of income.

policy decisions with respect to Partner Country nationals has remarkable implications for tax sovereignty. It highlights the Swiss view that the Partner Country's receipt of income from their nationals investing through Switzerland is a discretionary Swiss policy decision rather than any matter of right. In principle the Swiss agreements require jurisdictions to (1) cede a measure of their ability to assert their taxing authority domestically over their residents, (2) consider Swiss reactions in the course of making domestic taxing decisions, and (3) forego the option of seeking additional information from their residents.

These problems crystallize when one imagines anonymous withholding along the lines of the Swiss-U.K./German agreements in the context of an agreement between an asset management jurisdiction and a less powerful middle-income economy. A country without significant market leverage over Switzerland or other offshore asset management jurisdictions would, by entering into anonymous withholding agreements, significantly compromise its unilateral control over the appropriately domestic decisions about tax rates on capital income of domestic residents. Policymakers in such a jurisdiction would need to ask whether, if they altered their domestic taxing regime, Switzerland and every other jurisdiction providing them with anonymous withholding services would agree to go along. If such a jurisdiction were to rely on anonymous withholding, some of the resources that sustain the state would be in another sovereign's hands. Sovereign autonomy could be compromised for most countries, and over time, large asset management jurisdictions could gain significant power over many countries' tax policy choices, and perhaps influence over other foreign policy choices as well.

More generally, an anonymous withholding regime is not compatible with a progressive income tax and benefits system. Anonymous withholding undermines the enforceability of a tax or benefits system that provides assistance (such as an earned income tax credit or unemployment support) that phases out with income or savings.¹⁸³ Further, permitting anonymous withholding is incompatible with maintaining a fully functional comprehensive

183. It would not be possible to effectively administer an earned income tax credit that is not available to those with substantial amounts of capital income in a system that permits taxpayers to avoid reporting capital income by earning it through offshore accounts. Similarly, enforcing unemployment support programs along the lines of Germany's *Arbeitslosengeld II* program requires the government to be able to determine the amount of savings held by potential claimants.

income tax with graduated rates.¹⁸⁴ The Swiss agreements assume a jurisdiction has chosen a schedular income tax system (taxing different categories of income at fixed, flat rates) rather than a comprehensive income tax that applies a graduated rate schedule to all income or defined categories of income. In this way, anonymous withholding agreements compromise any state's authority over the domestic tax regime.

A critic might acknowledge the above concerns regarding domestic policy flexibility and sovereign autonomy, but dismiss them as alarmist, since there is heavy bias for home-country asset management. However, as described in Part I, the fact that today only 6.5 percent of global wealth is managed offshore masks the reality that in some regions outside the most-developed economies, offshore asset management is effectively the norm. For example, in Argentina, at least 47 percent of national wealth (and 74 percent of the wealth controlled by households with greater than \$100,000 in managed assets) is managed offshore.¹⁸⁵ Further, the offshore asset management industry continues to grow. The potential for expanded growth in the context of anonymous withholding is highlighted by the fact that the Swiss-German anonymous withholding agreement was explicitly conditioned on German concessions to facilitate Swiss financial institutions' access to German customers.¹⁸⁶ The concessions Switzerland extracted from Germany make it easier for wealthy Germans to bank exclusively through Swiss

184. If a country abandons tax or other social benefits intended to be limited to residents with low levels of taxable income, then anonymous withholding systems may be imperfectly reconciled with a comprehensive income tax system that accepts over-taxation by imposing the highest marginal tax rate for any given category of income on all income in that category of income on which anonymous withholding is imposed.

185. BCG, GLOBAL WEALTH, *supra* note 1, at 12. Nor is Argentina unique. For instance, in Mexico from 2005 to 2010, 75 percent of the 47 percent of national wealth held by millionaire households was managed offshore. *Id.*

186. The Swiss negotiated for simplified exemptions from regulation under the German Banking Act for Swiss financial institutions that want to supply banking and financial products in Germany, and were able to eliminate the requirement to either create a subsidiary or branch in Germany or operate in partnership with an existing German financial institution, in order to legally serve German clients. *See* Press Release, Swiss Fed. Dep't of Fin., Switzerland and Germany Initial Tax Agreement, *supra* note 118.

institutions without the Swiss institution maintaining any German footprint.¹⁸⁷ Similar provisions are incorporated in the Swiss-Austrian agreement.¹⁸⁸ If, in exchange for anonymous withholding, offshore asset management jurisdictions were able to consistently extract concessions allowing them to legally compete with domestic financial institutions without having local footprints or being subject to local regulation, a further shift toward offshore asset management among wealthy individuals could easily occur.

In contrast to anonymous withholding, an automatic information exchange regime would strengthen sovereign authority and thereby improve policy flexibility and governance capacity, particularly for less powerful sovereigns. Rather than constraining the set of tax policy choices a government may make, as anonymous withholding would, automatic information exchange broadens the potential for tax policies that can be consistently enforced among all residents. It allows for a more legitimate domestic political authority while reclaiming for the state authority over one important consequence of financial globalization.

C. Political Dynamics

Practically speaking, most nation-states are unlikely to provide anonymous withholding, and those that do are unlikely to provide anonymous withholding to a wide range of other nation-

187. The German Banking Act generally provides that financial service providers from non-European Economic Area (EEA) countries (Switzerland is not in the EEA) that want to supply banking and financial products in Germany must obtain a permit to create a subsidiary or branch in Germany. KREDITWESENGESETZ [KWG] [GERMAN BANKING ACT], Sept. 9, 1998, BUNDESGESETZBLATT [BGBl.] 1522, as amended, §§ 32(1), 33(1), 53(1) (Ger.). Such financial institutions are subject to the German banking rules regardless of whether they are established or resident in Germany, or are located or resident abroad but have focused on the German market to carry out business with persons who are resident or ordinarily resident in Germany. *Id.* § 32. Furthermore, client relationships with German residents must be established through a domestic financial institution. Under the agreement reached between Switzerland and Germany, the permit exemption procedure that was technically available to Swiss institutions will be simplified, and the obligation for Swiss institutions to initiate legal client relationships via a local German financial institution will be eliminated.

188. Austria-Switz. Cooperation Agreement, *supra* note 4, Memorandum on Procedural Aspects of Cross-Border Activities in the Financial Sector.

states. Furthermore, the proponents of an anonymous withholding system have no interest in its globalization. Most policymakers internationally should prefer automatic information reporting to anonymous withholding because the latter cannot be globalized. Further, there will come a point when bilateral anonymous withholding arrangements will impede progress toward information reporting arrangements for all but the most economically powerful countries. In contrast, automatic information exchange solutions that initially meet the demands of developed economies can be globalized over time to also provide benefits to other tax administrations.

The likely equilibrium for the anonymous withholding regime put forth by Switzerland would be for Switzerland to reach agreements with the large developed economies that can exert pressure for cross-border tax administrative support, neutralize the United States by moving forward with the Joint Statement II framework, and then cease to negotiate further anonymous withholding agreements with other governments. In time, pressure from the major developed economies besides the United States would likely lead other large offshore asset-management jurisdictions to follow Switzerland's lead and reach anonymous withholding agreements with these states as the price of resolving conflicts with the major developed economies. By the same token, a reciprocal broadly multilateral anonymous withholding regime in which most jurisdictions around the world agree to withhold anonymously for most other jurisdictions is highly implausible. Among other reasons, large developed economies are unlikely to agree to automatically collect tax for other, less powerful sovereigns.

1. Limited One-Way Anonymous Withholding Agreements

Switzerland's leadership recognizes that anonymous withholding in a small number of targeted agreements can diffuse pressure for Swiss information reporting to a broader group of countries.¹⁸⁹ Thus, in their agreements with Austria, the United Kingdom, and Germany, the Swiss insisted that those countries each commit to uphold the anonymous withholding model and not to work against it in dealings with third parties.¹⁹⁰ If anonymous withholding agreements are

189. See Leo Müller & Erik Nolmans, *Steuerabkommen: Daumen Drücken*, BILANZ (Dec. 10, 2011), <http://www.bilanz.ch/unternehmen/steuerabkommen-daumen-druecken>.

190. Both agreements provide that the parties will "neither violate the provisions [of the agreement] through an unilateral act nor work against the agreed provisions in their dealings with third parties." U.K.-Switz. Cooperation Agreement, *supra* note 13, Joint Declaration Concerning the Equivalence of this Agreement; Ger.-Switz. Cooperation Agreement, *supra* note 13,

reached with each of the large financial centers, other than the United States with which the Swiss financial industry does business (and in which Swiss banks have substantial business operations), the remainder of the world's jurisdictions would be relatively powerless to put pressure on Switzerland or its banks to further erode bank secrecy, or even to make anonymous withholding more widely available to other jurisdictions. Managing assets for nonresidents from most of the world would likely continue on a tax-shielded basis.

Eventually the large financial centers may be able to pressure other offshore asset management centers into anonymous withholding agreements if they so choose. The Swiss agreements appear structured to produce precisely such negotiations.¹⁹¹ Each agreement includes provisions that both allow Partner Country taxpayers to evade the force of the agreement by moving their assets before the effective date, and also give the Partner Country information on the jurisdictions to which those taxpayers most commonly choose to move those untaxed assets.¹⁹² It is important to recognize that for any large developed economy, anonymous withholding by Switzerland alone is unlikely to substantially deter tax evasion. High-quality wealth-management services are available in many jurisdictions. Arrangements based on the Swiss model only ensure that dedicated tax evaders from countries with such agreements do not keep Swiss bank accounts if they wish to avoid taxation. Evaders can easily close Swiss accounts and open accounts in other jurisdictions (such as Singapore), including non-Swiss branches of a Swiss bank. The Swiss agreements state that Swiss banks will not “actively encourage” their current clients to use this strategy—a provision of questionable enforceability and relevance, given that the agreements both permit and anticipate the transfers. Swiss banks are allowed to facilitate these asset transfers on request from current customers, and to promote

Gemeinsame Erklärung der Vertragstaaten zur Gleichgewichtigkeit des Abkommens (Joint Declaration Concerning the Equivalence of this Agreement); Austria-Switz. Cooperation Agreement, *supra* note 4, Gemeinsame Erklärung der Vertragstaaten zur Gleichgewichtigkeit des Abkommens (Joint Declaration Concerning the Equivalence of this Agreement).

191. .

192. British and German residents who transfer their assets before the last day of the fifth month following the effective date of the agreement can avoid the withholding tax imposed as the default compliance provision under the treaties. *See* Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 16; U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 18; Austria-Switz. Cooperation Agreement, *supra* note 4, art. 15.

evasion through non-Swiss branches of Swiss banks going forward. Thus, the statistical disclosure in the Swiss agreements enables Switzerland to enlist Germany, the United Kingdom, and other governments with which it enters agreements to level the playing field for Switzerland, relative to other offshore asset management jurisdictions.¹⁹³

If Germany and the United Kingdom ratify their agreements with Switzerland, they would likely be motivated to pursue further bilateral anonymous withholding agreements. After ratifying their agreements with Switzerland, they (or any other developed economies that accept the Swiss model) may find it difficult to promote or negotiate for automatic information exchange. Having accepted the premise, with Switzerland, that anonymous withholding is an acceptable substitute for automatic information reporting, and having agreed not to work against the anonymous withholding model, the current German and U.K. governments may find it difficult to refuse to accept anonymous withholding from other offshore asset management jurisdictions as a substitute for automatic information exchange. Indeed, but for the political pressure currently being exerted against ratification of the Swiss agreements, the current German and U.K. governments would seem poised to affirmatively pursue anonymous arrangements with other offshore asset management jurisdictions. This would include any negotiations with jurisdictions that Swiss data suggest are the major destinations for German and U.K. evader funds.¹⁹⁴ Anonymous withholding agreements between those jurisdictions and Germany and the United Kingdom would make it easier for all asset management jurisdictions to agree to anonymous withholding for a limited set of powerful states, and to reject broadly multilateral automatic information exchange. To effectively support the development of a broadly multilateral automatic information exchange system, Germany and the United Kingdom probably need to affirmatively decide not to ratify (or terminate) their agreements with Switzerland.

193. Meanwhile Joint Statement II and FATCA withholding ensure a better-than-level playing field for Swiss financial institutions vis-à-vis investments in the United States, relative to countries that have not entered into a framework for cooperation with the United States to facilitate implementation of FATCA. *See* Joint Statement II, *supra* note 5.

194. The Labor party in the United Kingdom and the Social Democratic Party in Germany both oppose the Swiss agreements, such that those agreements may not be ratified or, if ratified, might be terminated by a subsequent German or U.K. government.

2. Broadly Multilateral Reciprocal Anonymous Withholding

The second conceivable steady-state solution arising from the Swiss approach is a broadly multilateral anonymous withholding regime in which jurisdictions around the world agree to withhold anonymously for one another. Such a solution is highly implausible. Offshore asset-management jurisdictions have no interest in a global reciprocal anonymous withholding system. More importantly, the large developed economies would not contemplate such a system. The revenue Germany and the United Kingdom would receive through anonymous withholding from Switzerland greatly exceeds the amounts they would need to transfer to Switzerland if they were withholding on its behalf. Nevertheless, in the Swiss agreements, the Partner Countries agree only that Switzerland may request that measures be introduced by the Partner Countries that provide exchange of information from them to Switzerland, and only to the extent similar approaches are adopted by the Partner Country in relation to other states.¹⁹⁵ Switzerland represents an unusual case in which the revenue flow would be overwhelmingly in the Partner Country's favor. It is hard to imagine that these jurisdictions would be prepared or willing to provide anonymous withholding in the vast majority of cases, where the outflows from the Partner Country fisc could vastly exceed the inflows.

British and German behavior in this regard is both predictable and consistent with widely prevailing concepts of sovereignty in the tax context. In contrast to information reporting, anonymous withholding implies more than mere cooperation among governments. Rather, it requires governments to collect tax for one another. Cross-border anonymous withholding is a form of automatic collection assistance provided to other sovereigns. In the common law countries (which represent approximately half of the world's GDP),¹⁹⁶ the presumption against collecting revenue for other governments runs deep, both as a policy matter and as a legal matter.

Policymakers commonly understand limitations on the extent to which a nation will provide collection assistance to another nation as a straightforward application of the principle of

195. See U.K.-Switz. Cooperation Agreement, *supra* note 13, art. 36; Ger.-Switz. Cooperation Agreement, *supra* note 13, art. 34; Austria-Switz. Cooperation Agreement, *supra* note 4, art. 31.

196. M. Marshall, *World Economy Hinges on China's Bankruptcy Law, Wood Says*, Report in *News & Events*, VA. LAW (Mar. 16, 2005), http://www.law.virginia.edu/html/news/2005_spr/china_wood.htm.

territorially limited state sovereignty.¹⁹⁷ A key component of exclusive territorial authority is the unique right to impose tax on that territory. As a first-order matter, maintaining sovereignty requires the sovereign authority within a state to exclude another state from pursuing its tax claims in the territory of the home state.¹⁹⁸ The default assumptions that stipulate appropriate behavior by a political entity in a given situation create a substantial presumption against collection assistance.¹⁹⁹ States may agree to provide a taxing benefit on their territory to other states, but they must be provided significant incentives to do so.

Without strong contrary incentives, powerful states are highly unlikely to allow the erosion of their sovereign authority through facilitation of extraterritorial exercise of taxing power within their territory. This fact explains why, although the OECD Model Tax Convention has included a model provision for assistance in collection in specific cases (assuming all necessary information can be provided by the residence country) since 2003, the official commentary describes the provision in realist terms.²⁰⁰ The agreed commentary observes that during

197. Cf. *Pasquantino v. United States*, 544 U.S. 349, 379–80 (2005) (Ginsburg, J., dissenting) (“[A]s to foreign customs and tax laws, there is scant room for doubt about Congress’ general perspective: Congress has actively indicated, through both domestic legislation and treaties, that it intends ‘strictly [to] limit the parameters of any assistance given’ to foreign nations.”) (quoting *Att’y Gen. of Canada v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 119 (2d Cir. 2001)).

198. See, e.g., U.N. Secretariat, *Mutual Assistance in Collection of Tax Debts*, Report of the 10th Meeting of the United Nations Ad Hoc Group of Experts on International Cooperation in Tax Matters, U.N. Doc. ST/SG/AC.8/2001/L.2 (Aug. 30, 2001); ASIF H. QURESHI, *THE PUBLIC INTERNATIONAL LAW OF TAXATION: TEXT, CASES AND MATERIALS* (1994); Alan R. Johnson et al., *Reciprocal Enforcement of Tax Claims Through Tax Treaties*, 33 TAX LAW. 469, 469–70 (1980).

199. [REDACTED].

200. The United Nations Model Double Taxation Convention between Developed and Developing Countries has no collection assistance provision, although the UN Tax Committee is reported to have agreed to include an assistance collection provision in the next version of the U.N. Model Convention. Michael Lennard, Chief of the Int’l Tax Cooperation & Trade Section at the U.N. Fin. for Dev. Office, *The UN Model Tax Convention as Compared With the OECD*

negotiations each contracting state will need to decide whether collection assistance upon request (that is, limited to specific cases) should be included in a treaty with another state based on its own instrumental motives and legal traditions.²⁰¹ The OECD Model Commentary acknowledges that even when tax debts are fully determined by the residence state, and even in the limited context of case-specific assistance, collection assistance will only be provided between sovereigns where there is an alignment of interests and a shared judgment as to mutual economic benefit.²⁰²

As a judicial matter, the presumption against collecting revenues for other governments even in specific cases is enshrined in what is known as the revenue rule. The revenue rule overrides what are otherwise commonly applicable norms of cross-border judicial comity, and holds that a court will not give domestic effect to the taxes, fines, or penalties imposed by a foreign sovereign.²⁰³ Although it began as a common law doctrine,²⁰⁴ the revenue rule is

Model Tax Convention—Current Points of Difference and Recent Developments, 15 ASIA-PAC. TAX BULL. 4, 10 (2009).

201. *Id.*

202. The idea of cross-border collection assistance in some form has a longstanding place in international tax dialogue, but has never made much headway. The first proposal for cross-border assistance in recovering tax claims in specific cases arose in the League of Nations. FISCAL COMM., LEAGUE OF NATIONS, LONDON AND MEXICO MODEL TAX CONVENTIONS: COMMENTARY AND TEXT 100–01 (1946) (Model Bilateral Convention for the Establishment of Reciprocal Administrative Assistance for the Assessment and Collection of Direct Taxes: Mexico Draft; Model Bilateral Convention for the Establishment of Reciprocal Administrative Assistance for the Assessment and Collection of Taxes on Income, Property, Estates and Successions: London Draft). Subsequently the OECD developed the Model Convention for Mutual Administrative Assistance in the Recovery of Tax Claims in 1981. OECD, MODEL CONVENTION FOR MUTUAL ADMINISTRATIVE ASSISTANCE IN THE RECOVERY OF TAX CLAIMS: REPORT OF THE OECD COMMITTEE ON FISCAL AFFAIRS (1981). In both cases, collection assistance was limited to specific cases rather than any form of automatic withholding arrangement, let alone anonymous withholding. Neither convention ever came into force.

203. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 483 & reporter's note 1 (1987) (citing *Holman v. Johnson*, (1775) 98 Eng. Rep. 1120 (K.B.)) (“Courts in the United States are not required to recognize or to enforce judgments for the collection of taxes, fines, or penalties

sufficiently deeply entrenched as a default in both common law²⁰⁵ and civil law jurisdictions that it is sometimes described as “the first and most fundamental rule of international tax law.”²⁰⁶

rendered by the courts of other states.”). The sovereignty concerns underlying the revenue rule also explain why tax debts and claims are generally excluded from conventions and instruments regulating international cooperation in recognizing and enforcing legal judgments that are of general (rather than tax-specific) application. *See, e.g.*, Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, art. 1, Sept. 27, 1968, 1998 O.J. (C 27) 4; Council Regulation 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, 2001 O.J. (L 12) 2 (EC) (excluding revenue, customs, and administrative matters from its scope of application via article 1.1 of that regulation). *But see* European Convention on Mutual Assistance in Criminal Matters art. 1, Apr. 20, 1959, 472 U.N.T.S. 185 (allowing assistance in processing fiscal offences).

204. The rule as known at common law dates at least to *Attorney General v. Lutwydye*, a 1729 English court case that held that the court could not enforce a bond executed in Scotland to enforce Scottish import duties on tobacco because the obligation was a foreign tax obligation. *Att’y Gen. v. Lutwydye*, (1729) 145 Eng. Rep. 674 (Ex. Div.); *see, e.g.*, *Ludlow v. Van Rensselaer*, 1 Johns. 94 (N.Y. 1806) (defendant could not avoid enforcement of promissory note on the basis that plaintiff had violated a French revenue provision requiring French stamp tax first be paid); *see also* Brenda Mallinak, *The Revenue Rule: A Common Law Doctrine for the Twenty-First Century*, 16 DUKE J. COMP. & INT’L L. 79, 79–83 (2006).

205. *See, e.g.*, *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 413–14, 448, 450 n.11 (1964); *United States v. Harden*, [1963] S.C.R. 366, (Can.). *See also* *Gov’t of India v. Taylor*, [1955] A.C. 491 (H.L.) 508 (appeal taken from Eng.); *Williams & Humbert Ltd. v. W & H Trade Marks (Jersey) Ltd.*, [1958] A.C. 368 (H.L.) (appeal taken from Eng.); *Peter Buchanan Ltd. v. McVey*, [1955] A.C. 516 (surveying application of the revenue rule by U.K. courts), *aff’d*, [1955] A.C. 530 (Ir. S.C. 1951); William S. Dodge, *Antitrust and the Draft Hague Judgments Convention*, 32 LAW & POL’Y INT’L BUS. 363, 373 n.43 (2001) (treating the application of the revenue rule in both common law and civil law countries as a subcategory of a disinclination to enforce foreign public law).

206. Vitaly S. Timokhov, *Enforcing Tax Judgments Across Borders: How Collection Assistance Can Overcome Limitations of the “Revenue Rule” (Part I)*, 14 J. INT’L TAX’N 34, 37 (June 2003); Vitaly S. Timokhov, *Enforcing Tax Judgments Across Borders: How Collection*

While some argue that there have been incursions on the judicial doctrine, the basic judicial presumption reflects the policymaking default against collecting tax for foreign sovereigns.²⁰⁷

3. Multilateral Automatic Information Exchange

Unlike cross-border collection assistance, the idea of cross-border tax information exchange has global acceptance, at least upon request. Since 2009, every financial center of any significance, including all of the more than one hundred member countries of the Global Forum on Transparency and Exchange of Information, has endorsed the international standards calling for tax information exchange. Those standards are also endorsed by the G8, the G20, the United Nations, and the OECD. They call for exchange of information on request where it is “foreseeably relevant” to the administration and enforcement of the domestic laws of the treaty partner, provided that the exchanged information is only used for legitimate tax administration purposes. There are no restrictions on exchange permitted on the basis of bank secrecy or domestic tax interest requirements.²⁰⁸ A “high-level working panel” convened by the United

Assistance Can Overcome Limitations of the “Revenue Rule” (Part 2), 14 J. INT’L TAX’N 20 (Sept. 2003).

207. See, e.g., *Pasquantino v. United States*, 544 U.S. 349, 350, 369–70 (2005) (providing that “at its core, [the revenue rule] prohibited the collection of tax obligations of foreign nations,” and that “[c]ourts customarily refuse to enforce the revenue and penal laws of a foreign state, since no country has an obligation to further the governmental interests of a foreign sovereign”) (quoting *Banco Nacional de Cuba*, 376 U.S. at 448 (White, J., dissenting)).

208. See, e.g., JEFFREY OWENS & PASCAL SAINT-AMANS, OECD, PROMOTING TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES: A BACKGROUND INFORMATION BRIEF 2 (2010); *Work on Exchange of Information and Conclusion*, U.N. E.S.C.O.R. Comm. of Experts on Int’l Cooperation in Tax Matters, 2d Sess., Oct. 30–Nov. 3, 2006, U.N. Doc. E/c.18/2006/6/Add.1 (2006); G8 Agreement From the Gleneagles Communiqué Africa 14(i), 2005, *available at* http://www.unglobalcompact.org/docs/about_the_gc/government_support/PostG8_Gleneagles_Communique.pdf; G20 Communiqué: Meeting of Finance Ministers and Central Bank Governors ¶ 2, Oct. 15–16, 2005, *available at* http://www.mof.go.jp/english/international_policy/convention/g20/g20_051016.pdf; G7, *Economic Communiqué: Making a Success of Globalization for the Benefit of All* ¶ 16 (June 28,

Nations has previously proposed an International Tax Organization to provide a mechanism for multilateral tax information sharing to curb the scope of tax evasion on investment income earned abroad.²⁰⁹

The globally agreed standards are formally cabined to information exchange upon request. Thus, the breach of bank secrecy that these standards require technically only applies where there is a request for foreseeably relevant information about a specific individual. However, there is nothing in the standards that is conceptually limited to exchange upon request, and there is no normative reason for exchange to be limited to information about one individual at a time. Indeed, a newcomer with fresh eyes looking at these internationally agreed standards would have a difficult time understanding why they did not mandate that all ascribing jurisdictions routinely provide information exchange in those cases where the information is foreseeably relevant (for example in the case of capital income accruing to a known resident of another state with an income tax).

The recently revised Multilateral Convention provides a multilateral framework under which automatic cross-border tax information exchange could be established among a broad range of sovereign participants.²¹⁰ The 2010 protocol made changes that (when integrated with the preexisting convention) make the Multilateral Convention a landmark agreement. The

1996), *available at* <http://www.g7.utoronto.ca/summit/1995halifax/financial/index.html>; OECD, THE GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES 2 (2011), *available at* <http://www.oecd.org/tax/transparency/48981620.pdf>. *See also, e.g.,* ORG. FOR ECON. COOPERATION & DEV., OVERVIEW OF THE OECD'S WORK ON COUNTERING INTERNATIONAL TAX EVASION, *supra* note 23; OECD, TAX CO-OPERATION 2010: TOWARDS A LEVEL PLAYING FIELD—ASSESSMENT BY THE GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES 9, 15 (2010). A “domestic tax interest requirement” is a domestic law rule that tax information can only be exchanged with another government if it is also relevant to the tax burden imposed on the taxpayer by the jurisdiction providing the information. *See also* OECD, *supra* note [redacted] and accompanying text.

209. High-Level Int'l Intergovernmental Consideration of Fin. for Dev., Rep., transmitted by letter dated June 25, 2001 from the Secretary-General to the President of the General Assembly, U.N. GAOR, 55th Sess., Agenda Item 101, U.N. Doc. A/55/1000 (June 26, 2001), *available at* <http://www.un.org/esa/ffd/a55-1000.pdf>.

210. *See supra* notes 88–89 and accompanying text.

protocol incorporates the internationally accepted standards for the exchange of foreseeably relevant information regardless of bank secrecy, and moves in the direction of multilateral routine information exchange by requiring signatories to accept requests from all other signatories with respect to “ascertainable groups or classes of persons.” This aspect of the protocol indicates a shift in international norms toward multilateral automatic information exchange.²¹¹ The Multilateral Convention opens the door to multilateral automatic information exchange through provisions intended to facilitate such exchange, although it requires competent authorities to reach further agreements to bring automatic information exchange into force.²¹²

The amended Multilateral Convention can function as a full-fledged vehicle for automatic information exchange among signatories, while requiring countries to protect taxpayer information from misuse and respect taxpayer rights. On June 1, 2011, the convention was opened to signature by any country in the world. As of May 2012, thirty-five countries had signed the Protocol to the Multilateral Convention, and every G20 member had endorsed it.²¹³

211. The protocol amends the convention so as to clarify that a request can be made without the name and address of a specific taxpayer. OECD, THE MULTILATERAL CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS: AMENDED BY THE 2010 PROTOCOL, (article III of the 2010 Protocol amends Article 18 of the Multilateral Convention). The Explanatory Report to the Convention goes on to explicitly bless requests made with respect to ascertainable groups or classes of persons. See OECD, REVISED EXPLANATORY REPORT TO THE CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS²² (2010), *available at* <http://www.oecd.org/ctp/exchangeofinformation/48091084.pdf>. See also OECD, Update to Article 26 of the OECD Model Tax Convention and its Commentary, *supra* note 24. The changes to the Commentary to Article 26 of the OECD Model Convention agreed after the initial online release of this article move the Commentary to Article 26 in the direction of the Multilateral Convention’s stance with respect to ascertainable group requests.

212. See OECD, *supra* note , art. 6.

213. Argentina, Australia, Azerbaijan, Belgium, Brazil, Canada, Costa Rica, Denmark, Finland, France, Georgia, Germany, Greece, Iceland, India, Indonesia, Ireland, Italy, Japan, Korea, Mexico, Moldova, Netherlands, Norway, Poland, Portugal, Russia, Slovenia, South Africa, Spain, Sweden, Turkey, Ukraine, the United Kingdom, and the United States. See Council of Europe, *Status of the Convention on Mutual Administrative Assistance in Tax Matters and Amending Protocol*, COUNCIL OF EUR. (May 15, 2012),

The trend in universally accepted standards for information exchange, the development of a series of emerging automatic information exchange approaches, and the progress made by the Multilateral Convention suggest that acceptance of a widely utilized system that requires financial institutions to function as cross-border tax intermediaries through automatic information reporting may be within reach.

IV. THE PATH TOWARD A MULTILATERAL AUTOMATIC INFORMATION REPORTING SYSTEM

Any new regime for routine cross-border administrative assistance is likely to become an institutionally embedded structure that is susceptible to long periods of stasis. The risk of stasis following the present evolutionary moment in cross-border tax administrative assistance raises the stakes in the present contest between anonymous withholding and automatic information reporting. Since a partial anonymous withholding system can emerge via contracting, while automatic information exchange on offshore accounts by asset management jurisdictions likely requires coercion, partial anonymous withholding is the easier and more likely default. To avoid partial anonymous withholding and establish the superior automatic information reporting system, governments will have to make steady progress toward a relatively uniform multilateral approach to information exchange, and impose coercive incentives for participation.

As suggested in Part II, the starting point for a multilateral system likely involves reconciling the current OECD, EU, and U.S. approaches. Building such a system requires substantial agreement among participating countries about certain design features. The key dimensions of the OECD, EU, and U.S. systems that would need to be reconciled are routing,

<http://conventions.coe.int/Treaty/Commun/ChercheSig.asp?NT=127&CM=1&DF=&CL=ENG> (last visited June 19, 2012). The members of the G20 are Argentina, Australia, Brazil, Canada, China, the European Union, France, Germany, India, Indonesia, Italy, Japan, Mexico, the Republic of Korea, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, and the United States. *Members*, G20, <http://www.g20.org/index.php/en/members> (last visited July 30, 2012). At the November 2011 G20 Summit, all G20 countries also noted that, “we will consider exchanging information automatically on a voluntary basis as appropriate and as provided for in the convention.” G20, *Cannes Summit Final Declaration—“Building Our Common Future: Renewed Collective Action for the Benefit of All”*, G20, at ¶ 35 (Nov. 4, 2011), <http://www.g20-g8.com/g8-g20/g20/english/for-the-press/news-releases/cannes-summit-final-declaration.1557.html> (last visited June 19, 2012).

identification, reporting, scope, verification, and incentives. A comprehensive blueprint for reconciling the emerging approaches to automatic information reporting along each of these dimensions is beyond the scope of this Article.²¹⁴ However, Joint Statement I implies the need for such reconciliation, and the purpose here is to offer some observations as to what could be done to reconcile the emerging approaches and promote a multilateral system. I also suggest some safeguards to ensure that an emerging multilateral automatic information exchange system protects against the misuse of exchanged information.

First, the rules for establishing a multilateral automatic information reporting regime should be bifurcated. Cooperating jurisdictions should impose one set of obligations on financial institutions located in other cooperating jurisdictions, and a different, more stringent set of obligations on financial institutions located outside cooperating jurisdictions. Not only are different design decisions appropriate for these two fact patterns, but also, as the discussion below illustrates, creating two separate regimes would likely spur financial institutions to pressure governments to participate, since participation could reduce the burden for domestic financial institutions. While bifurcated rules are necessary, alone they are not sufficient to encourage the creation of a multilateral automatic information exchange system. Governments also must agree on a set of coercive incentives that push noncooperating jurisdictions to join the system and financial institutions to comply even before their governments do. The following discussion provides some preliminary views on how to apply these two principles in building a multilateral automatic information exchange system by considering certain design questions associated with routing, identification, reporting, verification, and incentives in a multilateral system.

214. One obvious point is that reciprocal identification and reporting obligations would need to be imposed on financial institutions in all cooperating jurisdictions. This would mean that, for example, U.S. financial institutions would need to exercise the same due diligence to identify accounts of non-U.S. persons and collect precisely the same information on accounts of non-U.S. persons that the United States wishes to receive with respect to U.S. persons with offshore accounts. Although it has finalized the bank deposit interest regulations, Treas. Reg. § 1.6049-1 et seq., 77 Fed. Reg. 23391 (2012), the U.S. Treasury has not yet provided regulatory guidance to this effect as a companion to its efforts under FATCA.

A. Routing

Routing issues are important because they represent the most basic structural inconsistency between today's emerging automatic information exchange approaches. Routing also deserves attention because routing raises questions about sovereign access to and authority over information. Under the OECD's TRACE approach, financial institutions report information regarding specific items of income received by a taxpayer to the government of the country of the source of the income received by the taxpayer. That government may then decide to exchange the information with the taxpayer's country of residence if it so desires and if appropriate information exchange arrangements are in place. Under the EU approach, in contrast, financial institutions report on specific items of income received by an EU resident to the government where the financial institution managing the assets resides. Information related to each other's resident taxpayers is then exchanged between EU governments through arrangements of reciprocity. Finally, under FATCA as legislated, foreign financial institutions report comprehensively on assets and certain measures of income of U.S. persons held and/or earned through accounts at those institutions.²¹⁵ They report directly to the government of the jurisdiction where the taxpayer resides (the United States).

The EUSD's routing system is superior for jurisdictions that are cooperating with one another. It ensures that financial institutions in cooperative jurisdictions need only send information to one government, under whose law they already operate, thereby avoiding the specter of thousands of financial institutions attempting to comply with different reporting obligations to dozens of governments. Reporting by financial institutions to the government of the jurisdiction in which they reside, followed by government-to-government exchange, also conforms most closely to current global understandings regarding first-instance sovereign access to banking information. The government of the asset management country presumptively can already access the relevant information today.²¹⁶ The EUSD system thus avoids the conflict-of-

215. See I.R.S. Notice 2011-34, *available at* <http://www.irs.gov/pub/irs-drop/n-11-34.pdf>.

216. Indeed, it is required to have access to such information for tax information exchange purposes pursuant to the internationally agreed standards for tax information exchange upon request. See OECD, *TERMS OF REFERENCE: TO MONITOR AND REVIEW PROGRESS TOWARDS TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES* 6–7 (2010), *available at* <http://www.oecd.org/dataoecd/37/42/44824681.pdf> [hereinafter OECD, *TERMS OF REFERENCE*].

law issues associated with financial institutions reporting directly to foreign sovereigns. It also avoids concerns about power shifts associated with adopting a multilateral information exchange regime that alters the distribution of information with respect to nonresident accounts.²¹⁷ Likely for these reasons, Joint Statement I contemplates adopting the EU routing system for cooperating countries.²¹⁸

FATCA's statutory routing system for reporting directly from financial institutions to foreign sovereigns violates local financial privacy and data protection law in many jurisdictions.²¹⁹ It is therefore inappropriate for countries that are cooperating with one another. However, requiring information reporting directly from would-be-compliant financial institutions located in noncooperating jurisdictions pressures those jurisdictions to cooperate. It also provides a mechanism for financial institutions that wish to cooperate with new global norms to do so regardless of their government's policy decisions. Thus, FATCA's statutory routing system provides a useful tool for eliciting compliance from cooperative financial

217. To illustrate the point, imagine that in order to comply with FATCA, the IRS issued administrative guidance requiring financial institutions to provide the IRS information on the accounts of all non-resident account holders (not just U.S. accounts). Imagine the IRS then promised to forward information it received about each country's residents to tax administrations around the world. In principle this arrangement could create a multilateral system. For certain sovereigns, such a system might even be attractive, especially if it would give them valuable information they did not believe they could obtain by other means. However, if such a system applied to nonresident accounts of all countries, the United States would have access to and control of all information about all nonresident accounts around the world. Many sovereigns would oppose such a system. In contrast, a globalized version of the EU routing system would send information about nonresidents through the country where asset management occurs. The government of the asset-management country presumptively already could access that information today. For that reason alone, this system seems both the most fair and least disruptive. Further, the EU routing system forwards only information about a country's residents to that country's government. In this way, it does not raise the same issues about informational power raised by the earlier hypothetical.

218. Joint Statement I, *supra* note 4.

219. See *supra* note 102 and accompanying text.

institutions in jurisdictions that resist cooperating with a multilateral information reporting regime, and for pressuring those governments to cooperate.

The ICG System's routing model, on the other hand, is inapt for a multilateral regime focused on residence taxation. It sends information around the horn from account holders' financial institutions to source countries, and from source countries on to residence countries. In the process it disaggregates the information relevant to residence countries—a complete picture of their residents' offshore accounts—and excludes part of that picture, namely information related to payments not eligible for reduced withholding.

B. Identifying Taxpayers and Their Country of Residence

The taxpayer identification rules for participating financial institutions in the ICG System require those institutions to check a customer's self-declared identity and residence against all other information the institution already has in its possession.²²⁰ The ICG System's principle (using information already in a financial institution's possession) is a more accurate starting point for a multilateral system than the EUSD's current rule that treats taxpayers as residing wherever they resided at the time their most recent passport was issued.²²¹ FATCA's customer identification rules are just one way of fleshing out the details of the OECD's principle, and those identification rules may prove a useful starting point for discussions of how to implement a

220. *Report by the Pilot Group on Improving Procedures for Tax Relief for Cross-Border Investors*, OECD (Feb. 8, 2010), available at <http://www.oecd.org/dataoecd/20/36/44556378.pdf>.

221. Discussion of proposals to, inter alia, strengthen the identification rules of the EUSD and ensure that it covers all payments that are equivalent to interest have been ongoing since 2008, but the European Union has not yet reached unanimity on these matters. *See* COMMISSION OF THE EUROPEAN COMMUNITIES, PROPOSAL FOR A COUNCIL DIRECTIVE AMENDING DIRECTIVE 2003/48/EC ON TAXATION OF SAVINGS INCOME IN THE FORM OF INTEREST PAYMENTS 15–16 (2008), available at [http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com\(2008\)727_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/savings_directive_review/com(2008)727_en.pdf).

multilateral regime.²²² However, FATCA's rules for customer identification (as described in proposed Treasury regulations released on February 8, 2012) are highly prescriptive.²²³

In many cases involving financial institutions in cooperating jurisdictions, highly prescriptive rules may be costly to implement without providing any benefit to governments above and beyond those available through a principles-based system. Rules that allow financial institutions to exercise greater judgment could substantially reduce costs. Governments should not be concerned about less prescriptive rules for financial institutions in cooperating jurisdictions, if cooperating jurisdictions (1) develop shared principles for due diligence to determine beneficial ownership of accounts, (2) impose legal sanctions on domestic financial institutions that fail to adequately discharge a legal duty to identify nonresident beneficial owners of accounts, and (3) commit to use credible domestic regulatory mechanisms to enforce these (potentially risk-based) rules (together "Principles-Based Rules"). However, a more prescriptive system, with tougher customer identification rules, is appropriate where domestic regulatory oversight is absent and therefore does not provide an additional incentive to good-faith compliance. The U.S. experience with UBS and other private banks might suggest some caution regarding reliance on know-your-customer information and subjective reason-to-know standards alone for financial institutions not located in participating countries. For the United States, bifurcation of customer identification rules would suggest tightening prescriptive due diligence rules imposed under FATCA regulations while agreeing to more principles-based and less onerous rules as part of the Joint Statement process with cooperating governments. Indeed the model intergovernmental agreement, released after this Article had entered the editorial process, effectively permits financial institutions in Joint Statement I countries to use less onerous, more principles-based techniques developed for anti-money-laundering purposes in order to identify accountholders and the country of residence of their controlling persons.

222. A broadly multilateral system would be unlikely to identify nonresident citizens. The United States is almost alone globally in taxing bona fide nonresident citizens as if they were residents. Indeed, bona fide nonresident U.S. citizens working outside the United States have in some instances encountered serious difficulties banking in the countries in which they reside as a result of FATCA. Such persons rightfully note that their bank accounts in the country where they reside are not offshore accounts and that it is inappropriate for regulatory rules to make it difficult for them to maintain residence country financial accounts.

223. Prop. Treas. Reg. § 1.1471-4, 77 Fed. Reg. 9029 (Feb. 8, 2012).

C. Reporting

In proposed regulations, the U.S. Treasury replaced FATCA's statutory rule for what information should be reported by financial institutions with a rule requiring reporting of dividends, interest, and other income, as well as gross proceeds, determined under the same principles that a financial institution uses to report information in its jurisdiction of residence.²²⁴ The U.S. Treasury's decision with regards to income reporting conforms the basis for determining amount and character of income for FATCA reporting purposes to the European Union's Directive on Administrative Cooperation in the Field of Taxation.²²⁵ However, if the FATCA regulations are viewed as a predecessor to a multilateral system, FATCA reporting guidelines also may represent the United States' initial view of what types of information should be reported in a multilateral system with respect to offshore accounts. As described in Part III, account balance reporting is likely important to addressing evasion with respect to untaxed principal. However, account balance reporting may not be required with respect to domestic accounts under most countries' existing law, even among countries that rely on information reporting systems to collect tax on capital income. Thus, the changes in domestic law or regulations to allow for account balance reporting for nonresident accounts will present a significant challenge for a multilateral system that would be significantly eased by agreed international standards in this regard.²²⁶

D. Verifying Financial Institution Compliance

If financial institutions must report the same information for both resident and nonresident account holders to the tax administration of the country in which they are located, then it may be reasonable to rely on participating countries' self-interest in their own tax base to ensure appropriate implementation of the taxpayer identification and information reporting rules.

224. Prop. Treas. Reg. § 1.1471-4(d)(4), 77 Fed. Reg. 9029, 9032 (Feb. 8, 2012).

225. See *supra* note 80 and accompanying text.

226. Note, however, that the Joint Statement implies that FATCA Partner Countries will implement legislation to collect and report the information required under FATCA. Joint Statement I, *supra* note 4.

Further verification arguably becomes unnecessary.²²⁷ The European Union sensibly relies on this principle, on the presumption that institutions whose compliance with the EUSD would need to be verified are already subject to domestic regulatory regimes that make similar demands. The concept would be similarly compelling in the context of a multilateral system if countries have agreed to Principles-Based Rules.

For compliant institutions in noncooperative jurisdictions, however, some independent verification system is needed to ensure compliance. Of course, noncooperative jurisdictions will not let the tax administration of a complying sovereign into their country to verify financial institution compliance. Thus, relying on independent accounting firms to verify compliance in noncooperative jurisdictions would seem the most promising approach in the context of a system that has achieved broad multilateral acceptance.²²⁸

E. Encouraging Compliance

As described in Part III.A ensuring compliance with a new global regime is likely to require some level of coercion, or what the G20 calls “defensive measures.” FATCA’s 30 percent withholding tax is best understood as such a defensive measure. Similarly, FATCA’s passthru payment rules are, at the highest level, best understood as an attempt to expand the reach of this defensive measure. Here, FATCA differs from the OECD approach, which lacks coercive measures to ensure broad compliance. It also differs from the EU approach, which can mandate government participation within the European Union but currently lacks mechanisms to broaden the system beyond the member states. A multilateral regime that realistically intends to ensure global compliance should require all participating jurisdictions to impose some defensive measure. These cooperating jurisdictions need not necessarily impose 30 percent withholding, but similar coercive measures are a necessary component of a multilateral automatic information reporting system. Otherwise noncooperative jurisdictions and institutions benefit from defecting

227. A multilateral regime could also incorporate an explicit requirement that the enforcement mechanisms that apply to ensure domestic reporting also must be applied with respect to nonresident accounts.

228. Cost considerations mitigate strongly against independent accounting firm verification until broad multilateral acceptance is achieved. This presents just one example of how verification rules under FATCA and verification rules for a multilateral system should be different.

from the emerging regime because they can become repositories of choice for tax evader assets without paying a significant price for making that business decision. In recognition of this reality, Joint Statement I committed to “develop a practical and effective alternative approach to achieve the policy objectives of passthru payment withholding.”²²⁹

Coercive measures are necessary to create a multilateral automatic information exchange system, but are also incompatible with the existence of bilateral anonymous withholding arrangements. Indeed, if one or more major financial centers were prepared to impose defensive measures, but were willing to suspend those measures if they received anonymous withholding from another jurisdiction on a bilateral basis, it would undercut the coercive force of coordinated defensive measures. The lost leverage affects not only the countries receiving anonymous withholding, but also all other countries participating in the multilateral automatic information exchange system. The negative consequences thus redound largely to less wealthy, less powerful economies. A jurisdiction can defect from the automatic information exchange system, provide anonymous withholding to a few powerful financial centers, and continue promoting anonymity without withholding for residents of all other jurisdictions. For this reason, the Swiss anonymous withholding agreements are difficult to reconcile with a multilateral automatic information exchange system.

A similar concern regarding lost leverage for a multilateral automatic information exchange system arises under the bilateral framework proposed by the United States and Switzerland in Joint Statement II. However, the impact of the Joint Statement II framework on third countries that desire automatic information exchange is mixed. Unlike the Swiss anonymous withholding agreements, Joint Statement II forces Swiss financial institutions to build the information reporting architecture required for FATCA compliance and Swiss law to accommodate such reporting as the price of avoiding FATCA withholding.

As with FATCA, coercive measures adopted to promote a multilateral system should function on the principle that a financial institution in a noncooperating jurisdiction will not be punished if it reports information directly, and circumvents the tax administration of the country in which the institution is located. Such measures put pressure on financial institutions to comply regardless of local law and on governments to change local law to allow financial institutions to comply.

229. Joint Statement I, *supra* note 4.

F. Addressing Concerns Regarding Potential Misuse of Information

One of the critical principles under today's existing international standards for information exchange upon request is that the residence state receiving information must ensure that exchanged information is only used for legitimate tax administration purposes.²³⁰ Countries that do not abide by this standard are not entitled to information exchange upon request under current international standards. The Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum), a peer review body that includes over one hundred member jurisdictions, is mandated to assess jurisdictions to ensure that they all adhere to this high standard, and those assessments are ongoing today. In an automatic information exchange system, the same high standards proscribing misuse of information would presumably apply. In fact, the current members of the Multilateral Convention have clarified that they will not admit to the convention new countries that do not have proper safeguards in place to ensure that exchanged information will not be misused. A multilateral automatic information exchange system should both (1) enforce the existing Multilateral Convention's upfront requirement that governments have laws in place consistent with international standards to prevent the misuse of

230. The current globally agreed rules developed over a long period in response to, *inter alia*, the concern that information exchange could be used to facilitate improper efforts to attach or confiscate assets by abusive or illegitimate regimes. Such concerns are important in an information exchange upon request system. Indeed, these concerns may be more pronounced in information exchange upon request than in automatic information exchange, because unlike automatic information exchange, information exchange upon request asks the requested jurisdiction to use its investigatory powers on behalf of the requesting state. The protections for taxpayer rights and exchanged information built into the current international standards are focused on ensuring that exchanged information is only used for legitimate tax administration purposes. *See* OECD Model Convention, *supra* note 23, at art. 26(2); OECD, AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS, art. 8 (2002), *available at* <http://www.oecd.org/dataoecd/15/43/2082215.pdf>; OECD, TERMS OF REFERENCE, *supra* note 216, at 8–9 (describing the globally agreed standard against which all 102 members of the Global Forum are presently being assessed, including terms of reference C.3. and C.4. regarding protecting against misuse of information and ensuring safeguards for taxpayers). *See also supra* note 112.

exchanged information and (2) provide for monitoring systems and credible sanctions over time (most notably, denial of information exchange or removal from the multilateral system) as part of the establishment of any multilateral automatic information exchange system.²³¹ Taking these two steps would both protect the integrity of an automatic information exchange system and very substantially encourage compliance with global standards for protecting taxpayer information from misuse.

CONCLUSION

In just a few short years, the world has gone from assuming that financial institutions generally do not support residence country taxation cross-border to arguing about how they should act as tax agents for residence countries. This is a remarkable shift in international norms. Focusing exclusively on the contest between the information reporting and anonymous withholding models for a new regime inappropriately obscures this growing consensus. The competing initiatives for cross-border tax administrative assistance put forth by the United States, the European Union, the OECD, and Switzerland, and the response of financial institutions to those proposals, all highlight the development of a new international regime in which financial institutions will be tax intermediaries cross-border.

Nevertheless, a great deal is at stake in the choices currently being made between partial anonymous withholding and a broadly available information reporting regime for administrative assistance cross-border. The choice between the two approaches is real even if it is a choice among the second-best and the consequences of choosing between the available alternatives

231. The appropriate monitoring system could involve an expansion of the current Global Forum assessment process, with a special in-depth ongoing monitoring system on the question of whether automatically exchanged information is used by a government that receives information in ways consistent with the existing international standards that protect taxpayers' rights and proscribe use of exchanged information for purposes other than legitimate tax administration purposes. Indeed, the beginnings of such a process will commence late in 2012. At that point, the Global Forum on Transparency and Exchange of Information Phase II peer reviews will begin to consider whether, in practice, jurisdictions conform to the rules limiting the use of information exchanged upon request to legitimate tax administration purposes. See OECD, REVISED METHODOLOGY FOR PEER REVIEWS AND NON MEMBER REVIEWS (2011), *available at* <http://eoi-tax.org/keydocs/2e322d785ed58b73985d040598b1aea9>.

seem somewhat distant for most jurisdictions. Path-dependence and the tendency for institutional structures in this area to become embedded suggest that suboptimal decisions made by a small number of powerful actors may dictate outcomes for both those actors and the rest of the world for a prolonged period.

Anonymous withholding is not likely to be made available to most countries. In contrast, information reporting provides a workable architecture for an emerging regime of financial institutions acting as cross-border tax intermediaries in which most countries may reasonably aspire to participate. Even though some jurisdictions can be counted on to resist a broadly available automatic information reporting system, if these countries become outliers, international regimes will evolve around them, and eventually pressure may make noncompliance with the regime unsustainable.

Emerging economy governments and other stakeholders, including civil society, have many reasons beyond sheer revenue to weigh in on the choices being made by the major actors in this evolutionary moment. Information reporting can help sustain tax morale in a financially integrated world. Information reporting may also allow capital income taxation to play a role in building a liberal democracy that is accepted as legitimate by its people, and to encourage taxpayers to engage with the polity and demand government accountability. Anonymous withholding in contrast institutionalizes differentiated treatment for the most sophisticated taxpayers from the rest of society. Further, anonymous withholding systems leave open the possibility that asset management jurisdictions may one day decline to implement a country's changes in its own tax regime, thereby undermining domestic authority as well as policy flexibility, especially for less powerful states.

Together, the emerging models presented by the OECD, the European Union, and the United States hold within them the seeds of a workable automatic information reporting regime. Multilateral vehicles also already exist to work toward a multilateral system. For instance, the Coordinating Body of the Multilateral Convention has the authority to study methods and procedures to increase international cooperation in tax matters, and the Multilateral Convention provides the legal authority for multilateral automatic information exchange. International tax policymakers should seize the present evolutionary moment and push for the emerging automatic information exchange approaches to be reconciled in a manner that can support the tax administration needs of developed and emerging economies alike.