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Joanna Heiberg

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FATCA: Toward a Multilateral Automatic Information Reporting Regime

Joanna Heiberg*

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* Candidate for J.D., Washington and Lee University School of Law, May 2013. I would like to thank my advisor, Professor Michelle Drumbl, for her guidance. I would also like to thank my family and friends for their support and encouragement.

I. Introduction

The Tax Justice Network estimates $11.5 trillion in global assets are hidden in offshore havens.[1] Offshore tax evasion was the primary issue in the recent case of *United States v. UBS AG*,[2] a dispute between the United States and Switzerland's largest bank, United Bank of Switzerland (UBS).[3] In 2007, former UBS banker and American citizen, Bradley Birkenfeld, revealed that UBS was actively involved in helping its U.S. clients evade taxes.[4] The Swiss bank entered into a deferred prosecution agreement with the United States, in which UBS admitted to fraud and conspiracy and agreed to pay $780 million in fines,

1. Editorial, *If Switzerland Can . . . ,* N.Y. TIMES, Aug. 22, 2009, at A16.

2. United States v. UBS AG, No. 09-20423-CIV, 2009 WL 2241122 (S.D. Fla. July 7, 2009).

3. *See generally* Jared Seff, *Cracking Down on Tax Evaders—Swiss Banking: Secrets, Lies, and Deception*, 38 S.U. L. REV. 159 (2010) (detailing the dispute between the United States, UBS, and Switzerland).

4. *Banking*: *A Crack in the Swiss Vault*, CBS NEWS (Aug. 15, 2010, 11:59 PM), http://www.cbsnews.com/stories/2009/12/30/60minutes/main6038169.shtml (last visited Sept. 21, 2012) (on file with the Washington and Lee Law Review). Birkenfeld revealed that UBS managed assets for 19,000 U.S. clients totaling approximately $19 billion. *Id.* He estimated that 90% of his own clients were trying to evade taxes. *Id.* He neglected, however, to disclose his dealings with his biggest client, California real estate developer Igor Olenicoff, whom Birkenhoff helped hide $200 million. *Id.* Birkenfeld later pled guilty to conspiracy to defraud the IRS and was sentenced to forty months in prison. *Id.*

penalties, interest, and restitution.[5] Subsequently, the United States sued UBS in an attempt to force disclosure of nearly 52,000 secret accounts.[6] As a result, the Swiss government struck an unprecedented deal with the United States to provide client names on 4,450 UBS accounts held by Americans despite its previous argument that handing over such information violated Swiss bank-secrecy laws.[7] Although the case was arguably a success for American tax enforcement officials, it brought to light many of the current inadequacies of U.S. international tax enforcement.[8]

In response to the UBS case and the call for heightened international tax enforcement, Congress enacted the Foreign Account Tax Compliance Act (FATCA).[9] By enhancing

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5. *See* Press Release, Dep't of Justice, UBS Enters Into Deferred Prosecution Agreement (Feb. 18, 2009), http://www.justice.gov/opa/pr/2009/February/09-tax-136.html (last visited Sept. 21, 2012) (on file with the Washington and Lee Law Review); *see also* Lynnley Browning, *U.S. Drops Criminal Charges Against UBS*, N.Y. TIMES, Oct. 23, 2010, at B3.

6. David Voreacos & Carlyn Kolker, *U.S. Sues UBS Seeking Swiss Account Customer Names*, BLOOMBERG (Feb. 19, 2009, 2:25 PM), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a_TaQP5WVZuA&refer=home (last visited Sept. 21, 2012) (on file with the Washington and Lee Law Review).

7. *If Switzerland Can*, *supra* note 1.

8. *See Hearing on Banking Secrecy Practices and Wealthy American Taxpayers Before the H. Comm. on Ways and Means*, 111th Cong. 4–5 (2009) [hereinafter *Hearing on Banking Secrecy*] ("The ongoing events surrounding UBS AG and its admitted criminal role in helping a number of wealthy U.S. individuals evade U.S. taxes have brought a spotlight to bear on international tax enforcement and the tools that we have at our disposal to help ensure compliance."); *see also infra* Part II.C (discussing existing international enforcement mechanisms).

9. FATCA was introduced to both houses of Congress on October 27, 2009. *See* Foreign Account Tax Compliance Act of 2009, S.1934, 111th Cong.; Foreign Account Tax Compliance Act of 2009, H.R. 3933, 111th Cong. The House passed a revised bill on December 9, 2009, changing the effective date to January 1, 2013 and adding a grandfather exception for existing obligations. *See* Carol Tello, *Reporting, Withholding, and More Reporting: HIRE Act Reporting and Withholding Provisions,* 39 TAX. MGM'T INT'L J. 243 (2010). The provisions were signed into law on March 18, 2010 under Title V of the HIRE Act. Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, 124 Stat. 71 (2010). The HIRE Act provides tax benefits to employers who hire certain previously unemployed workers. *Id.* §§ 101–02. The FATCA provisions were included as offsetting provisions to raise revenue needed to fund the exemptions. *Id.* § 501. The FATCA provisions comprise what is now Chapter 4 of the IRC. *Id.* (to be codified at I.R.C. §§ 1471–74).

information reporting, increasing withholding taxes for foreign financial institutions that do not engage in information reporting, and strengthening penalties for taxpayers who do not adequately report their income, FATCA makes it more difficult for U.S. persons to engage in offshore tax evasion.[10] Despite FATCA's worthwhile goals of increasing tax enforcement and tracking down tax evaders, its enactment raises several significant concerns.[11]

This Note will argue that international cooperation is essential for successful FATCA implementation. Part II will provide background information on offshore tax evasion and existing U.S. mechanisms for international tax enforcement. Part III will explain key FATCA provisions, and Part IV will discuss concerns regarding FATCA as originally enacted. Finally, Part V will introduce the proposed intergovernmental approach to FATCA and argue that international cooperation and development of standardized requirements will mitigate FATCA concerns and facilitate its implementation. Part V also argues that abandonment of the U.S. policy of citizenship-based taxation is necessary to achieve an efficient multilateral FATCA regime.

II. International Tax Enforcement

The U.S. federal income tax system is one of "voluntary compliance,"[12] meaning it is initially up to the taxpayer, rather than the government, to determine and pay the appropriate taxes.[13] The United States currently has one of the world's

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10. *Foreign Bank Account Reporting and Tax Compliance: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 111th Cong. 7 (2009) [hereinafter *FATCA Hearing*] (statement of Stephen E. Shay, Deputy Assistant Sec'y of the Treasury).

11. *See infra* Part IV (discussing primary areas of concern).

12. *See* Flora v. United States, 362 U.S. 145, 176 (1960) ("Our system of taxation is based upon voluntary assessment and payment, not upon distraint.").

13. *See* Rev. Rul. 2007-20, 2007-14 I.R.B. 863–64 ("References to a 'voluntary' tax system . . . mean a system that allows taxpayers to determine, in the first instance, the correct amount of their tax and report their liability on appropriate returns, rather than having the government make the determinations for them.").

highest compliance rates for tax collections.[14] Despite a relatively high compliance rate, the United States suffers from a significant tax gap.[15] The tax gap is the difference between the amount of tax imposed by law and the amount voluntarily and timely paid by taxpayers for a given year.[16] Nonfiling, underreporting, and underpayment of taxes are all forms of noncompliance that contribute to the tax gap.[17]

The two primary means of tax enforcement are withholding and information reporting.[18] Withholding taxes at the source eliminates the possibility of nonpayment.[19] Information reporting, on the other hand, ensures the government has another source of information to compare against the taxpayer's filing.[20] Thus, a large portion of the tax gap results from income that is subject to neither withholding nor information reporting.[21]

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14. *Hearing on Banking Secrecy, supra* note 8, at 68 (statement of Reuven S. Avi-Yonah, Professor of Law, University of Michigan Law School). Internal Revenue Service data for tax year 2006 report a voluntary compliance rate of 83.1% and a compliance rate of 85.5% after enforcement and late payments. I.R.S. News Release IR-2012-4 (Jan. 6, 2012).

15. The most recent tax gap estimates from the IRS are based on data from tax year 2006 and report a net tax gap of $385 billion for that year, including revenue collected from late payments and IRS compliance and enforcement efforts. IR-2012-4.

16. Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. & POL'Y REV. 7, 8 (2009); *see also Hearing on Banking Secrecy*, *supra* note 8, at 68 (noting that the tax gap refers to "a difference between the taxes [the IRS] collected and taxes it should have collected under existing law").

17. Internal Revenue Serv., *Tax Gap Facts and Figures*, 1 (2005), http://www.irs.gov/pub/irs-utl/tax_gap_facts-figures.pdf [hereinafter *Tax Gap Facts*].

18. *Hearing on Banking Secrecy*, *supra* note 8, at 68; *see also* IR-2012-4 ("Compliance is highest where there is third-party information reporting and/or withholding.").

19. Melissa A. Dizdarevic, Comment, *The FACTA Provisions of the HIRE Act: Boldly Going Where No Withholding Scheme Has Gone Before*, 79 FORDHAM L. REV. 2967, 2972 (2011).

20. *Id.*; *see also* James Andreoni, Brian Erard & Jonathan Reinstein, *Tax Compliance*, 36 J. ECON. LITERATURE 818, 821 (1998) (noting that "[i]nformation reporting severely limits the scope for tax evasion on many significant income and deduction items" and "reduces the potential for unintentional reporting errors by clarifying for the taxpayer the amount that legally should be reported").

21. *Hearing on Banking Secrecy*, *supra* note 8, at 68.

A. Offshore Tax Evasion

Experts estimate that offshore tax evasion costs the U.S. Treasury approximately $100 billion a year.[22] Because domestic tax laws vary from country to country, international taxation[23] provides unique opportunities for noncompliance and complicates enforcement efforts.[24] This is particularly true of tax haven countries. Although there is no single definition, the Organization for Economic Cooperation and Development (OECD) identifies four primary characteristics of tax haven countries: (1) absence of or nominal amount of taxes imposed; (2) lack of transparency about the application of tax laws and underlying documentation; (3) laws or administrative practices that prevent the effective exchange of information with other countries for tax purposes; and (4) absence of a requirement that the taxpayer's activity within their jurisdiction be substantial.[25] Access to these low-tax, secretive jurisdictions provides an opportunity for U.S. persons to effectively avoid taxation by moving assets and investments offshore.[26]

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22. Staff of S. Comm. on Homeland Sec. and Gov't Affairs Subcomm. on Investigations, 110th Cong., Rep. on Tax Haven Banks and U.S. Tax Compliance 1 (Comm. Print 2008). *But see Hearing on Banking Secrecy*, *supra* note 8, at 95 (recognizing that there are a range of estimates and it is difficult to get a precise number).

23. For the purposes of this Note, the term "international taxation" refers to the U.S. taxation of international transactions, persons, and investments. Taxpayers subject to the international provisions of the U.S. tax rules and reporting requirements can be grouped into four categories: (1) U.S. individuals working, living, or holding assets abroad; (2) U.S. entities doing business abroad; (3) Foreign individuals working or doing business in the United States; and (4) Foreign entities doing business in the United States. TAXPAYER ADVOCATE SERV., 2011 ANNUAL REPORT TO CONGRESS 129 (2011).

24. Dizdarevic, *supra* note 19, at 2972.

25. Org. for Econ. Coop. & Dev., *Tax Haven Criteria*, http://www.oecd.org/document/23/0,3343,en_2649_33745_30575447_1_1_1_1,00.html (last visited Sept. 21, 2012) (on file with the Washington and Lee Law Review).

26. *See, e.g.*, *Hearing on Banking Secrecy*, *supra* note 8, at 67 (explaining the extent to which U.S. residents can move assets offshore to tax haven jurisdictions and avoid paying U.S. taxes).

B. Chapter 3 Withholding: The Starting Point for International Tax Enforcement

As a preliminary matter, the United States uses a withholding system for U.S. source payments to foreign persons.[27] A withholding agent must withhold 30% of any payment of fixed or determinable annual or periodical (FDAP) income[28] made to a payee that is a foreign person, unless it has documentation associating the payee with either a U.S. person or a foreign "beneficial owner"[29] entitled to a reduced withholding rate.[30] A withholding agent making a payment to a foreign person need not withhold when the foreign person assumes withholding responsibility as a qualified intermediary (QI),[31] a U.S. branch of a foreign person, a withholding foreign partnership, or an authorized foreign agent.[32] Therefore, by withholding at the source, U.S. tax authorities ensure collection of the appropriate amount of tax on certain U.S. source income of foreign persons.[33] Because withholding does not apply to foreign assets of U.S. persons, however, additional enforcement mechanisms are needed to address offshore tax evasion.

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27. *See* I.R.C. §§ 1441–42 (2006) (mandating withholding of tax on payments to nonresident aliens and foreign corporations). The withholding provisions are codified in Chapter 3 of the Internal Revenue Code (the Code). *Id.* at §§ 1441–63.

28. I.R.C. § 1441(b) (2006). Examples of FDAP include interest, dividends, rent, salaries, and wages. *Id.* Exceptions are made for certain classes of income including portfolio interest, bank deposit interest, and short-term original issue discount. Treas. Reg. § 1441–2(a).

29. "The term beneficial owner means the person who is the owner of income for tax purposes and who beneficially owns that income." Treas. Reg. § 1.1441-1(c)(6).

30. *Id.* § 1.1441–1(b). A foreign person entitled to a treaty reduction of the 30% withholding rate must provide the withholding agent with a W–8BEN form prior to the time of payment in order to receive the treaty benefits. *Id.* § 1.1441–6(b)(1).

31. *See infra* Part II.C.3 (explaining the QI program).

32. Treas. Reg. § 1.1441–1(b)(1).

33. *See supra* notes 18–21 and accompanying text (noting that withholding at the source increases the voluntary compliance rate).

C. The Importance of Information Reporting

A core problem in tax enforcement is information asymmetry.[34] A taxpayer has knowledge of, or at least ready access to, the information necessary to determine his or her tax liability.[35] The government, on the other hand, must rely on the information it obtains directly from the taxpayer or from third parties.[36] This is true in both the domestic and the international context. For example, U.S. persons are legally obligated to disclose foreign accounts in excess of $10,000 on an annual Report of Foreign Banks and Financial Accounts (FBAR) form.[37] Without third-party reporting, however, the government has no way of knowing if a taxpayer failed to disclose or underreported his or her foreign assets. Thus, "third-party information reporting assists taxpayers in correctly computing and reporting their tax liabilities, increases compliance with tax obligations, reduces the incidence of and opportunities for tax evasion, and . . . helps to maintain the fairness of the U.S. federal income tax system."[38]

The United States uses a variety of tools to collect information regarding U.S. persons with foreign assets. Current information gathering methods include both cooperative and unilateral measures.[39]

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34. Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733, 1733 (2010).

35. *Id.*

36. *Id.*

37. I.R.S. Form TD F 90-22.1 (stating that FBAR reporting is required of all U.S. persons with "a financial interest in or signature authority over foreign financial accounts" exceeding $10,000 at any time during the calendar year). Civil penalties for failure to file an FBAR start at $500 for a negligent violation. 31 U.S.C. § 5321(a)(6)(A) (2006).

38. Regulations Relating to Information Reporting by Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities, 77 Fed. Reg. 9,022, 9,022 (proposed Feb. 15, 2012).

39. Cooperative methods of information gathering require international assistance whereas unilateral methods of information gathering do not. Samantha H. Scavron, Note, *In Pursuit of Offshore Tax Evaders: The Increased Importance of International Cooperation in Tax Treaty Negotiations After* United States v. UBS AG*,* 9 CARDOZO PUB. L., POL'Y & ETHICS J. 157, 178 (2010). Arguably, however, when unilateral methods are used to retrieve information regarding offshore accounts, international assistance is often required for the

1. Tax Treaties and Information Exchange Agreements

There are two principal forms of bilateral agreements used by U.S. tax authorities for the exchange of information with other countries: (1) articles in income tax treaties governing the exchange of information and (2) Tax Information Exchange Agreements (TIEAs).[40] Article 26 of the U.S. Model Income Tax Treaty[41] requires the contracting countries to exchange tax information as necessary for carrying out provisions of the treaty or domestic laws of the parties.[42] Information received under Article 26 is treated as confidential in the same manner as information obtained under the domestic laws of that country.[43] The agreement is limited to information that is legally obtainable in the normal course of administration of the requested country and does not include trade secrets.[44] Due to this limitation, banking secrecy rules may excuse production of information.[45]

Similarly, TIEAs are bilateral agreements between countries establishing policies and procedures regarding the exchange of information. TIEAs are generally used when the parties do not have a comprehensive bilateral income tax treaty containing an information exchange provision.[46] The agreements do not modify the substantive rules of taxation in either country, but instead provide for cooperation in eliciting information and other assistance for each country in the enforcement of its tax laws.[47] Since the United States

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IRS to obtain all the evidence needed for a successful investigation and prosecution. *Id.*

40. *Hearing on Banking Secrecy*, *supra* note 8, at 32 (statement of Peter H. Blessing, Partner, Shearman & Sterling).

41. U.S. Treas. Dep't Model Income Tax Treaty, Nov. 15, 2006 [hereinafter U.S. Model Treaty]. The U.S. Model Treaty is the starting point of U.S. negotiations for all tax treaties the United States enters into. PETER H. BLESSING & CAROL DUNAHOO, INCOME TAX TREATIES OF THE UNITED STATES ¶ 1.02[4] (1999 ed.).

42. U.S. Model Treaty, *supra* note 41, art. 26. para. 1.

43. *Id.* para. 2.

44. *Id.* para. 3.

45. *Hearing on Banking Secrecy*, *supra* note 8, at 33 (statement of Peter H. Blessing, Partner, Shearman & Sterling).

46. *Id.*

47. REUVEN AVI-YONAH ET AL., GLOBAL PERSPECTIVES ON INCOME TAXATION LAW 217 (2011).

and Barbados entered into the first TIEA in 1984, the United States has extensively used TIEAs to obtain information needed for tax enforcement.[48] Banking secrecy laws may also inhibit the United States' ability to gather information pursuant to a TIEA.[49]

2. Qualified Intermediaries

In addition to income tax treaties and information exchange agreements with other countries, the United States uses a QI program to incentivize cooperation from foreign entities.[50] The QI program began in 2001 and is primarily directed at U.S.-source income received by foreigners.[51] Pursuant to a QI agreement,[52] a foreign institution provides the IRS with certain information regarding its U.S. customers in exchange for simplified rules, including non-customer-specific reporting and the ability to claim more easily applicable exemptions or lower withholding taxes.[53] Although the QI program is a valuable tool in international tax enforcement, it has material shortcomings and, as evidenced by the

48. *Id.*

49. *Supra* note 45 and accompanying text.

50. The term "qualified intermediary" refers to an entity that is a party to a withholding agreement with the IRS and may be a foreign financial institution, a foreign clearing house, a foreign branch of a U.S. financial institution or clearing organization, a foreign corporation for purposes of presenting claims of benefits under an income tax treaty on behalf of its shareholders, or any other person acceptable to the United States. Treas. Reg. § 1.1441-1(e)(5)(ii). The IRS currently has over 5,000 QI Agreements in force. *Hearing on Banking Secrecy, supra* note 8, at 40 (statement of Peter H. Blessing, Partner, Shearman & Sterling).

51. Itai Grinberg, *Beyond FATCA: An Evolutionary Moment for the International Tax System* 13 (Georgetown Law Faculty Working Papers, Paper No. 160, 2012), *available at* http://scholarship.law.georgetown.edu/fwps_papers/160.

52. *See* Rev. Proc. 2000-12, 2000-01 C.B. 387.

53. Treas. Reg. § 1.441-1(e)(5); *see also FATCA Hearing*, *supra* note 10, at 7.

UBS case,[54] considerable potential for abuse with respect to U.S. accountholders.[55]

3. Voluntary Disclosure

On several occasions, the IRS has offered amnesty for voluntary disclosure by allowing U.S. taxpayers to disclose foreign assets without the threat of criminal punishment.[56] Although taxpayers escape criminal liability under the offshore voluntary disclosure initiatives (OVDI), financial penalties still apply.[57] The 2009 and 2011 OVDIs resulted in a combined 33,000 voluntary disclosures and the collection of more than $4.4 billion.[58] The repeated use of voluntary disclosure initiatives, however, may result in diminishing returns and reduce incentives to comply due to a belief that an opportunity will exist to come forward under future amnesties.[59]

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54. *See FATCA Hearing*, *supra* note 10, at 2 ("The recent UBS case revealed problems with the QI program that permitted tax evasion by U.S. persons."); *see also Hearing on Banking Secrecy*, *supra* note 8, at 40–41 (statement of Peter H. Blessing, Partner, Shearman & Sterling) (assessing the QI program and its current shortcomings).

55. *FATCA Hearing*, *supra* note 10, at 9–10 ("While [the QI] regime has been effective in improving compliance with U.S. tax laws in relation to collecting withholding taxes on foreign persons, its provisions relating to U.S. accountholders have been subject to abuse by some foreign banks.").

56. *See* I.R.S. News Release IR-2011-94 (Sept. 15, 2011) ("The programs gave U.S. taxpayers with undisclosed assets or income offshore a second chance to get compliant with the U.S. tax system, pay their fair share and avoid criminal charges."); *see also* I.R.S. News Release IR-2012-5 (Jan. 9, 2012) (announcing the reopening of the IRS voluntary disclosure program).

57. *See* IR-2012-5 (reporting that the 2012 program imposes a penalty of 27% of the highest aggregate balance in foreign accounts or value of foreign assets during the eight tax years prior to the disclosure).

58. *Id.*

59. *See* Leandra Lederman, *The Use of Voluntary Disclosure Initiatives in the Battle of Offshore Tax Evasion*, 55 VILL. L. REV. (forthcoming 2012) (arguing that repeated use of voluntary disclosure initiatives may have diminishing returns unless the government continues to make well-publicized criminal prosecutions).

4. Tax Whistleblowers

Another tool used for information gathering is whistleblower incentives. Under U.S. tax laws, a whistleblower may be entitled to up to 30% of the amount collected by the government from a noncompliant taxpayer.[60] Despite the high potential monetary rewards, whistleblowers may be reluctant to come forward due to the infrequency of whistleblower rewards awarded[61] and the possibility of criminal punishment.[62]

5. John Doe Summons

When the IRS suspects a federal tax violation has occurred by unknown persons, it may issue a "John Doe" summons for the relevant financial information.[63] The IRS may summon information when it can establish that (1) the summons relates to a particular person or ascertainable class; (2) a reasonable basis exists for issuing the summons; and (3) no adequate alternative for acquiring the information exists.[64] To enforce a summons in U.S. courts, the IRS must prove that the investigation serves a legitimate purpose, the information might be relevant to that

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60. I.R.C. § 7623(b)(1) (2006). Whistleblowers may be entitled to 15–30% of the amount collected, including penalties and interest, as a result of administrative or judicial action or settlement. *Id.* The amount of the award depends upon the extent to which the individual substantially contributed to the action or settlement. *Id.*

61. The first whistleblower award was received in 2011 by an in-house accountant and netted the IRS $20 million in taxes and interest. Associated Press, *IRS Awards $4.5M to Whistleblower,* CHICAGO SUN-TIMES (Apr. 8, 2011), http://www.suntimes.com/news/nation/4736164-418/irs-awards-whistleblower-4.5m (last visited Sept. 23, 2012) (on file with the Washington and Lee Law Review).

62. UBS whistleblower Bradley Birkenfeld was sentenced to 40 months in prison and received a $30,000 fine despite offering the U.S. Government information crucial to its UBS investigation. Erik Larson & Carlyn Kolker, *UBS Tax Fraud Case Whistleblower Gets 40-Month Prison Sentence*, BLOOMBERG (Aug. 21, 2009, 3:11 PM), http://www.bloomberg.com/apps/news?pid=news archive&sid=aqRUmD2LzH.E (last visited Sept. 21, 2012) (on file with the Washington and Lee Law Review); *see also supra* note 4 (detailing Birkenfeld's involvement in the UBS investigation).

63. I.R.C. § 7609(f) (2006).

64. *Id.*

purpose, the IRS did not already possess the information, and the initial requirements of Section 7609(f) were met.[65] Because a John Doe summons is a unilateral mandate, enforcement issues arise when a foreign entity holds the information.[66]

6. Title 31 Subpeonas

Most recently, the IRS has used Title 31 subpoenas[67] to compel U.S. taxpayers suspected of holding offshore accounts to turn over bank account details.[68] Under Title 31 of the U.S. Code, the U.S. government may compel production of records and documents for purposes of an investigation.[69] When subpoenaed, the taxpayer faces a choice of disclosing potentially self-incriminating evidence or being found in contempt of court and subject to civil or criminal penalties, including jail time.[70] Approximately a dozen Title 31 subpoenas were issued in 2011, and it remains to be seen whether the IRS will increase its use of this new enforcement technique.[71]

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65. *See* United States v. Powell, 379 U.S. 48 (1964).

66. *See* Emily Busch, Note, *To Enforce or Not to Enforce? The UBS John Doe Summons and a Framework for Policing U.S. Tax Fraud Amid Conflicting International Law and Banking Secrecy*, 83 TEMP. L. REV. 185, 198–201 (2010) (explaining that courts may quash a John Doe Summons based on comity and conflicting foreign laws).

67. 31 U.S.C. § 3804 (2006).

68. Lynnley Browning, *New US Tactic for Suspected Swiss Bank Tax Cheats*, REUTERS (Dec. 29, 2011, 12:15 AM), http://www.reuters.com/article/2011/12/29/uk-usa-swiss-client-subpoenas-idUSLNE7BS00620111229 (last visited Sept. 21, 2012) (on file with the Washington and Lee Law Review). American taxpayers receiving the subpoenas include those who applied too late to one of two voluntary disclosure programs and clients identified by several recently indicted or charged Swiss bankers. *Id.*

69. 31 U.S.C. § 3804(a) (2006). Title 31 subpoenas are more commonly used against drug smugglers and money launderers. Browning, *supra* note 68.

70. *Id.* § 3804(c). If an individual refuses to obey a subpoena, the U.S. District Courts have jurisdiction to enforce the subpoena. *Id.* Failure to obey a court order is punishable by the court as contempt. *Id.*

71. *Id.* Recently, a wealthy California taxpayer unsuccessfully challenged a Title 31 subpoena on Fifth Amendment grounds. M.H. v United States, 648 F.3d 1067 (9th Cir. 2011).

III. FATCA

Congress enacted FATCA in response to the gaps in existing tax enforcement mechanisms.[72] Although the ability to use offshore tax havens to evade income taxes has increased in recent decades, the U.S. government's tools to combat evasion have not changed significantly.[73] FATCA provides the IRS with the "enhanced tools it needs to continue its expansion of international tax enforcement."[74]

A. FATCA's Goals and Mission

FATCA's primary goal is to raise revenue by tracking down tax evaders.[75] More specifically, it is designed to address the "deliberate and illegal hiding of assets and income from the IRS by U.S. citizens and residents."[76] Because an estimated $100 billion is lost annually as a result of offshore tax abuses,[77] a significant amount of revenue is at stake.

B. FATCA's Design

FATCA is designed to increase the government's access to information regarding U.S. citizens and residents with foreign assets, in hopes of detecting and deterring offshore tax evasion. It

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72. *See supra* Part II.C (discussing existing enforcement mechanisms).

73. *See Hearing on Banking Secrecy*, *supra* note 8, at 68 (statement of Reuven S. Avi-Yonah, Professor of Law, Univ. of Mich. Law School) (noting that "since about 1980 there has been a dramatic lowering of both legal and technological barriers to the movement of capital, goods and services"); Grinberg, *supra* note 51, at 2 ("The ability to make, hold, and manage investments through offshore financial institutions has increased dramatically in recent years, while the cost of such services has plummeted." (citations omitted)).

74. *FATCA Hearing*, *supra* note 10, at 17 (statement of William J. Wilkins, Chief Counsel, Internal Revenue Serv.).

75. Micah Bloomfield & Dmitriy Shamrakov, *The Thirty Percent Solution?: FATCA Provisions of the HIRE Act*, STROOCK SPECIAL BULLETIN, Apr. 21, 2010, at 1.

76. *FATCA Hearing*, *supra* note 10, at 13.

77. 156 CONG. REC. S1745 (daily ed. Mar. 18, 2010); *see also supra* note 22 and accompanying text.

adopts a two-prong approach to enhancing the Government's access to information, one focusing directly on taxpayers and the other on foreign financial institutions (FFIs).[78]

1. Self-Reporting

FATCA requires individual U.S. taxpayers with foreign accounts and assets exceeding $50,000 on the last day of the tax year, or $150,000 at any time during the tax year, to report them on an information return.[79] Most American citizens living abroad will likely have over $50,000 in foreign financial assets and, as a result, meet the threshold for Section 6038 reporting.[80] Failure to disclose results in an initial $10,000 penalty.[81] Additionally, the new provisions extend the statute of limitations for failure to disclose from three years to six.[82] These reporting requirements operate in addition to FBAR filing requirements[83] and may be enforced using traditional IRS enforcement mechanisms.[84]

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78. Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, § 501, 511, 124 Stat. 71 (2010). FATCA also addresses several other areas of foreign asset reporting that are beyond the scope of this Note. *See id.* at § 521–41 (addressing passive foreign investment companies, foreign trusts, and dividend equivalent payments received by foreign persons).

79. I.R.C. § 6038D(a) (2006). The reporting threshold doubles for a married couple filing jointly. I.R.S. Instructions for Form 8938, 1 (Dec. 15, 2011). A higher reporting threshold of $200,000, or $400,000 if married and filing a joint return, applies to taxpayers living abroad. *Id.*

80. Alan S. Lederman & Bobbe Hirsh, *The American Assault on Tax Havens—Status Report*, 44 INT'L LAW. 1141, 1147 (2010).

81. I.R.C. § 6038D(d) (2006). The IRS may impose additional penalties of up to $50,000 for continued failure to file after IRS notification and 40% of any understatement of tax attributable to non-disclosed assets. I.R.S. News Release IR-2011-117 (Dec. 14, 2011).

82. *Id.* § 513(a), 124 Stat. at 111 (to be codified at 26 U.S.C. § 6501).

83. *See* IR-2011-117 ("The new Form 8938 requirement does not replace or otherwise affect a taxpayer's obligation to file an FBAR.").

84. *See FATCA Hearing*, *supra* note 10, at 15 (noting that FATCA creates reporting obligations and a penalty regime separate from FBAR and allows the IRS to enforce the new penalties using traditional IRS enforcement tools). Conversely, the IRS cannot enforce FBAR penalties because they are imposed through the Bank Secrecy Act and not the Code. *Id.* at 14. An FBAR penalty must instead be referred to the Justice Department for separate prosecution and collection. *Id.* at 15.

2. Third-Party Reporting

Perhaps the most controversial aspect of FATCA is its application to FFIs.[85] FATCA gives FFIs a choice between disclosure of U.S. account holders and a 30% withholding tax on U.S. source income.[86] In doing so, FATCA creates a powerful incentive for FFIs to disclose information regarding U.S. accounts.[87]

To meet the information reporting requirements, an FFI must agree to collect information necessary to identify its U.S. accounts.[88] For each U.S. account, the FFI must report the name, address, and Tax Identification Number (TIN) of each account holder; the account number; the account balance; and the gross receipts and withdrawals from the account.[89] Alternatively, an FFI may elect to be subject to the same reporting requirements as U.S. financial institutions.[90] These requirements operate in addition to any existing reporting obligations under a QI Agreement.[91]

If an FFI chooses not to comply with FATCA's reporting requirements, a 30% withholding tax is imposed on all "withholdable payments."[92] There are several notable distinctions

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85. "FFIs are defined in such a manner as to include foreign banks, foreign brokerage firms, foreign trust companies, foreign mutual funds, foreign hedge funds, foreign private equity funds, and other foreign funds engaged primarily in investing or trading in U.S. or foreign securities." Lederman & Hirsh, *supra* note 80, at 1143 (citing I.R.C. § 1471(d)(4), (5)). A subsequent IRS notice clarified this definition and excepted from FFI characterization certain foreign companies. *See* I.R.S. Notice 2010–60.

86. I.R.C. § 1471(a).

87. *See* 156 CONG. REC. S1746 (daily ed. Mar. 18, 2010) ("The legislative intent behind [this choice] is to force foreign financial institutions to disclose their U.S. account holders."); *see also FATCA Hearing*, *supra* note 10, at 10 (statement of Stephen E. Shay, Deputy Assistant Sec'y of the Treasury) ("[FATCA] will improve information reporting with respect to U.S. accountholders by creating a powerful incentive for [FFIs] to provide the IRS with the information it needs to identify persons seeking to evade U.S. tax.").

88. I.R.C. § 1471(b) (2006).

89. *Id.*

90. *Id.*

91. *Id.* § 1471(c)(3).

92. *Id.* § 1471(a). The term "withholdable payment" includes "any payment of interest . . . dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and any other fixed or

between FATCA withholding and existing withholding requirements under Chapter 3 of the Code.[93] First, FATCA imposes withholding on gross proceeds from the sale or disposition of income-producing property from a U.S. source and fixed or determinable annual or periodical (FDAP) income.[94] Second, Chapter 3 withholding only applies to payments to nonresident aliens and foreign corporations,[95] whereas FATCA withholding applies to all U.S. source payments.[96] Finally, failure to meet FATCA information disclosure requirements may result in a QI being withheld upon.[97] As a result, FATCA creates a more expansive withholding scheme than previously existed.[98]

IV. FATCA Issues and Concerns

Although many agree that increased enforcement of offshore tax evasion is desirable, critics have raised numerous issues associated with FATCA's approach.[99]

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determinable annual or periodical gains, profits, and income" from sources within the U.S. or "any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the [U.S.]." *Id.* § 1473(1)(A).

93. *See supra* Part II.B (describing Chapter 3 withholding).

94. *See supra* note 92 and accompanying text (discussing "withholdable payments"); *see also* I.R.C. §§ 1441(b), 1473(1) (2006).

95. *Id* §§ 1441–42.

96. *Id.* § 1473(1).

97. *Supra* note 91 and accompanying text.

98. *See supra* notes 93–97 and accompanying text (contrasting FATCA withholding from existing withholding requirements in the Code).

99. *See FATCA Hearing*, *supra* note 10, at 69 (statement of American Citizens Abroad) (raising concerns regarding citizens abroad, international trade and finance, and reciprocal treatment from foreign governments); *id.* at 72 (statement of Chamber of Commerce of the United States of America) (concerning potential limits on the flow of foreign capital into the U.S. and disruptions in the international capital markets); *id.* at 80 (statement of American Bankers Association) ("The scope and application of [FATCA] is overly broad and will lead to certain unintended consequences.").

A. Citizens Living Abroad

FATCA's enactment caused significant outcry from U.S. citizens living abroad.[100] Due to the financial and administrative burdens of holding U.S. accounts under a FATCA regime,[101] some FFIs are severing ties with U.S. accountholders.[102] As a result, U.S. citizens may be unable to establish and maintain bank accounts in foreign countries.[103] Depending on eventual FATCA exclusions, U.S. citizens may also face difficulty in purchasing certain foreign insurance policies and pension funds.[104]

Additionally, the burdensome individual reporting requirements and harsher penalties are causing Americans to re-evaluate, and in some cases terminate, their U.S. citizenry.[105]

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100. *See* Am. Citizens Abroad, *FATCA Destroys Lives and the US Economy*, AMERICAN CITIZENS ABROAD (Dec. 20, 2011), http://americansabroad.org/issues/fatca/fatca-destroys-lives-and-the-us-economy/ (last visited Sept. 21, 2012) (claiming that "FATCA legislation will destroy the lives of average, honest and hard working Americans") (on file with the Washington and Lee Law Review); *see also FATCA Hearing*, *supra* note 10, at 69–71 (statement of American Citizens Abroad) (expressing the organization's concerns with FATCA).

101. *See infra* Part IV.C (discussing the financial and administrative burden on FFIs).

102. *See FATCA Hearing*, *supra* note 10, at 70 (noting that UK, Swiss, Dutch, and Spanish banks are refusing American citizens residing in their countries as clients and closing accounts); Daniel J. Mitchell, *Why Obama's FATCA Law is a Threat to Business Growth*, FORBES (June 20, 2011, 11:50 AM), http://www.forbes.com/sites/beltway/2011/06/20/why-obamas-fatca-law-is-a-threat-to-business-growth/ (last visited Sept. 21, 2012) (citing a dozen accounts of U.S. citizens getting the cold shoulder from foreign banks) (on file with the Washington and Lee Law Review).

103. *See FATCA Hearing*, *supra* note 10, at 70 ("The [FATCA] legislation and reinforced QI regulations will make it all the more difficult for overseas Americans to maintain a bank account where they reside.").

104. *See* Lederman & Hirsh, *supra* note 80, at 1147 (discussing obstacles that citizens living abroad may face under FATCA).

105. *See* Barrie McKenna, *Americans in Canada Driven to Divorce From Their Country*, GLOBE AND MAIL (Nov. 8, 2011, 7:32 PM), http://www.theglobeandmail.com/news/world/americans-in-canada-driven-to-divorce-from-their-country/article2229969/ (last visited Sept. 21, 2012) (noting that 1,534 Americans renounced their U.S. citizenship in 2010, more than twice as many as in 2009 and a sevenfold increase from 2008) (on file with the Washington and Lee Law Review); *see also* Brian Knowlton, *More American Expatriates Give Up Citizenship*, N.Y. TIMES (Apr. 25, 2010), http://www.nytimes.com/2010/04/26/us/26expat.html (last visited Sept. 21, 2012) (discussing the increase in renunciation in U.S. citizenship and citing frustration with recent tax and banking regulation as the primary cause) (on file with the Washington and Lee

Renunciation of citizenship, however, comes at a price.[106] Individuals are not relieved of their existing tax liabilities and are required to file back taxes and pay any penalties owed. Furthermore, an exit tax is imposed on individuals with an annual income of approximately $150,000 or a net worth of at least $2 million.[107] Thus, renunciation only serves as a way for individuals to avoid U.S. reporting requirements and related penalties after the date of renunciation.

B. Conflict of Laws: Tax Treaties and Banking Secrecy

A second issue raised by FATCA is that it overrides any conflicting provisions contained in current income tax treaties.[108] The United States' policy concerning treaty override provides that "the treaty is superior if it is implemented after a law, but the law is superior if it is implemented after the treaty."[109] FATCA requires greater information reporting than current tax treaties.[110] If an FFI does not comply, FATCA imposes a 30% withholding tax regardless of reduced withholding rates under a governing treaty.[111] To obtain preferential rates under a treaty, taxpayers must rely on a refund mechanism.[112] Despite the

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Law Review).

106. The Department of State currently imposes a $450 fee for renunciation. *Id.*

107. I.R.C. § 877(a)(2) (2006). All property of an individual subject to these provisions is treated as sold on the day before expatriation for its fair market value and any gain or loss on such sale is recognized for the taxable year. *Id.* § 877A(a).

108. *See FATCA Hearing*, *supra* note 10, at 62 ("Treaty overrides adversely affect the treaty-making process and historically have been avoided unless essential to the ends sought by the legislation.").

109. Reuven S. Avi-Yonah, *Double Tax Treaties: An Introduction*, *in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT 105 (Karl P. Sauvant & Lisa E. Sachs eds., 2009). This is generally referred to as the "later in time" rule. *See* Whitney v. Robertson, 124 U.S. 190, 194 (1888) (stating that if a treaty and congressional law conflict, the treaty dated more recently controls).

110. *Compare supra* note 89 and accompanying text (detailing FATCA reporting requirements), *with supra* notes 42–46 and accompanying text (explaining the U.S. Model Treaty provisions regarding information exchange).

111. I.R.C. § 1471(a) (2006).

112. This practice is largely consistent with existing refund mechanisms

possibility of a refund, the taxpayer is not necessarily held harmless, as no interest will be paid on the refund amount where an FFI is the beneficial owner of the payment.[113]

Bank secrecy laws raise another issue of FATCA enforcement.[114] Because many countries forbid banks or companies to transfer client information directly to a foreign government, FFIs in those countries that serve U.S. citizens will have no choice but to be withheld upon.[115] Some view FATCA's conflict with bilateral agreements and foreign laws as U.S. legislative overreach and an imposition on national sovereignty.[116]

C. Costs and Administrative Burden on FFIs

Another concern with FATCA's requirements is the resulting burden on FFIs. First, banks face potentially high compliance costs related to new technology and staffing.[117] The Institute of International Bankers estimates that major global banks may

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under Section 1445(c)(1)(c). *See id.* § 1474(b)(1) (stating that, subject to certain exceptions, determination of whether a withholding resulted in overpayment shall be made as if the tax had been deducted and withheld under Chapter 3 of the Code). It is unclear whether FATCA withholding may be reduced to the level specified in a particular treaty if the withholding agent receives a beneficial owner withholding certificate (W-8BEN), as allowed under preexisting law. Treas. Reg. 1.1441–(6)(b).

113. I.R.C. § 1474(b)(2)(A)(i)(II) (2006).

114. *See* David Jolly & Brian Knowlton, *Law to Find Tax Evaders Denounced*, N.Y. TIMES, Dec. 27, 2011, at 1 ("Enforcement of the law will be tricky, as many countries . . . forbid banks or companies to transfer such information directly to a foreign government.") (quoting Jeffrey Owens, tax expert at the Organization for Economic Cooperation and Development).

115. *Id.*

116. *See* Scott D. Michel & H. David Rosenbloom, *FATCA and Foreign Bank Accounts: Has the U.S. Overreached?*, TAX ANALYSTS 709, 711 (2011), *available at* http://www.capdale.com/files/4178_FATCA%20Article.pdf ("In an era of delicately negotiated tax treaties and information exchange agreements between the United States and other nations, FATCA is seen as overreaching.").

117. John Greenwood, *TD Resists U.S. Plan to Catch Tax Cheats*, FINANCIAL POST (Apr. 26, 2011, 12:24 PM), http://business.financialpost.com/2011/04/26/td-opposes-u-s-plan-to-catch-tax-cheats/ (last visited Sept. 21, 2012) (noting that Toronto-Dominion Bank is resisting the regulation because it would cause the bank to incur $100 million in compliance costs) (on file with the Washington and Lee Law Review).

spend over $250 million to comply with the regulation,[118] while some businesses fear the annual costs will be in the billions.[119] Additionally, the reporting requirements create an administrative burden and raise efficiency concerns.[120] Ultimately, FATCA forces foreign institutions to bear the costs of tracking down U.S. tax evaders.[121]

D. Detriment to U.S. Investments

Due to FATCA's strategic design, the only way a foreign entity can avoid the reach of these provisions is by not investing in the United States.[122] Simply refusing to accept U.S. persons as account holders will not relieve a foreign entity from being subject to the FATCA provisions because it is the payment of U.S. source income that triggers its application.[123] Thus, the desire to avoid costs associated with compliance may discourage U.S. investments.[124] Alternatively, FFIs that choose to comply might shift compliance costs to U.S. investors.[125]

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118. *Id. But see A Temperature Check: Who's Ready for FATCA?,* RBC Dexia Investor Services 8 (2011) (reporting that 85% of respondents estimate costs at $1 million or less, with the majority (54%) expecting to spend less than $100,000).

119. *See* Jolly & Knowlton, *supra* note 114 ("FATCA . . . is now causing alarm among businesses outside the United States that fear they will have to spend billions of dollars a year to meet the greatly increased reporting burdens.").

120. *See Hearing on Banking Secrecy*, *supra* note 8, at 31 (statement of Peter H. Blessing, Partner, Shearman & Sterling) (noting that "there is a real economic efficiency cost to reporting requirements").

121. *See* Jolly & Knowlton, *supra*, note 114 ("[Foreign] entities are being asked, in effect, to pay for the cost of tracking down American tax evaders.").

122. Tello, *supra* note 9, at 3.

123. *Id.*

124. *See Comment: FATCA Could Well Cause Managers to Turn Their Back on the US*, HEDGEWEEK (May 9, 2011), http://www.hedgeweek.com/2011/09/05/130115/comment-fatca-could-well-cause-managers-turn-their-backs-us (last visited Sept. 21, 2012) (predicting foreign managers and investors will choose not to maintain U.S. assets) (on file with the Washington and Lee Law Review); *see also FATCA Hearing*, *supra* note 10, at 30 (citing concerns that the real cost of U.S. investment will increase significantly for non-U.S. investors); *id.* at 70 (noting that, as a result of FATCA, several FFIs are refusing to invest in American securities).

125. Bloomfield & Shamrakov, *supra* note 75, at 6.

E. Lack of Adequate Taxpayer Services

Finally, FATCA introduces additional complexity into an already highly complex system of international taxation.[126] Although the IRS claimed improvements to taxpayer service as its top strategic goal in 2008, there has been a shift in focus from taxpayer service to international law enforcement.[127] In her 2011 annual report to Congress, National Taxpayer Advocate Nina Olson expressed concern that "[t]he lack of efficient IRS-wide coordination of international taxpayer service may undermine the international enforcement initiatives and discourage future compliance by taxpayers dealing with the complexity and procedural burden of the international tax rules."[128]

V. International Collaboration Is Essential to FATCA Implementation

A. International Issues Require an International Solution

Because FATCA specifically targets foreign sources of information, international collaboration and compromise is essential to its successful implementation.[129] The development of a multilateral agreement could mitigate the potential unintended consequences of FATCA in several key ways.[130] First, international agreement would reduce the practical effect of treaty override and conflict with foreign law.[131] Further, the existence of a multilateral information exchange regime may

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126. *See* TAXPAYER ADVOCATE SERV., *supra* note 23, at 32–33 (explaining that the "complexity and administrative detail of the international reporting requirements are overwhelming").

127. *See id.* at 177 (detailing the IRS's organizational shift away from taxpayer service and toward enforcement).

128. *Id.* at 176.

129. *See FATCA Hearing*, *supra* note 10, at 10 (noting that international cooperation and coordination is key to FATCA's success) (statement of William J. Wilkins); *id.* at 59 ("A multi-lateral agreement on the sharing of taxpayer financial information would better serve the enforcement objectives of FATCA without [the] unintended consequences.") (statement of Dirk Suringa, Covington & Burlington LLP).

130. *Id.* at 62.

131. *Id.*

justify placing higher regulatory burdens on FFIs, as it would benefit more than one country. Similarly, developing international standards for cross-border information reporting would improve efficiency and lower compliance burdens on FFIs.[132] International agreement would also prevent governments from adopting a reciprocal withholding tax or conflicting reporting measures.[133] Finally, the more jurisdictions that participate in a multilateral automatic information exchange agreement, the less of an incentive FFIs and foreign investors would have to divest from the United States.[134]

B. Other Countries Are Willing to Collaborate

Because tax evasion is a global problem,[135] information exchange is of great interest to foreign tax authorities.[136] "Since April 2009, a growing number of governments and NGOs have called for the automatic exchange of tax information."[137] In recent years both the EU and the OECD developed proposals for multilateral automatic information reporting.[138] This trend evidences an acknowledgement that collaboration is essential in the fight against offshore tax evasion[139] and a willingness to participate in a multilateral automatic information reporting regime.

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132. Lack of international standards presents the possibility that FFIs will be subject to a variety of conflicting regulations from different countries.

133. *See FATCA Hearing*, *supra* note 10, at 61.

134. *Id.*

135. Doug Saunders, *We Need a Global Army of Tax Collectors*, GLOBE AND MAIL (Oct. 15, 2011, 2:00 AM), http://www.theglobeandmail.com/news/opinions/opinion/we-need-a-global-army-of-tax-collectors/article2201647/ (last visited Sept. 21, 2012) ("The non-payment of tax has become a chronic problem around the world.") (on file with the Washington and Lee Law Review); Jolly & Knowlton, *supra* note 114.

136. *Hearing on Banking* Secrecy, *supra* note 8, at 38 (statement of Peter H. Blessing, Partner, Shearman & Sterling) ("The information exchange process is of great interest to U.S. tax authorities, but for similar reasons it is of great interest to many foreign tax authorities.").

137. Grinberg, *supra* note 51, at 3 (citations omitted).

138. *See id.* at 17–23 (describing the current OECD and EU approaches to cross-border information reporting).

139. *Hearing on Banking Secrecy*, *supra* note 8, at 9 (statement of Doug Shulman, Comm'r, Internal Revenue Serv.).

C. Toward an Intergovernmental Approach

The United States took the first step toward international cooperation in February 2012.[140] In addition to releasing the proposed FATCA regulations,[141] the Treasury Department issued a Joint Statement[142] with France, Germany, Italy, Spain, and the United Kingdom announcing the desire to cooperate in an intergovernmental approach to improving international tax compliance and implementing FATCA.[143] Notably, the United States expressed its intent to reciprocate in collecting and exchanging information on accounts held in U.S. financial institutions by residents of FATCA partner countries.[144] The intergovernmental approach would address "legal impediments to compliance, simplify practical implementation, and reduce FFI costs."[145] International collaboration, therefore, "would enhance compliance and facilitate enforcement to the benefit of all parties."[146]

The joint statement proposes a bifurcated routing approach,[147] one for FATCA partners and another for non-partner nations. FFIs established in a FATCA partner nation would report information to that country.[148] This system ensures that

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140. Regulations Relating to Information Reporting by Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities, 77 Fed. Reg. 9,022, 9,023 (proposed Feb. 15, 2012) ("[C]onsistent with the policies underlying [FATCA], the Treasury Department and the IRS remain committed to working cooperatively with foreign jurisdictions on multilateral efforts to improve transparency and information exchange on a global basis.").

141. *Id.*

142. U.S. Treas. Dep't Press Release, 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. 8, 2012) [hereinafter Joint Statement].

143. *Id.*

144. *Id.* at A.5.

145. *Id.* at A.3.

146. *Id.*

147. Routing addresses how FFIs must route information to residence country governments. Grinberg, *supra* note 51, at 17.

148. Joint Statement, *supra* note 142, at B.2.b. This routing system is similar the EU Savings Directive approach. Grinberg, *supra* note 51, at 18–21 (describing the EU approach for automatic information reporting).

FFIs in cooperative jurisdictions need only send information to one government, under whose laws they already operate, avoiding the possibility of FFIs attempting to comply with different reporting obligations to dozens of governments.[149] "Reporting by financial institutions to the government of the jurisdiction in which they reside, followed by government-to-government exchange . . . conforms most closely to current global understandings regarding first-instance sovereign access to banking information."[150] This system avoids the conflict of laws issues associated with financial institutions reporting directly to foreign sovereigns.[151]

Compliant FFIs in non-partner countries, however, are required to report directly to the IRS under the original FATCA model.[152] This routing method allows financial institutions that wish to participate to do so regardless of their government's policy decisions.[153] It also pressures non-participating jurisdictions to cooperate.[154] Thus, the proposed intergovernmental approach's bifurcated routing method incentivizes cooperation, reduces reporting burdens for FFIs, and mitigates sovereignty concerns.

The Joint Statement also expresses a commitment "to working with other FATCA partners, the OECD, and where appropriate the EU, on . . . the development of reporting and due diligence standards." Development of uniform standards for reporting and due diligence would mitigate the burden on FFIs and streamline the process of automatic information reporting.[155]

The proposed intergovernmental approach is a step in the right direction, as it addresses many of the concerns associated

149. Grinberg, *supra* note 51, at 57.

150. *Id.*

151. *Id.*; *see also supra* Part IV.B (discussing conflict of laws issues associated with FATCA's unilateral approach).

152. *See supra* Part III.B.2 (discussing FATCA reporting requirements).

153. Grinberg, *supra* note 51, at 57.

154. *Id.*

155. *See FATCA Hearing*, *supra* note 10, at 17 ("It is fundamentally important to achieve consistent standards of transparency that support compliance without overly burdening the efficiency of cross border portfolio investment flows.") (statement of William J. Wilkins, Chief Counsel, Internal Revenue Serv.).

with FATCA while preserving the goal of the legislation. In addition to the five countries represented in the Joint Statement, others have expressed interest in participating.[156] Broader participation would improve effectiveness of a multilateral automatic information reporting system and increase pressure on resisting jurisdictions.[157] Eventually, noncompliance may become unsustainable.[158]

D. Room for Compromise: Citizenship-Based Taxation

Despite its commitment to a collaborative FATCA regime, the proposed intergovernmental approach ignores a significant underlying inconsistency: basis for taxation. Whereas most countries impose taxes on resident and source income, the United States also taxes nonresident citizens. This inconsistency provides an opportunity to reevaluate the policy of taxation based solely on citizenship[159] and, this Note argues, to terminate it.

First, strong non-FATCA based arguments exist in favor of eliminating citizenship-based taxation.[160] The United States is the only country in the world to base worldwide taxation solely on citizenship.[161] This policy dates back to the Civil War,[162] and is

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156. *See* FT Advisor, *Ireland and Luxembourg Support European FATCA Deal* (Feb. 17, 2012), http://www.ftadviser.com/2012/02/17/investments/offshore-funds/ireland-and-luxembourg-support-european-fatca-deal-Aal0cGugxkfNiHJYb1ql0H/article.html (last visited Sept. 21, 2012) (noting that Ireland and Luxembourg have come out in support of the Joint Statement) (on file with the Washington and Lee Law Review).

157. Grinberg, *supra* note 51, at 61.

158. *Id.*

159. *See id.* at 58 n.205 ("An eventual multilateral system would be unlikely to retain FATCA's concern with citizenship in addition to residence.").

160. *See* Reuven S. Avi-Yonah, *The Case Against Taxing Citizens* 2 (Pub. Law & Legal Theory Working Paper Series, Working Paper No. 190, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1578272 (arguing that "citizenship-based taxation is an anomaly that should be abandoned"); *see also* Cynthia Blum & Paula N. Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 VAND. J. TRANSNAT'L L. 705, 711 (2008) (arguing against citizenship-based taxation on administrability grounds).

161. *Id.* at 1. "Etitrea is sometimes mentioned as another one, but it is unclear that it actually taxes nonresident citizens." *Id.*

162. Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L.

protected via a "saving clause" in U.S. income tax treaties.[163] Historic U.S. justifications for taxing nonresident citizens, including deterring draft-dodging and flight of wealthy Americans, no longer apply.[164] Similarly, arguments in favor of taxing these individuals are weak,[165] especially in light of existing alternative bases for taxation.[166]

Second, FATCA imposes substantial burdens on U.S. citizens living abroad in the form of complex reporting requirements[167] and, in some circumstances, barriers to obtaining a foreign bank account, insurance, or pension.[168] Under FATCA, FBAR, and other existing reporting requirements, inadvertent noncompliance may result in steep civil and criminal penalties that are often disproportionately high in comparison to the amount of tax involved.[169] Abandoning taxation of nonresident citizens could lead to significant simplification and reduction of administrative costs, which likely exceeds the revenue collected solely on the basis of citizenship.[170]

Third, elimination of citizenship-based taxation would not impair FATCA's goals of tracking down tax evaders and raising revenue. FATCA was designed to fight offshore tax evasion by "bad actors" whose primary reason for establishing and maintaining unreported overseas accounts was to hide income

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REV. 443, 449 (2007).

163. *See* U.S. Model Treaty, *supra* note 41, Art. 1 para. 4. ("[T]his convention shall not affect the taxation by a Contracting State of its residents . . . and its citizens.").

164. *See* Avi-Yonah, *supra* note 160, at 1–2 (noting that this rule was created at a time when the income tax applied only to the rich and when some of the rich moved overseas to avoid the draft).

165. *See id.* at 6–10 (addressing the benefits, ability-to-pay, and administrability justifications for citizenship-based taxation).

166. The United States also imposes income tax on residents and U.S. source income.

167. *See supra* notes 79–80 and accompanying text (discussing FATCA reporting requirements); *see also* TAXPAYER ADVOCATE SERV., *supra* note 23, at 132 (discussing the overwhelming complexity and administrative detail of international reporting requirements).

168. *Supra* notes 103–04 and accompanying text.

169. *See* TAXPAYER ADVOCATE SERV., *supra* note 23, at 133–34 (listing potentially applicable civil and criminal penalties relating to individual U.S. taxpayers with foreign assets).

170. Avi-Yonah, *supra* note 160, at 8.

and avoid paying U.S. taxes they legally owe.[171] In contrast, the estimated five to seven million[172] U.S. citizens living abroad generally fall into a category of "benign actors"[173] whose primary reasons for establishing and maintaining overseas accounts are unrelated to tax. Nonresident citizens include a wide range of individuals, from those who choose or are assigned to live overseas due to the opportunities of globalization to "accidental citizens" who were merely born in America and left the country at a young age.[174] The average nonresident citizen holds foreign assets, including bank accounts, retirement funds, insurance plans, and investments, that are necessary for living and working in his country of residence. Similarly, due to international income exclusions and credits, citizens living abroad have, at most, a *de minimis* tax liability.[175] Despite this inconsistency, FATCA poses serious problems for U.S. citizens living abroad.[176]

Finally, termination of citizenship-based taxation would facilitate an intergovernmental approach to automatic information reporting.[177] Requiring financial institutions to identify both a taxpayer's residence and citizenship, as is currently the case, doubles the amount of work required for compliance with FATCA. Unlike other FATCA requirements under the intergovernmental approach, identifying a taxpayer's citizenship would only benefit the United States.[178] Conversely, the ability to apply a single standard for identifying taxpayers

171. *See supra* Part II.A (discussing FATCA's goals); *see also* TAXPAYER ADVOCATE SERV., *supra* note 23, at 194 (noting that international information reporting penalties, FBAR, and FATCA are designed to combat deliberate offshore tax evasion).

172. *See* TAXPAYER ADVOCATE SERV., *supra* note 23, at 192 n.7 (citing estimates that the number of U.S. citizens residing abroad is between five to seven million, not including U.S. troops).

173. *See id.* at 194 (listing examples of "benign actors").

174. Avi-Yonah, *supra* note 160, at 5.

175. *See* TAXPAYER ADVOCATE SERV., *supra* note 23, at 194 n.16 (noting that, in the 2009 tax year, only about 9% of international taxpayers had a U.S. tax liability after claiming the foreign earned income exclusion and applying the foreign tax credit).

176. *See supra* Part III.A (discussing the implications of FATCA for American citizens living abroad).

177. *Supra* note 159 and accompanying text.

178. *See supra* note 161 and accompanying text (noting that the United States is the only country that uses citizenship as a basis for taxation).

based on residence would improve efficiency and reduce the burden on financial institutions to the benefit of all FATCA partners. Further, this compromise may induce other countries to participate in the proposed intergovernmental approach. This may be especially true of countries, like Canada, that are home to a significant number of U.S. citizens.[179]

In sum, taxation of nonresident citizens is inconsistent with global norms, creates administrative inefficiencies, and impairs development of a multilateral FATCA regime. For these reasons, the United States should abandon the policy of citizenship-based taxation.

VI. Conclusion

Since its enactment, strong criticisms have been raised about FATCA's approach to international tax enforcement and its potential unintended consequences. In response, the U.S. government has expressed a willingness to adopt an intergovernmental approach to FATCA implementation. This Note argues that the type of international collaboration envisioned in the Joint Statement is essential to successful FATCA implementation. It also asserts that a multilateral automatic information reporting regime supports the policy goals of FATCA and mitigates the concerns associated with a unilateral approach. Finally, this Note argues that the United States should abandon its policy of citizenship-based taxation in order to facilitate a multilateral automatic information reporting regime.

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179. Barrie McKenna, *U.S. Eases Move on Offshore Tax Crackdown*, GLOBE AND MAIL (Feb. 8, 2011, 7:34 PM), http://www.theglobeandmail.com/report-on-business/international-business/us-business/us-eases-move-on-offshore-tax-crackdown/article4202478/ (last visited Sept. 23, 2012) (discussing Canada's conspicuous absence from the joint statement and noting that Canada is home to roughly one million U.S. citizens) (on file with the Washington and Lee Law Review).