
TAX HAVENS AND THE TRANSPARENCY WAVE OF INTERNATIONAL TAX LEGALIZATION

ROBERT T. KUDRLE*

ABSTRACT

Tax havens have posed an increasingly important challenge to the world economy, yet they receive little attention in the international economic law and policy literature. This relative neglect springs largely from taxation's tangential connection with the major structures of international economic governance. But a highly developed treaty regime has been in place for decades. The first wave of legalization aimed at relief from double taxation grew from an influential template for bilateral tax treaties promulgated by the League of Nations and the OECD. Developments outside that regime, particularly the growth of tax havens, generated the need for a second wave that began with a 1998 OECD report proposing cooperative action to combat both tax avoidance and evasion. Since that time, and particularly since the global financial crisis, this second transparency wave has developed beyond anyone's forecast. Although little can be done to prevent the competition-driven erosion of the tax itself, the OECD at the behest of the G-20 is now coordinating efforts to reduce the role of tax havens in corporate tax avoidance through greater cooperative action. The U.S., the OECD and the G20 are also jointly fashioning cooperation to decrease tax evasion. These efforts will likely succeed and will re-

* Orville and Jane Freeman Professor of International Trade and Investment Policy

Hubert Humphrey School of Public Affairs and the Law School
University of Minnesota
301 19th Avenue South
Minneapolis, MN

duce the role of the traditional tax haven very substantially.

1. INTRODUCTION

Tax havens have posed a large and growing challenge to international economic law and policy for decades, yet this issue has been missed by most legal and economic literature, probably because both problems and solutions have evolved outside of the major global governance institutions until quite recently. Interwar discussions about an appropriate means of relieving double-taxation led to a highly influential League of Nations and later OECD Model Treaty. This was the first wave of international legalization. But this "relief wave" of bilateral agreements proved wholly inadequate to confront the growing threat of tax havens, which are jurisdictions that essentially sell their legal discretion to abet tax avoidance and evasion in other states. Attention increased sharply after the publication of OECD's *Harmful Tax Competition* study of 1998 and has gained great momentum since the international financial crisis. This more recent activity has resulted in a sea change in legalized cooperation on the collection and sharing of information that can be called the "transparency wave".

The several dozen jurisdictions widely regarded as tax havens pose two rather distinct challenges, despite their frequent conflation in political rhetoric. Tax havens facilitate tax avoidance and they are complicit in tax evasion. The distinction is important because two different fiscal nets are involved; one aimed at corporate taxation and the other at personal taxation. Progress is now being made on both fronts at a rate that was unthinkable only a few years ago. Nevertheless, although the tax haven corporate role may shrink substantially with the development of greater cooperation, the competitive erosion of corporate income tax rates will continue. Consequently, there will be no equilibrium. However, the emerging cooperative legal regime aimed at decreasing tax evasion will likely succeed among developed countries and part of the developing world. This implies both a diminution in funds now passing through the tax havens and a large decrease in the total amount of tax evasion.

2. THE TAX HAVEN PROBLEM

International trade in goods and services generally rests on comparative advantage, economies of scale or unique products. Tellingly, most of the tax haven literature pays scant attention to any real advantages of those jurisdictions.¹ What this essay will call “pure” tax havens have imported (in real time) the lion’s share of the financial expertise controlling the activity booked there (e.g. the British Virgin Islands and the Cayman Islands). Haven success has rested almost entirely on zero or very low income tax rates supported by a trustworthy local institutional structure that shields financial activity from the eyes of foreign authorities and allows the untaxed funds involved to be redeployed in the global economy. Other recognized tax havens have offered some combination of substantial local expertise, a more complex economy, and higher tax rates; they will be referred to as “mixed” tax havens (e.g. Ireland and Switzerland). But, in addition to the pure and mixed havens,² many additional jurisdictions, most notably the United States, permit or encourage various tax haven elements. The absolute versus relative importance of various kinds of financial activity involving foreigners is what produces ambiguity in the use of “tax haven.” It can flag either pure and mixed tax havens or a broader set of jurisdictions that facilitate the avoidance or evasion of tax and related obligations elsewhere by tolerating or facilitating an otherwise redundant jurisdictional layer between investors and the final use of funds.

¹ An early work on the problem from a U.S. perspective is: Richard A. Gordon, *Tax Havens and Their Use By United States Taxpayers*, A Report to the Commissioner of Internal Revenue the Assistant Attorney General (Tax Division) and the Assistant Secretary of the Treasury (Tax Policy), 12 Jan., 1981 [<https://perma.cc/3CMS-43CY>].

² For a representative list of tax havens, see Jane G. Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, Congressional Research Service, 2013, available at <https://www.fas.org/sgp/crs/misc/R40623.pdf> (last visited 20 June 2014) [<https://perma.cc/9AZ5-67RL>].

2.1. *The Bounds of Legitimate National Policy*

Tax havens are widely seen as “poachers” of the tax base of other states, but how should lines be drawn? Specifically, what is unacceptable tax behavior by a state³ with respect to financial or real economic activity involving foreigners? Two extreme positions have failed to gain traction in most international policy discussions. One sees all tax or regulatory attraction of activity from one state to another as a negative element of globalization that should be countered.⁴ The opposite stance defends the mobility permitted by globalization as a welcome escape from “Leviathan” that should be encouraged.⁵ Implicitly rejecting both of these positions, the OECD suggested indicia of offense in its 1998 Report, *Harmful Tax Competition*⁶, which discusses: low or zero taxation combined with a lack of transparency in the operation of the tax regime⁷; a failure to collect and share information on investors; and either insubstantial domestic activity or “ring fencing,” defined as the application of different rules to foreigners than to residents.

³ This article will often employ the term “state” instead of “jurisdiction,” for brevity, but the policies of many of the most important tax havens are ultimately controlled from London.

⁴ See generally, Nicholas Shaxson, *TREASURE ISLANDS: TAX HAVENS AND THE MEN WHO STOLE THE WORLD* (2011).

⁵ See generally, Robert E. Litan & William A. Niskanen, *GOING DIGITAL! A GUIDE TO POLICY IN THE DIGITAL AGE* (1998).

⁶ See generally, OECD, *HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE* (1998), www.oecd.org/tax/transparency/44430243.pdf [<https://perma.cc/HJY4-EC88>][OECD, *HARMFUL TAX COMPETITION*].

⁷ The term “regime” abounds in taxation literature. It usually refers to a set of prevailing laws, policies, and practices within a jurisdiction, and that is one way the term will be used in this paper. This definition must be distinguished from the more technical meaning of “principles, norms, rules and decision-making procedures” in international relations. Steven D. Krasner, *Structural Causes and Regime Consequences: Regimes as Intervening Variables*, 36 INT’L ORG. 185, 185 (1982). In terms of the second usage, the main argument of this article is straightforward: the principle of transparency was grafted onto the original concern about overlapping taxation in several steps, beginning at about the turn of the twenty-first century. For reasons that are developed below, I do not accept Avi-Yonah’s claim that the enduring principle of the international tax regime is that “income from cross-border transactions should be subject to tax once (that is, not more but also not less than once), at the rate determined by the benefits principle.” Reuven S. Avi-Yonah, *Tax Competition, Tax Arbitrage, and the International Tax Regime*, U. MICH. LAW AND ECON. Working Paper No. 07-001; U. MICH. PUB. LAW Working Paper No. 73, 2007 available at <http://ssrn.com/abstract=955921> or <http://dx.doi.org/10.2139/ssrn.955921> (last visited 25 June 2014) [<https://perma.cc/PM57-58RC>].

Opacity about the identity of investors in the regime mainly serves to promote tax evasion, a crime in most countries⁸, while insubstantial activity contributes mainly to the legal avoidance of taxes. The legitimacy of setting non-discriminatory tax rates at any level chosen nationally was explicitly affirmed.⁹ Low taxes alone do not constitute grounds for foreign complaint.

2.2. *The Policy Window*

After the financial crisis, both the highly publicized episodes of tax evasion abetted by major banks and the low effective tax rates of many Multinational Corporations (“MNCs”) have generated more demand for government action since 2008 than ever before. Several major legal initiatives are now underway. The current situation can be considered with Kingdon’s classic conditions for U.S. policy change: the confluence of a perceived problem, a set of developed policy remedies, and a political configuration conducive to action.¹⁰

The use of tax havens as a dodge by both individuals and corporations has unprecedented visibility in many countries. Moreover, the political climate is ripe as politicians on both the left and right have declared the use of tax havens to be illegitimate and are determined to act. However, Kingdon’s third condition, finding an appropriate corrective policy, appears much more clearly defined and accepted for evasion than avoidance. Moreover, Kingdon, whose work rests on the unique dynamics of the U.S. political system, stresses the transitory nature of the “policy window” that opens only when all three conditions favorably align – and then often abruptly closes for an indeterminate period. Special attention to the U.S. political system seems appropriate, despite its differences from almost all others, because the U.S. remains by far the

⁸ The seriousness of tax crimes varies by jurisdiction. Switzerland brought its laws pertaining to foreign, but not domestic, tax evasion into closer conformity with international standards in 2009. Swiss Federal Department of Finance, *Switzerland to Adopt OECD Standard on Administrative Assistance in Fiscal Matters*, <http://www.efd.admin.ch/00468/index.html?lang=en&msg-id=25863> (last visited 15 June 2014) [<https://perma.cc/KQD6-C356>].

⁹ OECD, HARMFUL TAX COMPETITION *supra* note 6 and accompanying text, at 16.

¹⁰ See generally John W. Kingdon, AGENDAS, ALTERNATIVES, AND PUBLIC POLICIES (1984).

most important single actor for the issues discussed here, notwithstanding its decline in overall relative power.

3. THE ORIGINS OF THE LEGAL FRAMEWORK FOR THE FIRST WAVE OF COOPERATIVE TAXATION OF FOREIGN EARNINGS: RELIEF FROM OVERLAPPING TAXATION

The taxation of foreign earnings emerged as a serious policy issue early in the twentieth century as both corporate and personal income taxes came into widespread use. Elite belief held that such taxes should not cripple international capital (and some labor service) flows. This rested on a conviction that international commerce related to capital flows resembled international trade in goods: that the invisible hand generally produced mutually beneficial outcomes.¹¹ The U.S. pioneered attention to the issue by its crediting of foreign income taxes paid – on all kinds of investments as well as earned income abroad – against U.S. tax liabilities in 1918.¹² Prior to that time foreign income taxes were typically recognized only as a deductible expense. The U.S. lead was followed by other states, and the avoidance of “double taxation”¹³ was embodied in the League of Nations model tax treaty of 1928.¹⁴ This model treaty in turn was only slightly modified by the OECD¹⁵ in the post war decades to become the foundation of a web of over 3000 bilateral treaties today. Nearly all treaties allow for collaborative scrutiny of taxpayer claims by tax authorities and often to

¹¹ Michael J. Graetz & Michael M. O’Hear, *The “Original Intent” of U.S. International Taxation*, 46 DUKE L. J. 1021, 1043 (1997).

¹² *Id.* at 1043-59. See also Revenue Act of 1918, ch.18. §§ 222(a)(1), 238(a), 240(c), 40 Stat. 1057, 1073, 1080-82 (1919). The crediting was limited to the total of foreign taxes due in 1921. Revenue Act of 1921, ch. 136 §§ 222(a)(5), 238(a), 42 Stat. 227, 249, 258.

¹³ The term will be used, although it is misleading. Corporate income is double taxed *within* most states (at the corporate and individual levels), so crediting and exempting actually limit *triple* taxation. Single taxation is seldom achieved because few national systems pair corporate income taxation with complete shareholder relief.

¹⁴ League of Nations, Report Presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion, Doc. C.562 M.178 1928 II (1928) [<https://perma.cc/9MTZ-5GX8>].

¹⁵ OECD, DRAFT CONVENTION ON DOUBLE TAXATION OF INCOME AND CAPITAL (1963).

greater overall taxation.¹⁶ Unsurprisingly, the pure tax havens have had few such treaties.

3.1. Global versus Territorial Taxation

Absent powerful considerations otherwise, states will want to collect revenue from all entities within their sphere of enforcement. So if a natural person resident in country A earns income in country B, A will want to tax its resident, and B will want to tax the activity that produced the income. If all income streams were taxed at the same rate but only once, net “lenders” would favor the residence (home) principle and net “borrowers” the source (host) principle.¹⁷ Even though the U.S. was moving into creditor status in the early twentieth century, the internationally influential American tax credit designer, T.S. Adams, saw two major arguments for the source principle. First, nothing could prevent source countries from taxing local activity to any extent they chose, so arguments in favor of a pure residence principle to countries with scant foreign assets relative to foreign activity in their territory amounted to whistling in the wind. Second, the benefit principle of taxation suggested that the social framework—the legal, administrative, and physical infrastructure—for successful operation by foreign firms justified source taxation, although this argument has always remained abstract and unconnected with actual costs and benefits. In contrast, portfolio investment by foreigners, either through debt or equity, mapped much less clearly to any specific foreign government resource use. Hence, what legal scholars have characterized as the “1920s compromise” developed: direct investment was to be primarily taxed at source, while income flows from non-controlling investment were to be less heavily taxed at source with

¹⁶ Moreover, it is difficult to discern an impact of such treaties on overall investment because states have strong incentives to engage in unilateral or informally cooperative measures to avoid double taxation. See Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U. J. INT’L L. & POL. 939 (2000) (arguing that tax treaties are not necessary for preventing double taxation, and in fact actually facilitate collaboration on tax avoidance); R.B. Davies, *Tax Treaties, Renegotiations, and Foreign Direct Investment*, 33(2) ECON. ANALYSIS & POL. 251 (2003) (showing empirically that tax treaties do not increase foreign direct investment, contrary to popular thought.).

¹⁷ The terms are in parentheses because direct investment is ownership, not lending, and hosting is not borrowing; direct investment became an increasingly large part of total income flows over time.

most taxation levied by the residence country.¹⁸ The presumption was that source taxation of multinational profits served international business interests by affirming the appropriateness of considerable host country taxation at the home country's expense. This goes a long way towards explaining why the United Nations model treaty, first presented in 1980¹⁹, bears a strong resemblance to that developed by the high income countries in the League and the OECD.

Home (residence) countries have adopted two major approaches to corporate taxation of foreign earnings. Most states allow residual foreign profits to go untaxed at the corporate level at home, while crediting states offset foreign corporate tax payments against what would be home country tax liability.²⁰ However, the distinction between these two approaches is blurred in actual policy. Exemption systems typically involve exceptions for foreign corporate earnings deemed to be too lightly taxed abroad,²¹ while the principal remaining crediting country, the United States, allows the payment of tax due on foreign subsidiary earnings to be deferred until dividends are repatriated so long as those funds are deployed in active business abroad. Because such deferral essentially functions as an indefinite interest-free loan from the U.S. Treasury, abuse is inevitable. Conviction that such abuse is both rampant and increasing lies at the heart of much current U.S. dissatisfaction with its international corporate tax policy.

The acceptance of the model treaty as a baseline for bilateral

¹⁸ For largely complementary accounts, which nonetheless differ in important respects, compare Graetz & O'Hear, *supra* note 11, with Reuven S. Avi-Yonah, *All of a Piece Throughout: The Four Ages of U.S. International Taxation*, 25(2) VA. TAX REV. 313 (2005).

¹⁹ U.N. DEP'T OF INT'L ECON. & SOC. AFFAIRS, U.N. MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES, U.N. Doc ST/ESA/102, U.N. Sales No. E.80.XVI.3 (1980). The most recent revision is 2011. The UN model is somewhat more favorable to host countries.

²⁰ The U.S. approach differs from that of most other states, not just in the treatment of corporate income taxation, but also in the taxation of personal income. It uses a model treaty of its own for bilateral bargaining that reflects its uniquely comprehensive approach to taxing the income of residents and citizens while otherwise following the OECD quite closely. U.S. Department of the Treasury, 'Model Income Tax Treaty of 17 May 1977.' Reprinted in 1Tax Treaties (CCH) 153 (1978), 31 Bull. Int'l Fiscal Doc. 313 (1977).

²¹ K. S. Markle & L. D. Robinson, *Tax Haven Use across International Tax Regimes* (2012), <http://faculty.tuck.dartmouth.edu/images/uploads/faculty/leslie-robinson/marklerobinson.pdf> (last visited 20 June 2014) [<https://perma.cc/ZH48-XDF7>].

bargains avoided much redundant negotiation activity and signaled a willingness by host countries to engage with commercial partners on terms largely similar to prevailing practice.²² Also, in addition to the Model Treaty itself, there was an accompanying commentary that expanded on the meaning of its provisions and allowed individual members to express observations and reservations. In 1992, the American Law Institute noted that the OECD's model "has almost acquired the status of a multilateral instrument" due to its dominant role in determining the content of bilateral agreements and influencing their subsequent interpretation by domestic courts.²³

3.2. A Problematic Tax

Unlike the personal income tax, the corporate tax itself rests on no clear normative foundation,²⁴ and its limitations, even in a closed economy, have long been apparent. All corporate earnings are taxed, not just abnormally high returns; one segment of business is taxed arbitrarily relative to the rest with an inefficient impact on final product prices; and, over time, some capital shifts to the less highly taxed sector, driving down returns there. Globalization raised the specter of a far worse outcome: complete capital mobility implied that a national attempt to tax it at a higher rate than prevailing abroad would simply drive capital out until net returns rose to become internationally competitive again. This, in turn, would leave labor bereft, causing lower wages.²⁵ Leaving

²² Robert T. Kudrle, *European Resistance to U.S. Backsliding in the Attack on Tax Havens*, in Davis Bobrow (ed.), *HEGEMONY CONSTRAINED: EVASION, MODIFICATION, AND RESISTANCE TO AMERICAN FOREIGN POLICY* (2008).

²³ *AG of Can. v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 118, fn. 15 (2d Cir., 2001) (quoting *INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION II: UNITED STATES INCOME TAX TREATIES 3* (A.L.I. 1992)).

²⁴ Few have been persuaded by the occasional defense. For a recent attempt that stresses the tax's supposed limitation of corporate power, see generally Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90(5) VA. L. REV. 1193 (2002). For a response, see generally Yariv Brauner, *The Nonsense Tax, A Reply to New Corporate Tax Advocacy*, 2008 MICH. ST. L. REV. 591 (2008).

²⁵ The incidence of the corporate income tax remains highly contested. Some analysts find the relative burden falling on labor to be as low as 20 percent, Julie-Anne Cronin, Emily Y. Lin, Laura Power & Michael Cooper, *Distributing the Corporate Income Tax: Revised U.S. Treasury Methodology*, 66 NAT'L TAX J. 239 (2013), or less (Kimberly A. Clausing, *Who Pays the Corporate Tax in a Global Economy?*, 66 NAT'L TAX J. 151 (2013)). Another study estimates that labor's share of a marginal

distribution aside, the tax creates huge estimated allocative distortions.²⁶

3.3. *Real and Phantom Investment*

The simplest model of either credit or exemption by country A of earnings by its firms in country B ignores two issues that became increasingly important over time: the possible competitive tax advantages of firms genuinely based in a third country C, and the possibility that firms in country A could employ a subsidiary in a low-tax jurisdiction. This low-tax jurisdiction could be C, but is typically a jurisdiction without substantial real local activity - a tax haven, country D - to lower their host or home country tax bills.

Firms based in A can stand at a considerable disadvantage relative to otherwise similar multinational firms of other nationalities operating in B if effective residual taxation is higher. This simple international tax competition has so far defied international cooperation even within the EU where no minimum corporate tax rate has yet been accepted despite pressure from France and Germany.²⁷ Ireland's tax rate is 12.5 percent, and Bulgaria's is only 10 percent.

In addition to low tax rates, tax havens are marked by "insubstantial" activity, meaning the firm's location is largely or entirely just a legal claim. States have addressed the myriad tax haven threats to corporate tax revenues in various ways. While crediting systems aim at illegitimate deferral of tax partly by rules on the use of deferred funds in active business, exemption systems have sometimes employed blacklists of jurisdictions or filtered claims by tax rates or by types of income.²⁸

A closely related issue concerns claims of corporate headquarter locations. The discussion so far has treated "home" as an unproblematic combination of shareholders and firms, but matters

increase in the corporate tax lies within the range of 42 to 60 percent. Li Liu & Roseanne Altshuler, *Measuring the Burden of the Corporate Income Tax Under Imperfect Competition*, 66 NAT'L TAX J. 215 (2013).

²⁶ Dale W. Jorgenson & Kun-Young Yun, INVESTMENT - VOLUME 3: LIFTING THE BURDEN: TAX REFORM, THE COST OF CAPITAL AND U.S. ECONOMIC GROWTH (2001).

²⁷ Michael Webb, *Defining the Boundaries of Legitimate State Practice: Norms, Transnational Actors and the OECD's Project on Harmful Tax Competition*, 11(4) REV. INT'L POL. ECON., 787, 803 (2004).

²⁸ Markle & Robinson, *supra* note 21.

have seldom been so simple and have gained further complexity over time. While some countries define the site of corporate headquarters, and hence vulnerability for taxation, as the place of day to day management or corporate board meetings, the United States historically offered no guidance at all, resulting in a number of highly publicized “inversions” in the early twenty-first century, in which U.S. operations became a subsidiary and a previous subsidiary became firm headquarters (in the simplest case). Current law poses a double screen; the inversion is only safe from U.S. tax penalties if pre-existing shareholders retain less than 60 percent of the firm, or the firm has at least 25 percent of its business activity in the new jurisdiction. Higher ownership following the inversion may lead to a number of tax obstacles that were increased in 2014.²⁹ But entirely new firms owned by Americans face no U.S. legal obstacles to incorporating in tax havens or elsewhere abroad.

Despite systems that vary in many dimensions, the bilateral tax treaties of all high-income countries have also embraced many commonalities, including the principle that the transfer price of international transactions within the firm should be based on the value that would be struck by a seller and buyer operating independently.³⁰ However, this seemingly reasonable “arm’s length” principle has major weaknesses. Many transactions within the firm are unique, and the firm controls all of the relevant information, so tax officials are almost inevitably outmatched. These considerations, along with the draining of firm profits from high tax areas through loans from haven affiliates, has produced an extraordinary growth of U.S. corporate income booked to tax havens in recent years. One study found that tax shifting ranged from 57 to 90 billion dollars in 2008, or up to 30 percent of all U.S. corporate tax receipts.³¹ The complaint has grown ever louder that measures originally devised to prevent double taxation were fueling “double non-taxation.” Although the OECD has no estimate of the losses

²⁹ U.S. Treasury Department, *Fact Sheet: Treasury Actions to Rein in Corporate Inversions*, <http://www.treasury.gov/press-center/press-releases/Pages/jl2645.aspx> (visited 15 October 2014) [<https://perma.cc/2XUN-FZ2Y>].

³⁰ The most recent version of these guidelines, first developed in 1979, is OECD, *TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS* (2010) [<https://perma.cc/ZU6Q-LKTR>].

³¹ Kimberly A. Clausing, *The Revenue Effects of Multinational Firm Income Shifting*, 130 TAX NOTES 1580 (2011); see also Jane G. Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, Congressional Research Service, <http://www.fas.org/sgp/crs/misc/R40623.pdf> 2013 (visited 20 June 2014) [<https://perma.cc/H8JV-25X4>].

across its membership overall,³² there is evidence of both considerable tax shifting within Europe³³ and from Europe to lower tax jurisdictions.³⁴

Increased personal taxes on those with high incomes who own shares in corporations could raise revenue both more progressively and more efficiently than the corporate tax, but a swift and deliberate substitution would be politically impossible almost everywhere. Corporate taxes accounted for an average of 8.6 percent of total revenue across the OECD in 2014.³⁵ Up until now, the tax base has broadened as rates have steadily dropped, somewhat increasing revenue as a proportion of GDP in the high-income countries while generally maintaining its share elsewhere.³⁶ Ultimately, however, competitive rate erosion will diminish the overall role of the tax.

3.4. Personal Income Taxation and Hidden Investment

Personal income tax liability can also be treated either globally or territorially, and the several model treaties cover all income taxes. Income from personal services sold abroad has historically

³² OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING, http://www.oecd-ilibrary.org/taxation/addressing-base-erosion-and-profit-shifting_9789264192744-en (visited 15 May 2014) [<https://perma.cc/KD58-YGU5>].

³³ Alfons J. Weichenrieder, *Profit Shifting in the EU – Evidence from Germany*, www.ifs.org.uk/conferences/etpf_weichenreider.pdf_2006 (visited 25 June 2014) [<https://perma.cc/S5V7-BSBZ>].

³⁴ See Matthias Dischinger, *Profit Shifting by Multinationals: Indirect Evidence from European Micro Data*, Munich Discussion Paper 2007:30 (2007), http://epub.ub.uni-muenchen.de/2029/1/dischinger_2007_profi., (visited 15 September 2014) [<https://perma.cc/HV2S-M36F>]; see also Deloitte, *Understanding Corporate Usage of British Crown Dependencies and Overseas Territories*, A Report to the Independent Review of British Overseas Financial Centres, (2009), http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/foot_review_deloitte.pdf (visited 20 September 2014) [<https://perma.cc/EC2F-9EMS>].

³⁵ OECD, REVENUE STATISTICS <http://www.oecd.org/tax/revenue-statistics.htm> (visited on 1 May 2014) [<https://perma.cc/K5WG-6SjX>].

³⁶ International Monetary Fund, *Revenue Mobilization in Developing Countries*, Prepared by the Fiscal Affairs Department (2011), 33, <http://www.imf.org/external/np/pp/eng/2011/030811.pdf> (visited on 22 September 2014) [<https://perma.cc/P2RP-4PRN>]. It is important to distinguish a corporate income tax from natural resource (rent) taxation, which may be an essential and efficient source of development finance.

been exempt from home income tax by most of the countries of Europe, again in contrast to U.S. practice. But nearly all states try to tax the earnings of their own citizens' foreign investments, and the effective taxation of such asset income³⁷ (and of the assets themselves, whether held passively or as part of a directed business) has bedeviled tax authorities everywhere. Unlike domestic investments, foreign earnings are not accompanied by automatic or easily obtainable information for most home governments, and tax evasion has flourished with technology improvements that have made it increasingly easier for people to maintain secret investments abroad.

The League of Nations model treaty was short, and the issue of the exchange of information was not considered. The first post-war OECD draft model treaty of 1963 dealt with information exchange in Article 26, although very briefly. It says simply that the "Competent Authorities of the Contracting States" should exchange information "necessary for the carrying out of the Convention and of the domestic laws of the Contracting States concerning taxes covered" by the Convention.³⁸ Such information would include names and locations of those taxed to effectuate whatever division of tax authority the associated treaty prescribed. The pure tax havens had no such treaties, however, and they rejected all elements of transparency, thus abetting both corporate avoidance and personal tax evasion.

Pure havens typically did not levy either personal or corporate income taxes and therefore claimed to have no reason to collect and maintain data relevant to tax liabilities elsewhere. This stemmed directly from the "Revenue Rule" that has traditionally barred the enforcement of foreign tax laws as part of what Dodge calls the "public law taboo."³⁹ Similarly, mixed havens have typically claimed to prize the concept of financial privacy, and foreign investors in such states were often afforded the same rights as the locals. Their bilateral treaties sharply limited information exchange.⁴⁰

³⁷ The secret holding of foreign investments also protects asset transfer from taxation and shields assets from others with legal claims.

³⁸ OECD, DRAFT DOUBLE TAXATION CONVENTION (1963).

³⁹ William S. Dodge, *Breaking the Public Law Taboo*, 43 HARV. INT'L L.J. 161 (2002).

⁴⁰ Austria, Belgium, Luxembourg, and Switzerland withdrew their reservations to Article 26 only in 2009. Andorra Liechtenstein, and Andorra relented in 2010. OECD, PROMOTING TRANSPARENCY AND THE EXCHANGE OF INFORMATION FOR

Gabriel Zucman has estimated that eight percent of all personal wealth is held in tax havens, and three-quarters of that is not recorded.⁴¹ One recent study puts the annual tax loss at \$189 billion globally.⁴² Tax experts often stress that the importance of evasion—much more than avoidance—holds significance far beyond the amounts not paid. Such activity undermines public confidence in the integrity of the tax system and thus encourages additional evasion.⁴³

4. TAX ESCAPE AND THE BIRTH OF THE TRANSPARENCY WAVE OF COOPERATIVE INTERNATIONAL TAXATION OF FOREIGN EARNINGS.

The burgeoning problem of tax escape utilizing tax havens and the need for further international cooperation was already apparent in the U.S. as early as 1980 when the Treasury-commissioned Gordon Report declared:

The United States alone cannot deal with tax havens. The policy must be an international one by the countries that are not tax havens to isolate the abusive tax havens. The United States should take the lead in encouraging tax havens to provide information to enable other countries to enforce their laws.⁴⁴

On the other side of the Atlantic, the drive for increasing European unity confronted internal national practices that partners found intolerable. A meeting of European finance ministers in 1996 led to a series of proposals including a Code of Conduct on business taxation. As is often the case, this aspirational “soft law” set an enduring agenda.⁴⁵ The Code of Conduct aimed to identify

TAX PURPOSES, 2010 <http://www.oecd.org/newsroom/44431965.pdf> (visited on 10 July 2014) [<https://perma.cc/EAJ7-G2BM>].

⁴¹ Gabriel Zucman, *The Missing Wealth of Nations: Are Europe and the U.S. Net Debtors or Net Creditors?* 128 Q. J. ECON. 1324 (2013).

⁴² James S. Henry, *The Price of Offshore Revisited. New Estimates for “Missing” Global Private Wealth, Income, Inequality, and Lost Taxes*, TAX JUST. NETWORK (2012) http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf (visited on 29 September 2014) [<https://perma.cc/ST9S-7TJFv>].

⁴³ BENNO TORGLER, TAX COMPLIANCE AND TAX MORALE: A THEORETICAL AND ANALYSIS (2007).

⁴⁴ Gordon, *supra* note 1, at 10.

⁴⁵ Kenneth W. Abbott, Robert O. Keohane, Andrew Moravcsik, Anne-Marie Slaughter & Duncan Snidal, *The Concept of Legalization*, 54 (3) INT’L ORG. 401 (2000).

and remove those measures, directed at foreigners, that “provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question.”⁴⁶ The same meeting also considered information-sharing within the EU to counter growing personal tax evasion.

These transatlantic concerns informed the OECD deliberations that resulted in the report *Harmful Tax Competition* of 1998.⁴⁷ It identifies two broad categories of unacceptable behavior: “tax havens” and “harmful tax regimes.” The tax havens impose little or no tax on relevant income along with one or more of: (1) lack of effective exchange of information, (2) lack of transparency, or (3a) “insubstantial” activity attached to the claim of haven location. Criteria (1) and (2) are linked because if no local laws compel appropriate transaction recording, there is no information for the authority to share.

“Harmful tax regimes” within the OECD countries were identified by one or more of: (1), (2), and a final criterion, which can be designated (3b). Instead of requiring that the activity be “substantial,” the standard is “ring fencing,” i.e., whether the jurisdiction in question essentially uses a different tax rate for foreign business than it does for domestic firms.

International business subsequently lobbied strenuously against the restriction of “insubstantial” activity as arbitrary and unworkable. The Bush administration accepted only that part of the OECD effort that was aimed at tax evasion, and the attack on tax havens’ harboring of only nominal operations was formally dropped.⁴⁸ The OECD project then demanded only that tax havens make a public declaration to move towards transparency including the collection and exchange of tax information. Indeed, the pure havens were embraced as “partners” in a Forum that developed a model bilateral Tax Information Exchange Agreement (TIEA) in 2002. The model TIEA specifies that the scope of information to be collected and exchanged in response to a specific partner request

⁴⁶ Official Journal of the European Communities, *Conclusions of the Ecofin Council Meeting on 1 December 1997 Concerning Taxation Policy* (98/C 2/01), Annex 1 [<https://perma.cc/M9R7-4WW4>].

⁴⁷ See OECD, *supra* note 6.

⁴⁸ Contrary to what is commonly seen in the literature, however, the “insubstantial” element had been eviscerated before the outcome of 2000 U.S. election was determined; the Bush administration simply provided a *coup de grâce*. For a detailed account, see generally Kudrle, *supra* note 22.

should be “foreseeably relevant” to enforcement and not a broad request – something the OECD at the time called a “fishing expedition.”

The model agreement makes clear that dual criminality was not necessary for the legitimacy of the request, that the agreement applied to both civil and criminal matters, and that it applied to information in possession of a wide range of institutions.⁴⁹ Article 26 of the OECD model treaty was also revised to give specificity to the scope and procedures of information exchange that paralleled the model TIEA.⁵⁰ Over the next several years, a changed post-9/11 environment of heightened concern about money laundering and terrorist finance saw all but a few of the European tax havens accept the model agreement in principle.

5. SQUEEZING THE HAVENS ON CORPORATE TAXATION

The word “transparency” appears in the original HTC study to refer to the relation of governments to private actors and hence to discriminatory behavior,⁵¹ and the term is not used in the way that has since become most familiar in the international taxation literature: the collection and sharing of information about the economic circumstances of private parties.⁵² Nonetheless, once the project was refocused solely on tax evasion, the now dominant meaning became the *de facto* policy goal.

⁴⁹ See OECD, *Agreement on Exchange of Information on Tax Matters*, <http://www.oecd.org/ctp/harmful/2082215.pdf> [<https://perma.cc/3A6W-ETWR>] (containing the terms of the agreement). Formally, the agreement also had a multilateral version, but it was to be used only for a coordinated cluster of bilateral agreements. *Id.*

⁵⁰ In fact, there were a number of minor changes over the subsequent decade. For more details, see Carlo Barbarino & Sebastiani Garufi, *Transparency and Exchange of Information in International Taxation*, in *TRANSPARENCY IN INTERNATIONAL LAW* 172–96 (Andrea Bianchi and Peters eds., 2013) (discussing the changes in international taxation).

⁵¹ See OECD, *HARMFUL TAX COMPETITION* *supra* note 6, at 28. The original concern was never lost, however, and became a central concern of the Base Erosion and Profit Shifting project discussed *infra* Part 5.1.

⁵² Andrea Bianchi has recorded his book team’s surprise at finding the term “transparency” typically used without formal definition and that the chapter writers in the collective enterprise were free to use any meaning they chose. See Andrea Bianchi, *Power and Illusion: The Concept of Transparency in International Law*, in *TRANSPARENCY IN INTERNATIONAL LAW* 1–19, 8 (Andrea Bianchi and Peters eds., 2013) (describing this surprise).

Although the refocused drive for transparency after 2001 aimed mainly at personal tax evasion rather than corporate tax avoidance, the same popular anger and frustration after the global financial collapse that galvanized a determination to fight tax evasion also attracted attention to the central role of transparency in bolstering the effectiveness of the corporate elements of the tax regime. The G8 June 2013 Lough Erne declaration's first two points were: "1. Tax authorities across the world should automatically share information to fight the scourge of tax evasion. 2. Countries should change rules that let companies shift their profits across borders to avoid taxes, and multinationals should report to tax authorities what tax they pay where."⁵³

5.1. *The BEPS Project*

The challenge of increasing clarity and consistency in the corporate tax regime was taken up by the OECD in cooperation with the G-20. The OECD's 2013 Base Erosion and Profit Shifting (BEPS)⁵⁴ study started from the realistic assumption that the major national corporate tax systems will remain much as they are and outlines major challenges that stem from the meshing of differing national corporate systems. Although the study envisioned fifteen major tasks, most of what was considered involved greater information gathering and sharing along with the achievement of greater consistency in definition and legal treatment of various entities across states.

Rhetoric about lost revenue has driven much of the political determination to tighten the international corporate tax regime, yet the BEPS Action Plan notes that in many cases it "may be difficult to determine which country has in fact lost revenue."⁵⁵ This speaks volumes about the complexity of corporate arrangements and the great uncertainty that surrounds the incidence of the tax. This uncertainty could prove to be an advantage: states may seek clarity

⁵³ G8, *Lough Erne Declaration* (June 18, 2013), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207543/180613_LOUGH_ERNE_DECLARATION.pdf [<https://perma.cc/S7R4-W353>].

⁵⁴ See OECD, *Addressing Base Erosion and Profit Shifting*, (2013), <http://dx.doi.org/10.1787/9789264192744-en> [<https://perma.cc/BA4S-QDA3>] [hereinafter OECD, *Addressing Base Erosion*].

⁵⁵ *Id.*

and the avoidance of future conflict without much idea of the price paid – if any – for some incremental legal and policy changes in the pursuit of those goals. More generally, one could argue that continual uncertainty in forecasting both revenue and other elements of national gain has facilitated the implicit and formal agreements that make up the current international corporate tax regime.

Much of the BEPS project can be seen as an attempt to align the right to tax with the real economic activity that generates the income.⁵⁶ Many of the project's specific "pressure areas" aim directly at pure or mixed tax havens. These include an attack on national inconsistencies in business entity classification that some allow firms to escape tax altogether; greater attention to intra-firm financial transactions involving goods and services – especially intellectual property – as well as debt and in-house insurance (because intra-firm discretion can easily shift substantial income to jurisdictions with lower taxes); and more attention to often ineffective rules aimed to control firm use of tax havens directly. BEPS issued its final reports on the Action Plan elements in October of 2015.⁵⁷ Improvements are envisioned in both the OECD Model Treaty and in associated domestic legislation. But the many suggestions must be implemented at the national level. This will often involve legislative changes, and states have already shown widely varied reactions.

Expert opinion differs on likely progress in these areas, but greater transparency has found the broadest favorable reception.⁵⁸ Exposing state tax agreements with individual firms is least controversial, and most close observers agree that putting all MNC financial accounts together in a common format across countries and sharing that information among authorities would expose and il-

⁵⁶ *Id.* For a leading international lawyer's detailed analysis of the project's prospects, see also Sol Picciotto, *Can the OECD Mend the International Tax System?*, 71 TAX NOTES INT'L 1105, 1114–15 (2013) (containing an analysis of the project).

⁵⁷ See OECD, *BEPS 2015 Final Reports*, <http://www.oecd.org/tax/beps-2015-final-reports.htm> [<https://perma.cc/DZC7-X6R2>] (containing a list of the 2015 reports).

⁵⁸ See Sullivan & Cromwell, LLP, *OECD Standard for Automatic Exchange of Financial Account Information* (Feb. 27, 2014), <http://www.sullcrom.com/international-tax-cooperation-oecd-standard-for-automatic-exchange-of-financial-account-information> [<https://perma.cc/9YUF-FYWJ>] (considering the impact of the OECD standard). See also Itai Grinburg, *Breaking BEPS: The New International Tax Diplomacy*, (Georgetown Law School, Working Paper), <http://ssrn.com/abstract=2652894> [<https://perma.cc/K5RX-XYCG>] (focusing in part on the idea of transparency).

illuminate anomalies and guide jurisdictions in revising and coordinating their rules. To the continuing dismay of many advocacy groups, the U.S. and some other states reject the public release of detailed business information by country, but inter-governmental information exchange has broad backing.⁵⁹

Greater exchange of comparable information will strengthen the hands of tax authorities in their dealings with firms and with each other; such activity is a classic product of light governance institutionalization.⁶⁰ Much corporate tax avoidance in recent years has involved firms pitting governments against each other with the threat of shifting activities to other jurisdictions. A clearer understanding of what other states actually tax should bolster the assessment of such threats while at the same time putting the spotlight and additional political pressure on states offering concessions judged to be inappropriate. Many of these jurisdictions are pure tax havens, while some mixed havens, such as Ireland, the Netherlands, and Luxembourg, have displayed a record of tolerance for nominal activity that may be alloyed with substantial real investment.

5.2. *A Radical Alternative with Limited Appeal*

The prevailing method of host country taxation of subsidiary profits challenges lower income hosts much more than the rich. While MNC profit shifting—typically to tax havens—plagues rich hosts, it often completely defeats poor ones. In response, a UN-sponsored report in 2001 urged consideration of a complete change in international corporate taxation: a move to formula apportionment.⁶¹ The global tax base of each MNC would be divided across

⁵⁹ See OFFICE OF MGMT. & BUDGET, FISCAL YEAR 2015, EXEC. OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT FISCAL YEAR 2015 (2015), <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/spec.pdf> [<https://perma.cc/5XKD-KH6F>] (detailing the budget for the year 2015). Although the U.S. Treasury looked favorably at country by country firm reporting in the BEPS discussions and has claimed administrative authority to implement it, this position has been challenged by some Republican legislators. See also Mindy Herzfeld, *Will the United States Take Action on the BEPS Action Plan*, 79 TAX NOTES INT'L 817, (Sept. 7, 2015).

⁶⁰ See Barbara Koremenos, Charles Lipson & Duncan Snidal, *The Rational Design of International Institutions*, 55 INT'L ORG. 761-99 (2001) (describing the design of international institutions in various circumstances).

⁶¹ See G.A. REPORT 55/1000, U.N. DOC. A/55/1000 (June 26, 2011),

jurisdictions using some combination of assets, employment, and sales in a variant of what is done across many U.S. states and Canadian provinces,⁶² with each jurisdiction setting its own tax rate.

Most economists have not embraced the departure; any formula devised would encourage significant new inefficiencies while generating fresh administrative problems.⁶³ Under formula apportionment, states that are large, rich, or both would experience the greatest immediate gains. The recognized tax havens would stand substantially bereft, especially if the location of intellectual property assets were subject to careful scrutiny. But exactly because the shift in tax base would be so radical and the outcome of either unilateral or multilateral action so uncertain and potentially destabilizing, anything much beyond continuing UN discussion appears vanishingly unlikely. The slow and difficult path of policy development on formula apportionment in the EU⁶⁴ suggests the virtual impossibility of an agreement on a scheme acceptable to a broader range of influential countries. The OECD *Base Erosion* study flatly rejects formula apportionment as a general approach but leaves open the possible employment of formulas for some payment streams.⁶⁵

http://www.un.org/en/ga/search/view_doc.asp?symbol=A/55/1000 [<https://perma.cc/9LD4-KEVG>] (describing the changes it urged countries to implement).

⁶² See Kimberly A. Clausung & Reuven S. Avi-Yonah, *Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment* (The Hamilton Project, Brookings Institution Discussion Paper, 2007), http://www.hamiltonproject.org/assets/legacy/files/downloads_and_links/Reforming_Corporate_Taxation_in_a_Global_Economy_-_A_Proposal_to_Adopt_Formulary_Apportionment.pdf [<https://perma.cc/6YD3-RFLT>] (discussing the proposed system of formulary apportionment).

⁶³ See Rosanne Altshuler & Harry Grubert, *Formula Apportionment: Is it Better than the Current System and Are There Better Alternatives?* 63 NAT'L TAX J. 1145, 1145-84 (2010) (discussing why the apportionment system is not an improvement over the current system).

⁶⁴ See Christoph Spengel & Carsten Wendt, *A Common Consolidated Corporate Tax Base for Multinational Companies in the European Union: Some Issues and Options* (Oxford University Centre for Business Taxation, Working Paper 07/17, 2007), http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Working_Papers/Series_07/WP0717.pdf [<https://perma.cc/XSE5-GD96>] (detailing the issues related to the development of the system in the EU).

⁶⁵ See OECD, *Addressing Base Erosion*, *supra* note 54.

5.3. A Diminished Tax Haven Role for Corporations

Individual states will continue to adjust their international corporate tax rates and practices, but they differ so much now that any really consequential international agreement is most unlikely. For example, the U.S. has been slow to block the use of tax havens for corporate profit tax avoidance because tax officials partly share the view of U.S. MNCs that tax haven use is compensating for high U.S. corporate tax rates and the territorial system advantages of rival firms based elsewhere. Moreover, much of the avoided corporation taxation still benefits U.S. citizens rather than foreigners.

Overall, the corporate element of the transparency wave of cooperation will certainly produce some concrete results. More consistent approaches to various entity and transaction classifications will make double non-taxation easier to attack. More information from corporations in a common format to facilitate enforcement is being widely implemented. More information will likely be made public.⁶⁶ Intellectual property earnings may be assigned more closely to their jurisdiction of actual development.⁶⁷ Nevertheless, no comprehensive policy equilibrium will be established. Corporate tax competition will continue and independent or loosely cooperative national government measures to avoid the impact cannot succeed. In fact, national reforms that diminish the ability of states to discriminate between domestic firms and MNCs will likely accelerate rate erosion.⁶⁸ While backup taxation and various anti-avoidance measures could substantially decrease the use of tax havens by major corporations, the corporate income tax in most countries is doomed to decline in relative and perhaps absolute importance.

⁶⁶ See OECD, *A Step Change in Tax Transparency*, OECD (June 2013), http://www.oecd.org/ctp/exchange-of-tax-information/taxtransparency_G8report.pdf [<https://perma.cc/JPA2-5AYE>] (discussing due diligence requirements).

⁶⁷ The policy issue that most divides U.S. interests from virtually everyone else's, the minimum criteria for local operation sufficient to trigger corporate taxation, may be adjusted, although the U.S. will strongly resist substantial change.

⁶⁸ See James Hines Jr., *Treasure Islands*, 24 J. OF ECON. PERSPECTIVES 103, 104-05 (2010) (discussing how tax haven use responds to corporate tax rate and rule differences).

6. PERSONAL TAX EVASION AND ASSET SECRECY

Offshore tax evasion and other problems more exclusively based in secrecy differ from the avoidance issues just discussed. First, tax evasion is an intrinsically clearer concept. Most interstate differences in the legal treatment of evasion pale by comparison with the widely varying corporate tax systems. Second, while transparent behavior by host country governments and private agents can support a tightening of policies against avoidance, it provides the key to the detection and prosecution of tax evasion. Finally, the effective thwarting of evasion can involve sub-national levels of government and their legal prerogatives; this has been particularly marked in the United States.

6.1. *Cooperative Efforts to Combat Evasion*

Adherence to the OECD's model 2002 Bilateral Tax Information Exchange Agreement was first bolstered by terrorism concerns and then accelerated further by the search for villains following the financial crisis. By the London G-20 Summit of April 2009, there were no holdouts from the expressed goal of obtaining and recording beneficial ownership and earnings of financial assets booked in a jurisdiction and the transmission of that information to other governments upon request.⁶⁹ Many correctly judged that to have been a shallow victory, however. Despite near-universal participation in the Forum, the cooperation envisioned lacked a foundation of incentive compatibility: many of the states whose cooperation was seen as most essential—in particular most of the pure and mixed tax havens—lacked motivation to perform beyond the level necessary to avoid the ire and retaliation of more powerful states. Moreover, authorities had to identify potential malefactors before seeking information about them. Unsurprisingly, early statistical studies suggested little, if any, impact on tax evasion.⁷⁰ But, in a

⁶⁹ See OECD, *A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard*, OECD (Apr. 2, 2009) <http://www.oecd.org/dataoecd/38/14/42497950.pdf> 2009 [<https://perma.cc/UF9X-7D7N>] (detailing the progress of the implementation of the standard).

⁷⁰ See Robert T. Kudrle, *Did Blacklisting Hurt the Tax Havens?*, 11 (1) J. OF MONEY LAUNDERING CONTROL 11 (2009) (analyzing how blacklisting affected tax

series of developments that surprised many observers, the story did not end there.

6.2. A Unilateral U.S. Initiative

However much its hegemony has declined, U.S. leadership still matters greatly, and this is nowhere more apparent than in international taxation. The Bush administration paid lip service to the OECD's vision of information sharing but delayed action; it was widely anticipated that President Obama would break the regulatory logjam at Treasury.⁷¹ But the discontinuity turned out to be vastly greater. As part of macroeconomic stimulus legislation in the wake of the financial crisis, the administration pushed the Foreign Account Tax Compliance Act (FATCA) of 2010,⁷² which levied a withholding tax of 30 percent on all financial institutions placing investments from abroad into US markets beginning in July of 2014 unless those institutions reported information on detailed accounts with American connections.

The unfolding of FATCA revealed some remarkable dynamics. FATCA's initial logic seemed to be nationalist hegemonic assertion rather than cooperation. The U.S. presented foreign institutions, not governments, with a choice: collect information to prevent tax evasion by Americans or face a ruinous penalty. Major economic partners of the U.S. strongly objected to FATCA at the outset, both as unilateralism and as a threat to national laws protecting financial privacy. Many soon realized, however, that their own best interests were served by shifting the focus of cooperation from individual institutions to the national government and then bargaining for reciprocal action from the United States. Such a nationalization of compliance became the basis for the intergovernmental agreements (IGAs) that have now been struck with many countries and are under consideration with dozens more and have become the basis for bilateral agreements not involving the United States.⁷³

haven financial investment); *see also* Niels Johannesen & Gabriel Zucman, *The End of Bank Secrecy? An Evaluation of the G-20 Tax Haven Crackdown*, 6(1) AM. ECON. J. 65, 65 (2014) (evaluating the likely success of G-20 action).

⁷¹ Developments in this period are reviewed in Kudrle, *supra* note 22.

⁷² FATCA was part of the Hiring Incentives to Restore Employment Act (HIRE Act). For more details, *see* Hiring Incentives to Restore Employment Act (HIRE), Pub. L. No. 111-147, 124 STAT. 71 Title V, Subtitle A (2010).

⁷³ An alternative agreement favored by a minority of states retained the orig-

Once such agreements are made, financial institutions have a powerful interest in assuring their own government's cooperation to avoid foreign withholding.

U.S. international economic bargaining is always dogged by two complications that most countries lack: a major, independent legislative role in foreign policy and the prerogatives of the several states. Both characteristics cloud the future of FATCA. The standard language of a FATCA IGA states: "The United States is committed to further improve transparency and enhance the exchange relationship with [FATCA Partner] by pursuing the adoption of regulations and advocating and supporting relevant legislation to achieve such equivalent levels of reciprocal automatic exchange."⁷⁴ In other words, the U.S. executive declares support for a high degree of reciprocity but cannot assure it. Indeed, one dissenting Republican legislator pointed out in a letter to the Treasury that parallel obligation was not part of the enabling FATCA legislation.⁷⁵

Congressional intent and concurrence constrain the U.S. executive, but so do the several states. State law governs the formation and most regulation of American business. "Shell" companies with no purpose but obfuscation can completely conceal beneficial ownership and hence block transparency. They can be easily formed in many U.S. states. Some states, especially Wyoming and Delaware, require so little information on companies that they often serve as the weakest informational link in global webs of evasion. In principle, federal supremacy can overcome the problem,⁷⁶ but despite vastly differing political complexions, the states typically unite to battle federal encroachment, and they have done so strenuously on company information. Federal legislation to require the collection and verification of beneficial firm ownership

inal mechanism of foreign institutions dealing directly with the U.S. See Patrick Temple-West, *U.S. in Talks with Dozens of Nations on Anti-Tax Dodge Pacts*, THOMPSON-REUTERS NEWS SERV. (Nov. 8, 2012), <http://uk.reuters.com/article/uk-usa-tax-havens-idUKBRE8A71M020121108> [<https://perma.cc/SF2G-GZ5R>] (reporting on tax pacts).

⁷⁴ Allison Christians, *What You Give and What You Get: Reciprocity Under a Model 1 Intergovernmental Agreement on FATCA*, CAYMAN FIN. REV. (2013) at 2.

⁷⁵ See Letter from Bill Posey, Member of Congress, to Jack Lew, Secretary of the Treasury (Jan. 15, 2014), available at http://www.repealfatca.com/downloads/Posey_letter_to_Sec._Lew_July_1,_2013.pdf [<https://perma.cc/TF53-MJGY>] (discussing his concerns with FATCA).

⁷⁶ The earliest federal supremacy case involved a conflict between a state's prerogative and foreign policy. See *Ware v. Hylton*, 3 U.S. 3 (3 Dall.) (1796) (holding that the Treaty of Paris overruled a state law).

had been introduced four times (most recently on 1 August, 2013)⁷⁷ by the end of 2015 without success partly due to opposition from the National Association of Secretaries of State (NASS) defending state revenues from business formation fees and resisting inadequately funded federal mandates. Significantly, while foreigners were seeking a U.S. response in the spirit of FATCA in 2014, a NASS report on company formation completely ignores the international reciprocity and cooperation that would make domestic practice consonant with U.S. foreign policy declarations.⁷⁸

A few libertarian politicians want to abandon FATCA altogether and reject the pledges of transparency made at the G8 and G-20 meetings of 2013. But most of the Congress is now committed to some level of international cooperation, despite the barriers the U.S. faces to approximate the same level of information provision that it expects of others. Executive commitment was signaled by 2012 Treasury regulation changes first proposed in the Bush administration to oblige financial institutions to collect information on interest paid to foreigners so it can be shared internationally.⁷⁹

6.3. *The G-20 Drive*

The presence of many major developing states in the G-20 bolstered a determination in the OECD-initiated and G-20-embraced Global Forum on Transparency and the Exchange of Information for Tax Purposes—the more highly structured 2009 version of the TIEA-drafting Forum⁸⁰—to devise a more effective form of infor-

⁷⁷ See *Incorporation Transparency and Law Enforcement Assistance Act*, S. 1465, 113th Cong. (2013) (proposing a bill related to disclosure of beneficial owners of companies).

⁷⁸ See *Report and Recommendations on Assisting Law Enforcement in Fighting the Misuse of Corporate Entities*, NAT'L ASS'N OF SECRETARIES OF ST. (NASS) COMPANY FORMATION TASK FORCE (Dec. 2012), http://www.nass.org/component/docman/?task=doc_download&gid=1336&Itemid= [<https://perma.cc/ZQ4Q-UU99>] (failing to address these issues).

⁷⁹ See U.S. Internal Revenue Bulletin: 2012-20, 14 May 2012, D. 9584, Guidance on Reporting Interest Paid to Nonresident Aliens, https://www.irs.gov/irb/2012-20_IRB/ar07.html [<https://perma.cc/CAH2-9X8V>] (including the details of the proposal). Some have also suggested that all businesses in the U.S. register with the IRS, but this too is an assertion of federal supremacy in previous state governance.

⁸⁰ See OECD, *Global Forum on Transparency and the Exchange of Information for Tax Purposes, 'Information Brief'*, OECD (Nov. 2013), http://www.oecd.org/tax/transparency/global_forum_background%20brief.pdf [<https://perma.cc/>

mation exchange. Emboldened by the apparent determination of the U.S. and the EU to move strongly against tax evasion, in 2010 the Forum adopted a revised version of the multilateral Convention on Mutual Administrative Assistance on Tax Matters developed by the OECD and the Council of Europe in 1988.⁸¹ This revised instrument contains all the core requirements of the model bilateral information agreement,⁸² but it also covers a broader range of taxes, allows joint tax investigations and—most importantly—provides the option of automatic information exchange similar to the FATCA provisions.⁸³ The OECD is serving as the *de facto* secretariat for the G-20 in developing the technical elements of automatic information exchange as well as the boilerplate for incorporation of the new approach into national law. The entire project is being devised to achieve legal and administrative congruence of FATCA with both the European Savings Directive (on financial investment information sharing begun in 2003)⁸⁴ and the Convention. This new approach holds the potential to deter tax evasion substantially. The literature on domestic taxation demonstrates that automatic earnings reporting to governments results in much higher levels of tax compliance than is achieved otherwise.⁸⁵

6.4. *The Challenges Facing Poor Countries*

Poor and less powerful countries always saw that the bilateral information-sharing regime, inadequate for even the most influen-

6HLH-6JUS] (providing information on the Global Forum).

⁸¹ See OECD, *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters*, OECD (2011), http://www.uscib.org/docs/multilateral_convention_mutual_admin_assistance_tax.pdf [https://perma.cc/YG2P-AHJC] (amending the previous Convention). For the most recent version of the cooperative standard, see OECD, *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, OECD PUBLISHING (2014).

⁸² The model instrument was devised in both a multilateral and a bilateral version, but only the later proved important.

⁸³ See OECD, *Automatic Exchange of Information: What is it, How it Works, Benefits, What Remains to be Done*, OECD (2012), <http://www.oecd.org/tax/exchange-of-tax-information/automaticexchangeofinformationreport.htm> [https://perma.cc/6NT6-FD2P] (discussing the automatic exchange).

⁸⁴ See Council Directive 2003/48, 2003 O.J. (L157) 1 (EC) (detailing the directive on taxation).

⁸⁵ See US GEN. ACCT. OFF., *Taxpayer Compliance Analyzing the Nature of the Income Tax Gap*, <http://www.gao.gov/assets/110/106680.pdf> [https://perma.cc/GRN6-SGLF] (documenting the testimony statement made regarding the tax gap).

tial states, would always leave them least well-served when seeking assistance. They also face evasion challenges beyond those of the higher income states. Businesses and the well-off see tax collectors as their opponent everywhere, but this is greatly amplified by poor countries' governments, which typically try to control the economy more extensively and do so with far more corruption than is usual in the rich states. Among myriad regulations, many poor states maintain exchange controls that make many capital flows illicit. Moreover, the very existence of substantial wealth ownership at home or abroad may invite extortion from within the government and elsewhere. Therefore, the secrecy motive in foreign investment extends well beyond the desire to escape taxation, the most prominent goal for most rich-world law evaders. Capital flight or anonymous "round tripping" of investment back into a state make the transparency stakes far higher for both the governments and the private entities involved than within the rich world.

While poor countries could potentially see a greater change in their fiscal fortunes from automatic information exchange than richer ones, an uncertainty of the emerging regime of automatic transfer of information surrounds what level of probity a government must assure to be provided with such information. The OECD encourages the automatic exchange of information with treaty partners only when the receiving country has the legal framework, administrative capacity, and appropriate processes in place to ensure the confidentiality of the information received and that such information is only used for the purposes specified in the instrument.⁸⁶ While it is unlikely that states with most of the South's population will be excluded from automatic information exchange, the denial of such information will inevitably be used as a political weapon.⁸⁷

⁸⁶ See OECD, *Standard for Automatic Exchange of Financial Account Information*, OECD. (2014), <http://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-financial-account-information-common-reporting-standard.pdf> [<https://perma.cc/R8JS-D5XZ>] (reporting on the standard and agreement).

⁸⁷ For example, banks in Florida and their political representatives would certainly fight to assure that a Venezuelan government of the Chavez coloration would remain ineligible for information sharing. See Lee A. Sheppard, *News Analysis: Globalization and International Tax Rules*, 70 TAX NOTES INT'L 613 (2013).

6.5. A Smaller Evasion Role for the Tax Havens

For many states, using information exchanged automatically will at first resemble trying to drink from a fire hose, and there will be unevenness in the production of such information by treaty partners. Nevertheless, the new regime can be expected to reduce evasion considerably. Across all countries, rich and poor, remaining evasion is likely to become more varied and diffuse across hiding jurisdictions than it is today. The tax havens will be subject to special scrutiny. As the emerging regime matures, systematic failures of will or competence by any single jurisdiction will bring greater attention and—at least if the backsliding state lacks overall power—retaliation beyond anything yet seen. The Global Forum has not specified an enforcement mechanism of the kind that looms so large in FATCA, but when asked whether countries would be sanctioned for failure to share information, Michael Ralston of the Australian Tax Office, while chairing the Global Forum, responded that, “sanctions are a political question ... countries have their own sanctions for partners that fail to cooperate.”⁸⁸

Some automatic information exchange now appears inevitable, but how smooth and comprehensive the implementation will be turns to a great extent on the unpredictable course of U.S. politics. FATCA provided major U.S. partners with an opening to demand reciprocity, and the IGAs as well as U.S. concurrence with G8 and G-20 declarations mean that a failure to respond to foreign expectations will have much greater political visibility at home and abroad than was the case in the Bush administration. Nevertheless, if the U.S. political picture changes sufficiently before components of a new regime are firmly embedded in international practice, the policy window may shut with American cooperation delayed indefinitely. This is an unlikely but possible outcome.

7. CONCLUSION

The international economic law of taxation has moved through two waves: first, the relief wave supported treaty cooperation to reduce double taxation. That treaty system was both limited in

⁸⁸ Lee A. Sheppard, *OECD Global Forum on the Defensive about Information Exchange*, 64 TAX NOTES INT'L 343 (2011).

participation and in the amount and character of information shared by signatories. The tax havens grew in response to these limitations and gave rise to the second transparency wave of recent years.

Policy reforms advanced by the OECD as well as purely national initiatives now seem likely to constrain substantially the use of recognized tax havens by international business to avoid the corporation income tax. The decline in the tax haven role in corporate taxation will follow hesitant, piecemeal policy adjustments by major home and host governments, each wary of putting national firms at a disadvantage or driving real resources away. Each state's decision-makers will attempt to estimate the national economic interest while being pressured by lobbies with very clear ideas about what they want. Publicized data on corporate funds in tax havens helps keep the policy window open. The corporate tax role of pure tax havens will eventually diminish sharply as home country legal changes require that claims of jurisdictional location become more connected with the real activities of the firm. Firms will adapt to the new rules and closer scrutiny about insubstantial activity, and this suggests locational diffusion out of pure and sometimes mixed tax havens to other jurisdictions. Substantial corporate tax harmonization is not on the horizon.⁸⁹

Tax evasion and asset secrecy may finally be yielding to effective international cooperation. The unexpectedly influential transparency initiative by the U.S., FATCA, began as an attempt to address only American evasion problems but has evolved towards reciprocity. U.S. policy can be subject to sharp discontinuities, however, and the most that can be said now is that the more highly evolved reciprocity practices become following bilateral agreement, the less likely is a reversal. The parallel activity in the Global Forum, based on well more than a decade of consideration by the OECD and with the leadership of the entire G-20, has yielded an organizational structure and a multilateral convention that can be expected to identify and deter much evasion through the tax havens.

Transparency wave reforms affect personal and corporate taxes in quite different ways, but when the various initiatives are

⁸⁹ As an OECD official described the BEPS project, "[t]here's no suggestion of tax harmonization in any of this . . . It's neither possible nor necessarily sensible to try to attempt that. What we've done is more surgical." Amanda Athanasiou, *Commentators Question Assertions in BEPS Action Plan*, 74 *TAX NOTES INT'L* 391, 392 (2014).

considered as a package, they promise an overall regime that provides far more information over a vastly greater number of jurisdictions than ever before. And that portends a substantial diminution in the role of tax havens in the world economy.