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# The Offshore Tax Enforcement Dragnet

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# THE OFFSHORE TAX ENFORCEMENT DRAGNET

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ABSTRACT

*Taxpayers who hide assets abroad to evade taxes present a serious enforcement challenge for the United States. In response, the United States has developed a family of initiatives that punish and rehabilitate non-compliant taxpayers, raise revenues, and require widespread reporting of offshore financial information by financial institutions and taxpayers. Yet, while these initiatives help catch willful tax cheats, they have also adversely affected immigrants, Americans living abroad, and "accidental Americans."*

*This Article critiques the United States' offshore tax enforcement initiatives, such as the Foreign Account Tax Compliant Act and the Internal Revenue Service's offshore voluntary disclosure programs. It argues that the United States has been overly focused on two policy priorities in designing enforcement at the expense of competing considerations: First, the United States has attempted to equalize enforcement against taxpayers with solely domestic holdings and those with harder-to-detect offshore holdings by imposing harsher reporting requirements and penalties on the latter. But in doing so, it has failed to appropriately distinguish among differently situated taxpayers with offshore holdings. Second, the United States has focused on revenue and enforcement, paying less attention to the significant compliance costs and potential social harms that its initiatives create.*

*The confluence of these two policy priorities risks creating high costs for the wrong taxpayers. While offshore tax enforcement may have been designed to catch high-net-worth tax cheats, it may instead impose disproportionate burdens on those immigrants and expatriates who have less ability to complain, comply, or "substitute out" of the law's grasp. This Article argues that the United States should redesign its enforcement approach to minimize these risks and suggests reforms to this end.*

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## INTRODUCTION

Consider the following hypothetical: Al is a wealthy American looking to minimize his income taxes. He decides to hide some assets offshore, away from the gaze of the Internal Revenue Service (IRS). Al approaches NovoBank, a Swiss private bank. Protected by Swiss bank-secrecy laws, NovoBank's clients enjoy a high degree of secrecy in their holdings. Bruno, a NovoBank banker, helps Al move money into a secret NovoBank account in Switzerland. Al does not report or pay U.S. tax on the income generated by these assets for several years. In addition to Al, Bruno has opened NovoBank accounts for other clients, including Clara, a Swiss citizen and resident who holds U.S. citizenship by birthright; and Dorian, a Swiss citizen who moved to the United States five years ago for work. Neither Clara nor Dorian has reported income earned from these Swiss accounts to the United States.

Now imagine that the United States has discovered that Americans like Al have been hiding assets in secret Swiss bank accounts to avoid paying taxes, in violation of U.S. tax law.

This hypothetical illustrates in simple terms the offshore tax evasion challenge.[1] Such offshore tax evasion has long existed, but U.S. authorities were fully alerted to the magnitude of the problem in 2008, thanks to a whistleblower.[2] The paradigmatic offshore evader is a high-net-worth American like Al who has stashed financial assets offshore to avoid paying U.S. taxes, assisted by the likes of Bruno and NovoBank.[3] However, there are other taxpayers with U.S. ties who hold assets offshore who, although perhaps not fully tax compliant, may possess less willful intent. These include "accidental Americans" like Clara and immigrants to the United States like Dorian. Thus, the enforcement challenge confronting the United States is how to hold Al wholly accountable while appropriately sorting for more benign actors like Clara and Dorian.

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[1] Craig M. Boise, *Breaking Open Offshore Piggybanks: Deferral and the Utility of Amnesty*, 14 GEO. MASON L. REV. 667 (2007) (analyzing the use of amnesty programs to increase compliance); Itai Grinberg, *The Battle over Taxing Offshore Accounts*, 60 UCLA L. REV. 304 (2013) (describing information reporting and withholding initiatives to tax offshore accounts); Ruth Mason, *Citizenship Taxation*, 89 S. CAL. L. REV. 169 (2016) (describing cross-border challenges raised by taxation of Americans based on citizenship); Shu-Yi Oei & Diane M. Ring, *Leak-Driven Law*, 65 UCLA L. REV. (forthcoming 2018) (evaluating how tax authorities use data leaks to enforce tax compliance across borders).

[2] *See, e.g.*, Jeremiah Coder, *IRS Pays Birkenfeld $ 104 Million Whistleblower Award.*, 136 TAX NOTES 1359 (2012); Randall Jackson, *Former UBS Banker Indicted in Tax Evasion Case*, 50 TAX NOTES INT'L 519 (2008); Randall Jackson, *Swiss Bank Official Detained by U.S. Authorities*, 50 TAX NOTES INT'L 473 (2008).

[3] *See, e.g.*, Stephanie Soong Johnston, *U.S. Advancing in Battle Against Offshore Tax Evasion*, 68 TAX NOTES INT'L 543 (Nov. 5, 2012).

In the aftermath of the 2008 whistleblower revelations regarding tax evasion using Swiss bank accounts, the United States developed a family of legislative, regulatory, and prosecutorial measures to combat offshore tax evasion. These offshore tax enforcement[4] measures include (1) the IRS's Offshore Voluntary Disclosure Programs (ODVPs), which offer criminal amnesty to taxpayers who come clean; (2) the Department of Justice (DOJ) Tax Division's Offshore Compliance Initiative, which consists of criminal prosecutions of individual taxpayers and facilitators and a "Swiss Bank Program" designed to bring offending Swiss banks into compliance through deferred and non-prosecution agreements; (3) the Foreign Account Tax Compliance Act of 2010 (FATCA), a far-reaching piece of legislation designed to procure information about the offshore financial holdings of U.S. taxpayers from foreign countries and banks;[5] and (4) the web of bilateral intergovernmental agreements (IGAs) signed between the United States and various foreign governments that effectuate FATCA.[6]

Proponents and defenders of offshore tax enforcement have described these measures as important steps in punishing offenders, ensuring the taxation of offshore capital, and discouraging evasion.[7] However, others have been critical, some harshly so.[8] The conversation often has a flavor of the left hand

[4] Others sometimes refer to these measures as "global tax enforcement," "offshore tax compliance," or "offshore compliance initiatives."

[5] Foreign Account Tax Compliance Act, Pub. L. No. 111-147, 124 Stat. 71, 97 (2010) (codified as amended at I.R.C. §§ 1471–1474 (2012)). FATCA was enacted as part of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

[6] *See generally infra* Section II.A.

[7] *See, e.g.*, Joshua D. Blank & Ruth Mason, *Exporting FATCA*, 142 TAX NOTES 1245 (2014); Itai Grinberg, *Taxing Capital in Emerging Countries: Will FATCA Open the Door?*, 5 WORLD TAX J. 325 (2013); Grinberg, *supra* note 1; J. Richard Harvey Jr., *FATCA—A Report from the Front Lines*, 136 TAX NOTES 713 (2012); J. Richard (Dick) Harvey Jr., *Offshore Accounts: Insider's Summary of FATCA and Its Potential Future*, 57 VILL. L. REV. 471 (2012) [hereinafter Harvey, *Offshore Accounts*]; Young Ran (Christine) Kim, *Considering "Citizenship Taxation": In Defense of FATCA*, 20 FLA. TAX REV. 335 (2017); Leandra Lederman, *The Use of Voluntary Disclosure Initiatives in the Battle Against Offshore Tax Evasion*, 57 VILL. L. REV. 499 (2012); Susan C. Morse, *Tax Compliance and Norm Formation Under High-Penalty Regimes*, 44 CONN. L. REV. 675 (2012); *see also* William R. Davis & Lee A. Sheppard, *Keneally Reports Success with Swiss Bank Program*, 73 TAX NOTES INT'L 414 (2014); Kristen A. Parillo, *U.S. Disclosure Program Deemed a Success*, 56 TAX NOTES INT'L 161 (2009). Others have made broader suggestions for how to implement FATCA or otherwise pursue offshore compliance. *See, e.g.*, Boise, *supra* note 1; Joanna Heiberg, *FATCA: Towards a Multilateral Automatic Information Reporting Regime*, 69 WASH. & LEE L. REV. 1685 (2012); Susan C. Morse, *Ask for Help, Uncle Sam: The Future of Global Tax Reporting*, 57 VILL. L. REV. 529 (2012) [hereinafter Morse, *Ask for Help, Uncle Sam*]; Scott A. Schumacher, *Magnifying Deterrence by Prosecuting Professionals*, 89 IND. L.J. 511 (2014).

[8] *See, e.g.*, Bruce W. Bean & Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperialism?*, 21 ILSA J. INT'L & COMP. L. 333 (2015); Allison Christians, *A Global Perspective on Citizenship Taxation*, 38 MICH. J. INT'L L. 193 (2017) [hereinafter, Christians, *Global*

not talking to the right: Those in favor of the U.S. approach seem convinced of its efficacy and necessity, and those leery of it regard the U.S. enforcement initiatives as costly, overreaching, obnoxious, and unfair.[9]

This Article weighs in on the side of offshore tax enforcement's critics. It argues, however, that these critics have not gone far enough in articulating the underlying concerns driving their criticisms. The United States' enforcement initiatives are not flawed simply because they are poorly designed. Rather, these design flaws are symptomatic of two policy priorities that the United States has implicitly embraced and that profoundly color its enforcement choices. First, the United States has attempted to equalize enforcement against taxpayers with solely domestic holdings and those with harder-to-detect offshore holdings (domestic–offshore parity) by imposing harsher reporting requirements and penalties on the latter; but in doing so, it has failed to appropriately distinguish among differently situated taxpayers with offshore holdings (intra-offshore distinctions). Second, the United States has focused on revenue recoupment and enforcement, but has paid less attention to the high externalized costs imposed on certain actors and to aggregate social welfare impacts more generally.

The disconnect between supporters and detractors of offshore tax enforcement exists largely because supporters of the U.S. approach tend to agree with (or are at least willing to tolerate) the underlying policy priorities that the United States has pursued, while detractors remain skeptical. The

*Perspective*]; Allison Christians, *Putting the Reign Back in Sovereign*, 40 PEPP. L. REV. 1373 (2013) [hereinafter Christians, *Putting the Reign Back in Sovereign*]; Allison Christians, *The Dubious Legal Pedigree of IGAs (and Why It Matters)*, 69 TAX NOTES INT'L 565 (2013) [hereinafter Christians, *Dubious Legal Pedigrees of IGAs*]; Michael S. Kirsch, *Revisiting the Tax Treatment of Citizens Abroad: Reconciling Principle and Practice*, 16 FLA. TAX REV. 117, 161–70 (2014) [hereinafter Kirsch, *Revisiting*]; Mason, *supra* note 1, at 213–15; Noam Noked, *FATCA, CRS, and the Wrong Choice of Who to Regulate*, 22 FLA. TAX REV. (forthcoming 2018); Oei & Ring, *supra* note 1; Lee A. Sheppard, *FATCA is a Drone: What to Do About Compliance?*, 64 TAX NOTES INT'L 10 (2011); Frederic Behrens, Comment, *Using a Sledgehammer to Crack a Nut: Why FATCA Will Not Stand*, 2013 WIS. L. REV. 205 (2013); Melissa A. Dizdarevic, Comment, *The FATCA Provision of the Hire Act: Boldly Going Where No Withholding Has Gone Before*, 79 FORDHAM L. REV. 2967 (2011); Reuven S. Avi-Yonah & Gil Savir, *Find It and Tax It: From TIEAs to IGAs* (Mich. Law Pub. Law & Legal Theory Research Paper Series, Paper No. 443, 2015), https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2567646; Allison Christians & Arthur Cockfield, Submission to Finance Department on Implementation of FATCA in Canada, (Mar. 10, 2014) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2407264; Arthur J. Cockfield, FATCA and the Erosion of Canadian Taxpayer Privacy, Report to the Office of the Privacy Commissioner of Canada, (Apr. 2014) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2433198.

9 *See, e.g.*, Sheppard, *supra* note 8 ("FATCA is a drone. It's obnoxious, expensive, arrogant, extraterritorial, and likely to cause a fair amount of collateral damage while occasionally hitting its targets. It's just like those expensive drones cruising around the Middle East and parts of eastern Africa. Moreover, FATCA, like the ever-expanding drone program, won't go away for quite a while.").

ongoing debate over offshore tax enforcement is, at its core, about which set of priorities one thinks is more important, and how to weigh each against the other.

This Article argues that the confluence of the United States' dual commitments has led to a costly enforcement approach that risks creating disproportionate and unfair burdens on immigrants, American expatriates, and accidental Americans. While more research is required to understand and quantify those costs, the existing evidence suggests that they are high in relation to revenue collected.[10] There is reason to think that some of these taxpayers not in the originally targeted population have been disproportionately affected.[11]

In short, it is plausible that offshore tax enforcement may be a legal regime designed to catch high-net-worth tax evaders that also ensnares other groups with less ability to complain, comply, or "substitute out" of the law's grasp. This Article argues that in light of this risk, the United States should give more weight to intra-offshore distinctions and externalized costs, both of which are important considerations that have not received the attention they deserve. It suggests reforms that do so.

This Article's unique contribution is to argue that offshore tax enforcement's problems are not idiosyncratic, but are the result of the deliberate and problematic policy priorities on which the United States has focused at the expense of competing considerations. Additionally, this Article is the first to analyze all of the United States' offshore tax enforcement initiatives as a unified and comprehensive enforcement approach driven by a common underlying vision, rather than as piecemeal laws and programs. This underlying vision needs to be probed and understood in order to undertake consistent and well-thought-out reforms that reflect clear policy priorities and directions.

Part I explains the vexing problem of offshore tax enforcement and describes the key challenges it has posed for the United States. Part II describes the interlocking web of offshore tax enforcement initiatives that the United States has adopted, and explains how they have worked. Part III advances the main thesis of this Article, arguing that the problematic features of the U.S. enforcement initiatives are not one-off glitches, but rather are the result of two fundamental priorities that the United States has embraced while

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[10] *See infra* Section III.B.
[11] *See infra* Section III.A.

not taking other considerations adequately into account: (1) a focus on domestic–offshore parity while paying less attention to making appropriate intra-offshore distinctions and (2) attention to revenue and enforcement while insufficiently taking into account the high externalized costs of the enforcement initiatives. Finally, Part IV explores how offshore tax enforcement could be redesigned to better account for intra-offshore distinctions and aggregate social welfare.

This Article's analysis comes at a particularly appropriate time: The DOJ has recently concluded its Swiss Bank Program and is turning its attention beyond Switzerland to offshore financial holdings in other jurisdictions.[12] Meanwhile, FATCA information reporting has begun to take effect. Other countries are learning and borrowing from the U.S. experience with FATCA in designing similar information-exchange legislation.[13] This moment of closing out enforcement against Swiss Banks, pursuing tax evaders further afield, and moving towards FATCA implementation is an appropriate juncture at which to evaluate how the U.S. enforcement initiatives have performed so far, consider how their flaws ought to be corrected, and map out directions for further research.

## I. THE VEXING PROBLEM OF OFFSHORE TAX ENFORCEMENT

The problem of offshore tax enforcement stems from practical difficulties in enforcing the U.S. income tax regime across international borders. Section A explains the offshore tax enforcement challenge and highlights distinctive features of the offshore enforcement landscape that exacerbate this challenge. Section B then summarizes the pre-2008 U.S. attempts at offshore tax enforcement and why they were inadequate. Section C explains how the events of 2008 created a sea-change in enforcement initiatives.

### *A. The Offshore Tax Enforcement Challenge*

The difficulties that the United States has faced in doing offshore tax enforcement stem from the confluence of a number of factors. The jurisdictional decision to tax U.S. citizens and other U.S. residents on their worldwide income creates enforcement challenges for the United States and

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12 *See* Emily L. Foster, *Swiss Bank Program Lives on in "Legacy Phase,"* 84 TAX NOTES INT'L 143 (2016); William Hoke, *Focus Shifting Away from Switzerland, Investigators Say*, 149 TAX NOTES 628 (2015); Nathan J. Richman, *Final Swiss Bank Program Entity Resolution Complete*, 154 TAX NOTES 64 (2017).

13 Blank & Mason, *supra* note 7; Grinberg, *supra* note 7; *see also* OECD, STANDARD FOR AUTOMATIC EXCHANGE OF FINANCIAL ACCOUNT INFORMATION IN TAX MATTERS (2014).

compliance difficulties for a heterogeneous group of taxpayers. The mobility of financial capital, systemic risk concerns, and international politics exacerbate these enforcement challenges.

### 1. *Citizenship-Based, Worldwide Taxation on a Heterogeneous Pool of Taxpayers*

The United States taxes its citizens on their worldwide income from whatever source derived and, importantly, imposes this income tax whether or not the citizen is actually living in the United States.[14] Thus, a U.S. citizen living in New Jersey is taxable on rents from real estate in the Bahamas, interest earned on a Hong Kong bank account, and dividends paid on shares of a British company, even though that income is not earned from U.S. sources.[15] If that U.S. citizen moved to Mexico, she would still be subject to U.S. tax on worldwide income despite her foreign domicile, as long as she remained a U.S. citizen.[16] These U.S. citizens must file U.S. tax returns, declare all income—both from domestic and foreign sources—on the return, and comply with various other information reporting requirements. While the U.S. allows taxpayers to take a foreign tax credit against their U.S. tax liability for income taxes paid to other countries,[17] this does not relieve U.S. taxpayers of their tax filing and information reporting obligations with respect to that foreign income.[18]

The United States also taxes some non-citizens on their worldwide income, just like U.S. citizens. U.S. green card holders (legal permanent residents), for example, are also considered "tax residents" and are taxed on their worldwide income, on par with citizens.[19] Certain long-term U.S. residents who are not

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[14] I.R.C. § 61 (2012); Cook v. Tait, 265 U.S. 47, 56 (1924). This Article takes U.S. citizenship-based, worldwide taxation as a given and focuses on the design of offshore enforcement given this jurisdictional decision. For examples of literature debating the merits and design of citizenship-based taxation, see Cynthia Blum & Paula N. Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 VAND. J. TRANSNAT'L L. 705 (2008); Christians, *Global Perspective*, *supra* note 8; Kirsch, *Revisiting*, *supra* note 8; Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443 (2007); Mason, *supra* note 1; Daniel Shaviro, *Taxing Potential Community Members' Foreign Source Income*, 70 TAX L. REV. 75 (2016); Edward A. Zelinsky, *Citizenship and Worldwide Taxation: Citizenship as an Administrable Proxy for Domicile*, 96 IOWA L. REV. 1289 (2011).

[15] I.R.C. §§ 861–862. Although such "source" designations are in some sense arbitrary, they are widely recognized conventions used in U.S. cross-border taxation to allocate income among jurisdictions.

[16] That citizen might be eligible for a foreign earned income exclusion under I.R.C. § 911.

[17] *Id.* § 901 *et seq.*

[18] Even where there is a tax treaty between the United States and that country, the filing obligation may still exist. *See* INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, PUB. NO. 519, U.S. TAX GUIDE FOR ALIENS 47–48 (2017) (discussing how to report income and treaty benefits on a tax return).

[19] I.R.C. § 7701(b)(1).

citizens and not green card holders may also be taxed on worldwide income if they have spent enough days in the United States under the "substantial presence test" of the Internal Revenue Code.[20] Thus, long-term residents of the U.S.—including foreign workers working on long-term U.S. visas—may also be taxable on their worldwide income and may also be subject to the same tax and information reporting rules.

Thus, the pool of taxpayers subject to U.S. worldwide taxing jurisdiction who may experience offshore tax issues is heterogeneous. Some may be willful evaders, but others may be Americans working overseas, accidental Americans, or green card or long-term visa holders who are taxed as U.S. residents.

These populations are numerically significant. The State Department has estimated that as of fiscal year 2015, an estimated 9 million U.S. citizens were living overseas.[21] The Department of Homeland Security (DHS) Office of Immigration Statistics estimates that as of January 1, 2012, an estimated 13.3 million green card holders lived in the United States.[22] The number of naturalized U.S. citizens stood at about 20 million as of 2014.[23] And the total U.S. immigrant population was about 43.3 million as of 2015, or about 13.5% of the total U.S. population.[24] DHS estimates the number of unauthorized

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[20] *Id.* § 7701(b)(3). In general, an individual will meet the substantial presence test if she is "present in the United States on at least 31 days during the calendar year" and if "the sum of the number of days . . . [she] was present in the United States during the current year and the 2 preceding years (when multiplied by the applicable multiplier [specified by the statute]) equals or exceeds 183 days," computed under a statutory formula. *Id.* The substantial presence test generally will not apply if the taxpayer was "present in the United States on fewer than 183 days during the current year" and can prove that she had a tax home in the foreign country and a closer connection to that foreign country. *Id.* § 7701(b)(3)(B). "Tax home" is defined in I.R.C. 911(d)(3). *See id.* § 911(d)(3). There are a number of technical exceptions and carve-outs, and the determination of residence may also be modified if there is an existing tax treaty. *See id.* § 7701(b)(3).

[21] BUREAU OF CONSULAR AFFAIRS, U.S. DEP'T OF STATE, *CA by the Numbers*, https://travel.state.gov/content/dam/travel/CA_By_the_Numbers.pdf (last updated May 2017) [https://web.archive.org/web/20160616233331/https://travel.state.gov/content/dam/travel/CA_By_the_Numbers.pdf].

[22] Nancy Rytina, *Estimates of the Legal Permanent Resident Population in 2012*, U.S. DEP'T HOMELAND SECURITY (July 2013), https://www.dhs.gov/sites/default/files/publications/ois_lpr_pe_2012.pdf.

[23] *Naturalization Trends in the United States*, MIGRATION POL'Y INST. (Aug. 10, 2016), http://www.migrationpolicy.org/article/naturalization-trends-united-states.

[24] *Frequently Requested Statistics on Immigrants and Immigration in the United States*, MIGRATION POL'Y INST. (Apr. 14, 2016), http://www.migrationpolicy.org/article/frequently-requested-statistics-immigrants-and-immigration-united-states. The Migration Policy Institute defines immigrants to include those without U.S. citizenship at birth, such as naturalized citizens, green card holders, refugees and asylees, unauthorized immigrants, and temporary work visa holders. *Id.*

immigrants at about 11.4 million as of January 2012.[25] The number of work visa holders living in the United States is not clear.

Not all of these inbound and outbound migrant populations will have offshore tax holdings and assets. But it seems likely that many could. As Professor Allison Christians has argued, while some of these latter categories may fail to report income willfully, in other cases, their failure may be a result of not understanding their tax obligations or something closer to negligence.[26]

### 2. *Distinctive Enforcement and Compliance Challenges Across Borders*

Implementation of the United States' worldwide tax regime across borders creates distinctive enforcement challenges.

*Information Asymmetry*. Most pertinently, there is a clear information asymmetry problem. The United States has faced persistent difficulties in obtaining information about the income of its taxpayers earned from foreign sources, for example, interest earned on a foreign bank account. Income earned from domestic sources has traditionally been subject to third-party withholding and information reporting (for example, wage withholding on Form W-2 and reporting of interest and other income on Form 1099), while withholding and reporting on foreign income has been much less complete.[27] The lack of adequate third-party reporting and the relative ease of obscuring foreign income and assets from the United States have made it easier for taxpayers to not report income on those assets.

*Compliance Challenges for Taxpayers.* Cross-border taxation also raises compliance challenges for taxpayers. The decision to tax all citizens on worldwide income regardless of actual residence means a citizen who resides abroad and has never lived in the United States, or has lived in the United

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[25] Bryan Baker & Nancy Rytina, *Estimates of the Unauthorized Immigrant Population Residing in the United States: January 2012*, U.S. DEP'T HOMELAND SECURITY (Mar. 2013), https://www.dhs.gov/sites/default/files/publications/Unauthorized%20Immigrant%20Population%20Estimates%20in%20the%20US%20January%202012_0.pdf.

[26] Christians, *Global Perspective*, *supra* note 8.

[27] *See, e.g.*, I.R.C. §§ 1441 *et seq.* (2012); *id.* § 3402. *See generally* James Alm et al., *Do Individuals Comply on Income Not Reported by Their Employer?* 37 PUB. FIN. REV. 120 (2009); Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733 (2010) [hereinafter Lederman, *Reducing Information Gaps*]; Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695 (2007); Joel Slemrod et al., *Does Credit-Card Information Reporting Improve Small-Business Tax Compliance?* (Nat'l Bureau of Econ. Research, Working Paper No. 21412, 2015), http://www.nber.org/papers/w21412.

States only briefly, is nonetheless taxed on worldwide income.[28] So, for example, a U.S. citizen who acquired citizenship by birthright or a minor who automatically acquires citizenship when her parents naturalized is subject to worldwide U.S. taxation, even if she has never lived in the United States.[29] Similarly, a citizen who is born in the United States or its territories but who moves away is nonetheless subject to U.S. taxation on her worldwide income.[30] Green card holders temporarily living abroad who have not abandoned their green card status are also considered U.S. tax residents subject to tax on worldwide income.[31] Some of these taxpayers may not be aware of their citizenship, their obligation to pay taxes on worldwide income, or their obligation to file tax and information returns.

Some of these enforcement and compliance challenges are not specific to the United States. For example, the challenges of enforcing cross-border taxation arise in any country that taxes its residents on worldwide income. However, other challenges are distinctive to the United States. In particular, the decision to tax U.S. citizens *regardless of residence* has presented difficulties for some taxpayers.[32]

*Complexity*. Cross-border tax compliance is made more challenging by the law's complexity. In addition to the basic rule of worldwide taxation, taxpayers with cross-border issues may also have to grapple with rules regarding the foreign tax credit and the foreign earned income exclusion.[33] They may be subject to the so-called "anti-deferral" rules pertaining to controlled foreign corporations (CFCs) and passive foreign investment companies (PFICs), which prevent taxpayers from deferring tax liability by shifting assets offshore and holding them in entities.[34] Many of these rules pre-date the current wave of U.S. initiatives, but their impact has become more resonant in the post-2008 enforcement environment.[35] In addition, the process of computing and determining offshore income may be more complex than for domestic assets, due to the lack of corroborative information reporting (e.g., taxpayer not

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28 *See* Christians, *Global Perspective*, *supra* note 8, at 203; Mason, *supra* note 1, at 171–72.

29 Again, these taxpayers may be eligible for the foreign earned income exclusion or a foreign tax credit, but these do not obviate the need to file and pay taxes. I.R.C. §§ 901, 911.

30 Christians, *Global Perspective*, *supra* note 8, at 203.

31 I.R.C. § 7701(b).

32 Montano Cabezas, *Reasons for Citizenship-Based Taxation?*, 121 PENN. ST. L. REV. 101 (2016) (suggesting the need for new rationales for citizenship-based taxation); Mason, *supra* note 1 (discussing citizenship taxation).

33 *Id.* §§ 901, 911.

34 *See, e.g.*, *id.* §§ 957, 1291.

35 *See supra* note 34; *see generally infra* Section II (describing the offshore enforcement initiatives).

receiving a Form 1099 or W-2), the need to convert foreign currency to U.S. dollars, and the need to file various informational forms.[36] Complexity means that taxpayers may have a difficult time finding competent tax preparers, may have to incur higher compliance costs, or may be more susceptible to mistakes.

*Systemic Risk and Politics*. All of these offshore enforcement and compliance challenges take place in an environment in which systemic risk concerns must be navigated. Major facilitators of offshore evasion include banks, so the possibility of bank destabilization and failure must be considered in deciding how to sanction them, if at all. These considerations may lead prosecutors to enter into deferred- and non-prosecution agreements (DPAs and NPAs) with banks, rather than actually prosecuting them.[37] Such corporate DPAs and NPAs have been criticized as unfair.[38]

U.S. cross-border tax enforcement also takes place against a backdrop of international politics, tax treaties, and information exchange agreements. The need to operate within the framework of international tax and fiscal diplomacy has imposed ongoing frictions on the United States' ability to seamlessly obtain taxpayer information from foreign jurisdictions.

*Capital Mobility*. Finally, financial capital is mobile. Taxpayers can quickly move assets across jurisdictions, or can transform reportable assets (e.g., bank accounts) into non-reportable ones (e.g., real estate). Often, they can do so faster than the taxing authority can detect or enforce against the asset. The speed at which money can move is particularly problematic given that international politics and systemic risk may act as brakes on governments' ability to act.

## *B. Pre-2008 Enforcement Initiatives*

Prior to 2008, the United States did make some efforts to enforce offshore tax compliance. But these were largely ineffective.

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[36] *See infra* Section II.A.3.

[37] *See generally* BRANDON L. GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS (2014); Brandon L. Garrett, *Globalized Corporate Prosecutions*, 97 VA. L. REV. 1775 (2011); Brandon L. Garrett, *The Rise of Bank Prosecutions*, 126 YALE L.J. (2016).

[38] *See supra* note 37; *see also* PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT (Anthony S. Barkow & Rachel E. Barkow eds., 2011) (studying regulatory function of DPAs and NPAs).

### 1. *Tax Treaty Provisions for Exchange of Information*

The United States has signed treaties for the avoidance of double taxation with many countries, and these treaties include Article 26, which provides for the exchange of information between signatories.[39] Article 26 requires each contracting state to exchange information relevant for carrying out the treaty provisions or the domestic tax laws of each treaty partner, including information relating to tax assessment, administration, enforcement, prosecution, or appeals.[40] But treaty-based information exchange is only provided "on request."[41] Thus, if the United States does not know the specific identities of the individual taxpayers, or does not know about the evasion, it may be unable to make a sufficiently targeted request.[42] There are also grounds upon which the treaty partner has historically been able to decline such a request. Moreover, the United States does not have treaties with all countries. For these reasons, treaty-based exchange of information has not been a sufficient mechanism through which to police offshore tax evasion.

### 2. *TIEAs and MLATs*

The United States has also entered into Tax Information Exchange Agreements (TIEAs) with various countries, typically those with whom the United States does not have a double tax treaty.[43] Unlike tax treaties, TIEAs only govern the terms of exchange of information between signatories.[44] Like tax treaties, TIEAs provide for information exchange only upon request, and requests prove difficult if the requesting country does not already have prior information.[45] In addition, many TIEAs are limited because governments are

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39 *United States Income Tax Treaties—A to Z*, INTERNAL REVENUE SERV., https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z (last visited Oct. 17, 2017).

40 Diane Ring, *Article 26: Exchange of Information*, *in* GLOBAL TAX TREATY COMMENTARIES (Richard Vann et al. eds., 2017) (discussing these elements in the OECD model treaty).

41 *Id.* § 1.2.5.3.

42 *Id.* § 1.2.3.

43 I.R.C. § 274(h)(6)(C) (2012). Before 2008, the United States had entered into TIEAs with only a few tax-haven jurisdictions, including Antigua, the Cayman Islands, Bahamas, the British Virgin Islands, Netherlands Antilles, Guernsey, the Isle of Man, Jersey, and Aruba. *Tax Information Exchange Agreements (TIEAs): United States*, OECD, http://www.oecd.org/tax/transparency/taxinformationexchangeagreementstieas unitedstates.htm (last visited Oct. 20, 2017); *see also* Robert T. Cole et al., *U.S. Income Tax Treaties — U.S. Competent Authority Functions and Procedures*, Tax & Acct. Ctr. (BNA) (2014). After 2008, the United States signed TIEAs with Liechtenstein, Gibraltar, Monaco, and Panama, but by this time TIEAs had largely been superseded in importance by other multilateral initiatives, including FATCA and the Common Reporting Standard. Cole et al., *supra*.

44 Ring, *supra* note 40, § 3.1.1.

45 *Id.* §§ 2.1.4, 3.1.3.

not required to exchange information if it requires deviation from their own laws or the laws of the requesting country.[46]

In addition to TIEAs, the United States has also entered into Mutual Legal Assistance Treaties (MLATs) with a number of countries.[47] MLATs are non-tax-specific bilateral agreements that allow the signatories to obtain evidence from the treaty partner in criminal proceedings.[48] However, MLATs do not extend to civil tax proceedings. Some do not even permit the exchange of tax-related information.[49] Thus, like TIEAs, MLATs have been of limited utility in the battle against offshore tax evasion.

### 3. *The "Qualified Intermediary" Regime*

Another key mechanism by which the United States attempted offshore tax enforcement was through the "Qualified Intermediary" (QI) regime. The QI system, which took effect on January 1, 2001, required foreign financial institutions (FFIs) that were QIs to collect documentation with respect to U.S. and foreign customers, to perform U.S. tax withholding on certain customers, and to file U.S. information returns with respect to others.[50]

However, the QI regime did not require reporting of *foreign-source* income paid to U.S. taxpayers. U.S. customers could therefore evade taxes by investing abroad in activities generating foreign-source income. QIs were also not required to look through foreign shell entities to determine the actual beneficial owner. This meant that a U.S. person could create a foreign entity with a separate legal identity, and the QIs would take the position that this entity was the beneficial owner of the income or assets and not inquire (or report) further.

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[46] Cole et al., *supra* note 43.

[47] *Treaties and Agreements*, U.S. DEP'T STATE (Mar. 7, 2012), http://www.state.gov/j/inl/rls/nrcrpt/2012/vol2/184110.htm.

[48] *Id.*

[49] IRM 4.60.1.8(3) (Sept. 19, 2014); Cole et al., *supra* note 43, at A-64.

[50] 26 C.F.R. § 1.1441-1 (2017); Harvey, *Offshore Accounts*, *supra* note 7, at 474. Before the QI system took effect, a U.S. taxpayer could invest in U.S. ventures through an FFI account and the FFI would not be required to report information about that taxpayer to the United States. Harvey, *Offshore Accounts*, *supra* note 7, at 474. U.S. taxpayers could thus avoid reporting or paying tax on that income. In addition, U.S. payors (e.g., U.S. banks) were not required to obtain information from FFIs about their foreign clients (e.g., foreign shell entities), and hence did not properly withhold taxes on U.S. source payments to these foreign customers made through the FFIs. *Id.* In effect, the QI system changed things by requiring QIs to "know your customer."

### 4. *FBAR Filing*

The United States has historically also obtained information about foreign financial accounts via the so-called Form "FBAR" (Financial Crimes Enforcement Network (FinCEN) 114), "Report of Foreign Bank and Final Accounts."[51] U.S. persons with an interest in or signatory authority over foreign financial accounts exceeding $10,000 are required to file this form.[52] Before 2008, however, FBAR enforcement was not strictly policed.[53] Moreover, the focus of FBAR enforcement was more about money laundering than tax compliance. Thus, FBAR compliance was historically low. FBAR enforcement has ramped up since the current wave of initiatives came into effect.[54]

## C. *The 2008 Whistleblower Leaks*

Two significant whistleblower leaks in 2008 significantly changed the offshore tax enforcement landscape, and led to the development of the current family of enforcement initiatives.

### 1. *The UBS Leak*

The more significant leak occurred with respect to UBS Bank in Switzerland. In 2007, Bradley Birkenfeld, a former private banker at UBS, blew the whistle on the bank and shared information about secret client accounts and improprieties at UBS Bank with the DOJ, the Securities and Exchange Commission (SEC), the IRS, and the U.S. Senate.[55] For his trouble, Birkenfeld was arrested and charged by federal prosecutors with conspiracy to defraud the United States, to which he pled guilty and was sentenced to forty

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[51] Dep't of the Treasury, TDF 90-22.1, Report of Foreign Bank and Financial Accounts (2011). This form "FBAR," which was previously a paper filing, now can only be filed electronically. *See BSA E-Filing System*, FIN. CRIMES ENFORCEMENT NETWORK, http://bsaefiling.fincen.treas.gov/main.html (last visited Sept. 11, 2017).

[52] *See* 31 U.S.C. § 5314 (2012); 31 C.F.R. § 1010.350 ("Reports of foreign financial accounts."); *supra* note 51.

[53] Amanda Athanasiou, *News Analysis: Minding the Gap in FBAR Filings*, 81 TAX NOTES INT'L 722 (2016).

[54] *Id.*

[55] BRADLEY C. BIRKENFELD, LUCIFER'S BANKER: THE UNTOLD STORY OF HOW I DESTROYED SWISS BANK SECRECY (2016); *see also* Oei & Ring, *supra* note 1 (discussing the UBS and other leaks). For a detailed summary of the UBS scandal, see William Byrnes, *Background and Current Status of FATCA and CRS (Sept. 2017 Edition)*, *in* LEXISNEXIS GUIDE TO FATCA & CRS COMPLIANCE § 1.03[1] (Tex. A&M Univ. Sch. of Law Legal Studies Research Paper Series, Research Paper No. 17-75, 2017) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3045459.

months in prison.[56] Yet, he was also awarded $104 million under a new whistleblower law.[57]

The information Birkenfeld provided caused significant outrage in tax and public circles. Propelled by the UBS scandal, the IRS and DOJ began to investigate UBS's illegal activities, punish the bank, and develop other enforcement strategies. On July 1, 2008, the IRS served a "John Doe" summons on UBS to obtain information regarding up to 52,000 U.S. taxpayers who had used UBS accounts to evade taxes.[58] Subsequently, on February 28, 2009, UBS entered into a DPA with the DOJ, pursuant to which UBS agreed to pay $780 million to the United States,[59] including interest and penalties, and to turn over a small number of client names.[60] The DPA specifically allowed the United States to continue to seek enforcement of the 2008 John Doe summons.

After much diplomatic and legislative maneuvering,[61] the United States ultimately obtained information concerning approximately 4,000 account

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[56] Motion for Sentence Reduction, United States v. Birkenfeld, Case No. 08-60099-CR-ZLOCH (S.D. Fla. Aug. 17, 2009); Sentencing Memorandum of Defendant Bradley Birkenfeld, *Birkenfeld*, Case No. 08-60099-CR-ZLOCH (Aug. 18, 2009); David D. Stewart, *Former UBS Banker Sentenced to 40 Months in Prison*, 124 TAX NOTES 747 (2009).

[57] I.R.C. § 7623 (2012); *see* Coder, *supra* note 2; Ken Stier, *Why Is the UBS Whistle-Blower Headed to Prison?*, TIME (Oct. 6, 2009), http://content.time.com/time/business/article/0,8599,1928897,00.html.

[58] Press Release, U.S. Dep't of Justice, Federal Judge Approves IRS Summons for UBS Swiss Bank Account Records (July 1, 2008), https://www.justice.gov/archive/tax/txdv08584.htm; *Levin Statement on Swiss Rejection of UBS Settlement*, 2010 WORLDWIDE TAX DAILY 110-31 (2010).

[59] *See* Deferred Prosecution Agreement, United States vs. UBS AG, Case No. 09-60033-CR-COHN (S.D. Fla. 2009), https://www.justice.gov/sites/default/files/tax/legacy/2009/02/19/UBS_Signed_Deferred_Prosecution_Agreement.pdf. Of the $780 million, $380 million represented disgorgement of profits from cross-border business. The remainder represented unpaid withholding taxes, interest, penalties, and restitution for unpaid taxes. *Id.*

[60] *Id.*

[61] On August 19, 2009, the IRS and DOJ announced an agreement with the Swiss government to let UBS disclose 4,450 client names per treaty request by UBS. *See Agreement Between the United States of America and the Swiss Confederation*, INTERNAL REVENUE SERV. (Aug. 19, 2009), http://www.irs.gov/pub/irs-drop/us-swiss_government_agreement.pdf; *see also* Press Release, U.S. Dep't of Justice, U.S. Discloses Terms of Agreement with Swiss Government Regarding UBS (Aug. 19, 2009), http://www.justice.gov/opa/pr/us-discloses-terms-agreement-swiss-government-regarding-ubs; I.R.S. News Release IR-2009-75 (Aug. 19, 2009). However, UBS clients appealed, and in January 2010, the Swiss Federal Administrative Court ruled that the agreement violated Swiss law. The Swiss government then sought parliamentary approval for the agreement to give it the force of a treaty. In March 2010, Switzerland and the United States signed a protocol that allowed the Swiss Federal Tax Administration to determine which clients' data could be disclosed, but that prevented disclosure until parliament actually approved. *Protocol Amending the Agreement Between the United States of America and the Swiss Confederation*, BUNDESAMT FÜR JUSTIZ BJ (Mar. 2010), https://www.bj.admin.ch/dam/data/bj/wirtschaft/fallubs/aenderungsprotokoll-amtshilfeabkommen-e.pdf. In April 2010, the Swiss Federal Administrative Court rejected the UBS clients' appeal, paving the way for disclosure of the clients' names. David D. Stewart, *Swiss Court Upholds Provisional Application of UBS Agreement.*, 58 TAX NOTES INT'L 385 (2010).

holders, far fewer than the 52,000 it had originally sought.[62] Using this data, the United States set about punishing offenders, pressuring others into voluntarily coming clean, and developing a comprehensive system of regulation and enforcement to deal with offshore tax evasion.

### 2. *The LGT Leak*

Around the same time, a smaller scandal emerged in Liechtenstein involving LGT Bank when an employee stole confidential client data of about 1,400 offshore clients.[63] The data revealed that LGT had been active in helping offshore clients hide assets in Liechtenstein by maintaining undisclosed client accounts, advising clients to open accounts held by Liechtenstein foundations to hide their beneficial ownership, helping clients design complex structures to hide asset ownership, and helping disguise transfers of assets to and from LGT accounts.[64]

In early 2008, a number of countries, including the United States, started investigating offshore tax evasion by their citizens based on the LGT data.[65] The United States and Liechtenstein eventually signed a TIEA in December 2008, effective for tax years beginning on or after January 1, 2009.[66]

The UBS and LGT leaks were significant drivers in spurring the United States to investigate and address offshore tax evasion.[67] In 2008, the U.S. Senate Subcommittee on offshore banks and tax evasion issued a major report, which triggered a serious push towards reform.[68]

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62 The remaining few hundred were not turned over because they did not meet the criteria. On November 16, 2010, the IRS announced that it had withdrawn the John Doe summons. *IRS Withdraws 'John Doe' Summons Against UBS Over Tax Fraud* Allegations, 220 Daily Tax Rep. (BNA) GG-1 (Nov. 17, 2010).

63 *See* STAFF OF U.S. SENATE PERMANENT SUBCOMM. ON INVESTIGATIONS, 110TH CONG., TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 2 (2008) [hereinafter 2008 SENATE REPORT]; *see also* Randall Jackson, *Bank Sells Trust Businesses in Wake of Tax Scandal*, 53 TAX NOTES INT'L 951 (2009); Lynnley Browning, *Banking Scandal Unfolds Like a Thriller*, N.Y. TIMES (Aug. 14, 2008), http://www.nytimes.com/2008/08/15/business/worldbusiness/15kieber.html.

64 *See* 2008 SENATE REPORT, *supra* note 63, at 2.

65 I.R.S. News Release IR-2008-26 (Feb. 26, 2008); Randall Jackson, *Germany Recovers Millions Through Liechtenstein Tax Investigations*, 58 TAX NOTES INT'L 113 (2010); Randall Jackson, *More Tax Cheats in the Doghouse over Liechtenstein Tax Evasion*, 2008 WORLDWIDE TAX DAILY 62-2 (2008) (citing investigations by the United Kingdom, Italy, France).

66 *See* Joann M. Weiner, *News Analysis: The New TIEA: A Christmas Gift to Liechtenstein*, 52 TAX NOTES INT'L 831 (2008); *Agreement Between the Government of the United States of America and the Government of the Principality of Liechtenstein on Tax Cooperation and the Exchange of Information Relating to Taxes*, U.S. DEP'T OF TREASURY, https://www.treasury.gov/press-center/press-releases/Documents/us%20liechtenstein%20tiea.pdf (last visited Apr. 1, 2018).

67 Oei & Ring, *supra* note 1 (explaining how these leaks have driven the direction of tax law).

68 2008 SENATE REPORT, *supra* note 63.

## II. THE U.S. APPROACH TO OFFSHORE TAX ENFORCEMENT

In the wake of the 2008 whistleblower leaks, the United States has developed a family of initiatives designed to combat offshore tax evasion. Section A presents a taxonomy of U.S. offshore tax enforcement initiatives, section B describes the mechanisms underpinning how these initiatives work, and section C briefly discusses the extant scholarly and policy commentary on their effectiveness.

### *A. A Taxonomy of Current Offshore Tax Enforcement Strategies*

The United States' offshore tax enforcement initiatives can be roughly grouped into three categories: (1) initiatives aimed at punishing bad behavior, (2) backward-looking regulatory initiatives geared toward bringing past and current offenders into compliance, and (3) forward-looking initiatives geared toward enforcing compliance by gathering data on taxpayers and their bank accounts.

These categories are not watertight, but rather function as rough heuristics that facilitate analysis. Together, these initiatives form a web of regulation and enforcement via which various actors are held accountable, are constrained in their ability to evade, and are harnessed as information sources to help catch other evaders. The interactions between these initiatives generate compliance cascades by using information extracted from one actor to gather (or threaten to gather) data about other actors, thus encouraging follow-on disclosure and compliance.

#### *1. Punishment*

First, the United States has prosecuted taxpayers, bankers, and others who engaged in or facilitated offshore tax evasion. The United States began these prosecutions using information obtained through the UBS DPA and the 2008 John Doe summons.[69] The United States has also obtained additional information about other offenders using information gathered under its offshore voluntary disclosure programs and Swiss Bank program.[70]

The DOJ pursued prosecutions of offshore tax offenders as part of its Offshore Compliance Initiative (OCI), which has been advertised as one of the

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[69] *See supra* notes 58–62 and accompanying text.

[70] *See infra* Section II.B.1 (describing cascading compliance dynamics inherent in offshore tax enforcement).

Tax Division's top litigation priorities.[71] The DOJ's OCI page at one point boasted that "[f]rom 2008 through April 2013, the Tax Division has charged over 30 banking professionals and 60 account holders, thus far resulting in five convictions after trial and 55 guilty pleas, including 2 trial convictions and 16 guilty pleas in the first four months of 2013 alone."[72] The number of indictments, prosecutions, and pleas has likely grown since that announcement. While exact numbers are difficult to find, one prominent tax blog reports as of July 2016 the indictments of 117 taxpayers with offshore accounts and forty-nine enablers (bankers, attorneys, and advisors), generating 104 guilty pleas and nineteen guilty verdicts.[73] In a November 2, 2016 speech to the American Bar Association, Principal Deputy Assistant Attorney General Caroline Ciraolo noted that the DOJ, in collaboration with the IRS Criminal Investigations unit, had charged over 160 U.S. accountholders with tax evasion and failure to report offshore assets along with fifty enablers.[74]

While most Swiss banks received DPAs and NPAs in the aftermath of the UBS scandal, the DOJ did secure guilty pleas from Wegelin Bank and Credit Suisse, two major Swiss Banks.[75] In fact, the guilty plea led to Wegelin's closure.[76]

### 2. *Backward-Looking Regulatory Initiatives*

Punishment aside, the United States has also pursued programs designed to bring banks and taxpayers who have previously evaded taxes back into

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71 *Offshore Compliance Initiative*, U.S. DEP'T OF JUSTICE, https://www.justice.gov/tax/offshore-compliance-initiative (last visited July 20, 2015) [http://www.lb7.uscourts.gov/documents/14-13301.pdf] [hereinafter *Offshore Compliance Initiative 2015*].

72 *Id.*

73 Jack Townsend, *Offshore Charges/Convictions Spreadsheet (7/22/16)*, FED. TAX CRIMES, http://federaltaxcrimes.blogspot.com/p/offshore-charges-convictions.html (last visited July 22, 2016).

74 Caroline D. Ciraolo, Principal Deputy Assistant Attorney General, Dep't of Justice, Keynote Address at the American Bar Association's 27th Annual Philadelphia Tax Conference (Nov. 2, 2016), *in Principal Deputy Assistant Attorney General Caroline D. Ciraolo Delivers Keynote Address at the American Bar Association's 27th Annual Philadelphia Tax Conference*, U.S. DEP'T OF JUSTICE, https://www.justice.gov/opa/speech/principal-deputy-assistant-attorney-general-caroline-d-ciraolo-delivers-keynote-address (last updated Dec. 21, 2016).

75 Press Release, U.S. Dep't of Justice, Credit Suisse Pleads Guilty to Conspiracy to Aid and Assist U.S. Taxpayers in Filing False Returns (May 19, 2014), https://www.justice.gov/opa/pr/credit-suisse-pleads-guilty-conspiracy-aid-and-assist-us-taxpayers-filing-false-returns; Press Release, U.S. Dep't of Justice, Swiss Bank Pleads Guilty in Manhattan Federal Court to Conspiracy to Evade Taxes (Jan. 3, 2013), https://www.justice.gov/usao-sdny/pr/swiss-bank-pleads-guilty-manhattan-federal-court-conspiracy-evade-taxes.

76 Nate Raymond & Lynnley Browning, *Swiss Bank Wegelin to Close After Guilty Plea*, REUTERS, Jan. 4, 2013, 10:11 PM, http://www.reuters.com/article/us-swissbank-wegelin-idUSBRE9020O020130104.

compliance. The two key initiatives in this category are the IRS's Offshore Voluntary Disclosure Programs (OVDPs) for individuals and the DOJ's Swiss Bank Program for Swiss banks.[77]

### a. *Offshore Voluntary Disclosure Programs*

The IRS's OVDPs are designed to encourage offenders to voluntarily disclose the existence of offshore assets and accounts in exchange for reduced penalties and protection from criminal prosecution. In exchange, the IRS can collect more revenue and potentially obtain more information about banks, facilitators and other taxpayers. The IRS announced OVDPs in 2009, 2011, and 2012, and updated the program in 2014.[78]

The 2009 OVDP was announced in March 2009 against the backdrop of the UBS DPA and enforcement of the 2008 John Doe summons.[79] This played on taxpayer fears, and some taxpayers who did not know whether their information would be exposed decided to enter the OVDP rather than risk criminal prosecution.

After the 2009 OVDP closed on October 15, 2009, the IRS subsequently announced the 2011 OVDP on February 8, 2011.[80] The 2011 OVDP expired on September 9, 2011.[81] In January 2012, the IRS then announced the 2012 OVDP.[82] The IRS made some modifications to the 2012 OVDP in June 2014,

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[77] Again, my classification of these programs as backward-looking and compliance-centered does not mean that they are not also punitive or without forward-looking elements. Both programs do have fines and penalties and have been used to investigate other offshore tax evaders and to pressure banks and foreign governments going forward. Stephen Joyce, *Offshore Data Invaluable in Building Civil, Criminal Cases*, 124 Daily Tax Rep (BNA) G-4 (June 28, 2016).

[78] Lederman, *supra* note 7, at 500–01, 501 n.8. The IRS did also have a 2003 OVDP associated with its credit card initiative. *Id.* at 501 n.13; *see also Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014*, INTERNAL REVENUE SERV., https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised (last updated Dec. 20, 2017). For a detailed survey of the OVDPs, see Byrnes, *supra* note 55, § 1.04[1].

[79] *Voluntary Disclosure: Questions and Answers*, INTERNAL REVENUE SERV., https://www.irs.gov/newsroom/voluntary-disclosure-questions-and-answers (last updated Oct. 1, 2017); *2009 Offshore Voluntary Disclosure Program*, INTERNAL REVENUE SERV., https://www.irs.gov/uac/2009-offshore-voluntary-disclosure-program (last updated Aug. 27, 2017).

[80] I.R.S. News Release IR-2011-14 (Feb. 8, 2011); *2011 Offshore Voluntary Disclosure Initiative*, INTERNAL REVENUE SERV., https://www.irs.gov/uac/2011-offshore-voluntary-disclosure-initiative (last updated Aug. 12, 2017).

[81] *2011 Offshore Voluntary Disclosure Initiative, supra* note 80 (extending the original August 31, 2011 deadline).

[82] I.R.S. News Release IR-2012-64 (June 26, 2012); I.R.S. News Release IR-2012-5 (Jan. 9, 2012); *2012 Offshore Voluntary Disclosure Program*, INTERNAL REVENUE SERV., https://www.irs.gov/uac/2012-offshore-voluntary-disclosure-program (last updated Sept. 10, 2017).

and on March 13, 2018, the IRS announced that it would start winding down the program and would close it on September 28, 2018.[83]

### *i. Core Program Features*

The OVDPs have evolved since 2009, but the programs have unifying features.[84] In all versions, entrance into the OVDP allowed taxpayers to avoid criminal prosecution by paying (1) back taxes and interest owed for a number of years (between six and eight), (2) an accuracy- or delinquency-related penalty on the unreported income for those years, and (3) a miscellaneous offshore penalty (between 20% and 25% of the highest amount in the foreign bank account or highest asset value).[85] Taxpayers entering the OVDPs are also required to file amended or late FBARs and turn over information about foreign bank accounts, including bank names and bank contacts, to the United States.[86]

### *ii. Reduced Penalties and Simplified Procedures*

The IRS did make provisions for those with smaller account balances who did not know they were U.S. citizens or who satisfied certain criteria indicating that the noncompliance was less serious. This has generally taken the form of reduced penalty structures and simplified procedures. For example, the 2011 and 2012 OVDPs implemented a 12.5% penalty for those with offshore account balances under $75,000[87] and a 5% penalty for overseas residents who did not know they were U.S. citizens and taxpayers who (1) did not open the account, (2) had minimal contact with the account, (3) did not withdraw more than $1,000 in any year covered by the OVDP, and (4) had paid taxes on the

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83 I.R.S. News Release IR-2014-73 (last updated Aug. 3, 2017); I.R.S. News Release IR-2018-52 (last updated Mar. 13, 2018). The IRS noted that the streamlined program would remain in place, although the streamlined procedures, too, could be ended at some point in the future. *See* sources cited *infra* notes 91–99 and accompanying text.

84 *See* Byrnes, *supra* note 55, § 1.04[1].

85 The 2009 OVDP required six years of back reporting and implemented a 20% miscellaneous offshore penalty. *Voluntary Disclosure: Questions and Answers*, *supra* note 79. The 2011 version increased the reportable years to eight and the miscellaneous offshore penalty to 25% and the 2012 version increased the penalty to 27.5%. Lederman, *supra* note 7, at 516; *2012 Offshore Voluntary Disclosure Program*, *supra* note 82. Thus, at least in some respects, later versions of the OVDP were designed to ensure that 2009 entrants into the program were not prejudiced. Starting in 2014, the IRS began requiring that the full penalty be paid upfront to enter the OVDP. *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014*, *supra* note 78.

86 *See Voluntary Disclosure: Questions and Answers*, *supra* note 79 (Question 25).

87 *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2012*, INTERNAL REVENUE SERV., https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers (last updated Aug. 27, 2017) (FAQ 53).

amounts deposited.[88] These reduced penalties were extended to 2009 OVDP participants in order to not disadvantage them.[89]

The 2009, 2011, and 2012 OVDPs also contained a mechanism under which a taxpayer could enter the OVDP but then opt out of the OVDP penalty structure in favor of a standard audit once proposed penalties were assessed, if the taxpayer's facts suggested that the OVDP penalties were too high.[90] A taxpayer might choose to opt out in cases in which the facts show that she was not willful.

In 2012, the IRS announced a "streamlined" procedure to let certain taxpayers resolve their offshore tax issues in a simplified manner involving lower penalties.[91] The 2012 version of the streamlined program was open to U.S. taxpayers residing abroad who owed $1,500 or less in tax for any of the covered years.[92] Taxpayers were required to fill out a "risk assessment questionnaire," and the level of review given the taxpayer's submission depended on the answers.[93] All penalties were waived.[94] Adoption of the streamlined program potentially stopped taxpayers from having to use the regular OVDP just for its opt-out mechanism.[95]

In 2014, the IRS modified the streamlined program, opening it up to taxpayers residing in the United States and eliminating the $1,500 threshold and risk questionnaire.[96] However, the 2014 streamlined program required

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[88] Lederman, *supra* note 7, at 515; *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2012*, *supra* note 87 (FAQ 52); *see also* I.R.S. News Release IR-2012-64, *supra* note 82; *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, STEPTOE & JOHNSON, http://www.steptoe.com/publications/2011_20OVDI_20FAQs.pdf.

[89] Lederman, *supra* note 7, at 516.

[90] Memorandum from Steven T. Miller, Deputy Comm'r for Servs. & Enf't, Internal Revenue Serv., OVDI Opt Out and Removal Guide & Memorandum (June 1, 2011), https://www.irs.gov/pub/newsroom/2011_ovdi_opt_out_and_removal_guide_and_memo_june_1_2011.pdf; Lederman, *supra* note 7, at 516; *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014*, supra note 78 (FAQs 49, 51, 51.3).

[91] I.R.S. News Release IR-2012-65 (June 26, 2012); *Streamlined Filing Compliance Procedures*, INTERNAL REVENUE SERV., https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures (last updated Sept. 11, 2017) (noting an effective date of September 1, 2012).

[92] *See* sources cited *supra* note 91.

[93] I.R.S. News Release IR-2014-73 (last updated Aug. 3, 2017).

[94] *Id.*

[95] 1 NAT'L TAXPAYER ADVOCATE, 2013 REPORT TO CONGRESS 231 (2013) [hereinafter 2013 NTA REPORT] ("Recognizing the OVD programs were excessively burdensome and unfair to benign actors, in 2012 the IRS created a 'streamlined' program that allows some 'low risk' nonresidents to avoid the burdensome opt-in-opt-out process.").

[96] I.R.S. News Release IR-2014-73, *supra* note 93.

taxpayers to certify that previous failures were due to non-willful conduct.[97] The 2014 streamlined program continued to waive penalties for program-eligible U.S. taxpayers living abroad, and imposed a penalty of 5% of the maximum aggregate balance of the unreported financial accounts of U.S. residents.[98] Given the expansion of the streamlined program to include non-willful U.S. taxpayers residing in the United States, the 5% and 12.5% reduced penalty structures in the regular OVDP were eliminated.[99]

*iii. Numbers*

As of October 2016, the IRS reported that the three OVDPs had brought in more than 55,800 disclosures and yielded over $9.9 billion in taxes, interest, and penalties since 2009.[100] The streamlined program had brought in 48,000 taxpayers and yielded about $450 million in taxes, interest, and penalties.[101] More recently, the IRS reported that the regular OVDPs had brought in 56,000 taxpayers and $11.1 billion in taxes, interest, and penalties and that the streamlined programs had brought in an additional 65,000 additional taxpayers.[102]

*b. Swiss Bank Program*

The Swiss Bank Program represented the culmination of U.S.–Swiss attempts to create a framework under which Swiss banks could cooperate with

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97 *Id.*

98 *Offshore Voluntary Disclosure Program Frequency Questions and Answers 2014*, *supra* note 78; *Transition Rules: Frequently Asked Questions (FAQs)*, INTERNAL REVENUE SERV., https://www.irs.gov/individuals/international-taxpayers/transition-rules-frequently-asked-questions-faqs (last updated Aug. 3, 2017).

99 *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014*, *supra* note 78.

100 I.R.S. News Release IR-2016-137 (Oct. 21, 2016); *see also* TREASURY INSPECTOR GEN. FOR TAX ADMIN., No. 2016-30-030, IMPROVEMENTS ARE NEEDED IN OFFSHORE VOLUNTARY DISCLOSURE COMPLIANCE AND PROCESSING EFFORTS (2016); I.R.S. News Release IR-2016-116 (last updated Aug. 4, 2017). The IRS had previously reported that the 2009 OVDP brought in 15,000 disclosures and collected $3.4 billion in back taxes, interest and penalties prior to its closing date, with another 3,000 disclosures after its closing date. I.R.S. Fact Sheet FS-2014-6 (last updated Aug. 3, 2017). The 2011 program brought in 15,000 disclosures and $1.6 billion (based on 70% of cases closed that year), and the 2012 program had brought in 12,000 disclosures as of June 2014. *Id.*

101 I.R.S. News Release IR-2016-137, *supra* note 100. Thus, the IRS commissioner noted that in total, the IRS had collected about $10 billion and brought 100,000 taxpayers into compliance via the OVDPs as of October 2016. *Id.*

102 I.R.S. News Release IR-2018-52, *supra* note 83.

the United States in its offshore tax investigations while remaining compliant with Swiss laws.[103]

### *i. Origins of the Program*

Based on information obtained from the Birkenfeld leak and from OVDP participants, the United States became aware that other Swiss banks had also facilitated offshore tax enforcement and turned its prosecutorial attentions to those banks.[104] However, the Swiss banks were prohibited from sharing information with the United States by Swiss domestic laws.[105]

The risk of U.S. prosecution of Swiss banks became apparent to Swiss authorities after the United States indicted three Wegelin Bank employees in January 2012, and Wegelin itself pled guilty and ceased operations.[106] These developments prompted the Swiss Federal Council (Parliament's upper house) to propose legislation in 2013 that would exempt banks from criminal prosecution under Swiss laws and allow them to share data with the United States.[107] However, in June 2013, the Swiss National Counsel (the lower house) rejected the bill, announcing an alternative "Plan B" on July 3.[108] Plan B—which was ultimately enacted into law on August 29, 2013—is the current Swiss Bank Program.[109]

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[103] *See generally* Corinne Nhaissi, *Swiss Bank Accounts: Lifting the Veil*, COLUM. BUS. L. REV. ONLINE (Oct. 5, 2013, 5:07 PM), https://cblr.columbia.edu/swiss-bank-accounts-lifting-the-veil/ (describing the Swiss Bank Program). For a more detailed description of the Swiss Bank Program, see Byrnes, *supra* note 55, § 1.03[3].

[104] Walter H. Boss & Andrea Scherrer, *From Birkenfeld to the Program: A Review of the Swiss-U.S. Tax Dispute*, 71 TAX NOTES INT'L 1203 (2013). The United States apparently did not ask for data identifying bank clients because that information could only be obtained under the administrative assistance procedure in Article 26 of the U.S.–Swiss treaty. (It was unclear whether client information could even have been obtained under Article 26 because the Protocol Amending the U.S.–Swiss Treaty to permit these disclosures has not yet been ratified.) *See* Protocol Amending Tax Convention with Swiss Confederation, U.S.-Switz., June 5, 2014, S. Treaty Doc. 112-1 (2011).

[105] BUNDESGESETZ ÜBER DEN DATENSCHUTZ [FEDERAL ACT ON DATA PROTECTION] June 19, 1992, SR 235.1 art. 6 (prohibiting transfer of employee names); SCHWEIZERISCHES STRAFGESETZBUCH [STGB] [CRIMINAL CODE] Dec. 21, 1937, SR 311.0, art. 271 (prohibiting banks from taking actions on behalf of a foreign authority (the United States) in Switzerland).

[106] Boss & Scherrer, *supra* note 104, at 1204.

[107] On April 4, 2012, the Swiss Federal Council authorized Swiss banks under U.S. investigation to transfer the requested bank and employee data by exempting them from the prohibitions of the Swiss Criminal Code. Boss & Scherrer, *supra* note 104, at 1204. However, the Swiss Data Protection Act remained a problem. Thus, in May 2013, Swiss Federal Council proposed "Lex USA." *Id.*

[108] *Id.* at 1205.

[109] Boss & Scherrer, *supra* note 104, at 1204; *Swiss Bank Program*, U.S. DEP'T OF JUSTICE, https://www.justice.gov/tax/swiss-bank-program (last updated Feb. 6, 2017).

*ii. Program Details*

Broadly speaking, the Swiss Bank Program allowed Swiss banks to resolve potential criminal liabilities by entering into deferred and non-prosecution agreements with the United States.[110] The Program grouped banks into four categories based on level of culpability or criminal exposure. The heart of the program consisted of so-called Category 2 banks, which were banks not already under DOJ investigation, but that had reason to believe they had committed U.S. tax offenses.[111] In contrast, Category 1 banks were those already under DOJ investigation as of August 29, 2013.[112] Category 1 banks were not eligible for the program; instead, they had to interface with the DOJ directly and were generally able to enter into DPAs with the United States.[113]

Category 2 banks were required to inform the DOJ about their cross-border business involving U.S.-related accounts, including the names and functions of key employees and information about fund transfers into and out of U.S.-related accounts closed during the applicable period (so-called "leaver lists").[114] These banks were also required to turn over the names of relationship managers and third parties associated with these accounts.[115] Thus, Category 2 banks turned over a treasure trove of information, short of actual client names.

Category 2 banks were assessed fines based on a percentage of the high balance amount in their U.S.-related accounts, which varied based on dates.[116] Banks were more heavily penalized if they accepted fund transfers from UBS

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[110] Boss & Scherrer, *supra* note 104, at 1205. The program was built on three components: (1) an August 29, 2013 Joint Statement between the U.S. and Swiss governments setting the Program's parameters; (2) the U.S.'s development of the U.S. tax program for Swiss Banks; and (3) a Swiss-side model authorization governing the parameters of bank cooperation with U.S. authorities within the scope of existing Swiss law. U.S. DEP'T OF JUSTICE, JOINT STATEMENT BETWEEN THE U.S. DEPARTMENT OF JUSTICE AND THE SWISS FEDERAL DEPARTMENT OF FINANCE (Aug. 29, 2013) [hereinafter JOINT STATEMENT]; FED. DEP'T OF FIN., SWISS CONFEDERATION, GUIDANCE NOTE ON THE SWISS MODEL ORDER OF JULY 3, 2013 (2013); *see also* U.S. DEP'T OF JUSTICE, THE TAX DIVISION'S FURTHER COMMENTS ABOUT THE PROGRAM FOR NON-PROSECUTION AGREEMENTS OR NON-TARGET LETTERS FOR SWISS BANKS (June 5, 2014).

[111] Boss & Scherrer, *supra* note 104, at 1205–06.

[112] *Id.*

[113] *Id.* Category 3 and 4 banks are those eligible to receive a "non-target letter" from the DOJ, either because they had not engaged in any U.S.-illegal misconduct and agreed to certain compliance safeguards, or because they had a strictly local client base and no offshore business. *Id.*; *see also* Emily L. Foster, *ABA Section of Taxation Meeting: Swiss Bank Program Lives on in "Legacy" Phase*, 153 TAX NOTES 236 (2016).

[114] Boss & Scherrer, *supra* note 104.

[115] *Id.* at 1207.

[116] The fine was 20% of the undeclared account amount for accounts existing as of August 1, 2008; 30% for accounts opened between August 1, 2008 and February 28, 2009; and 50% for accounts opened after February 28, 2009. JOINT STATEMENT, *supra* note 110, § II.H, at 6.

and other banks in the aftermath of the UBS leak.[117] A bank could reduce the fine if it could show that the client had already declared the account to the IRS or it had already been disclosed under an OVDP.[118]

In exchange for their cooperation, Category 2 banks received non-prosecution agreements with the DOJ.[119] The deadline for signing letters of intent for Category 2 banks was December 31, 2013, and the last NPA was signed on January 27, 2016.[120] Altogether, the DOJ entered into seventy-eight NPAs with eighty Category 2 banks, and collected $1.37 billion in penalties from those banks with respect to 35,000 U.S.-related accounts.[121]

### 3. *Forward-Looking Regulatory Initiatives*

The statutory capstone of the United States' battle against offshore tax evasion is FATCA.[122] FATCA is widely regarded as a major turning point in the development of automatic exchange of financial information among various countries.[123]

#### a. *Obligations of Foreign Financial Institutions*

FATCA generally requires FFIs to report bank account information of U.S. persons to the United States and to withhold taxes on certain accounts.[124] If the FFI does not comply, FATCA mandates that parties making interest, dividend, rent, and other payments to that FFI must withhold and remit 30% of any such payment to the IRS.[125] This rule applies to *all* withholdable payments to the

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117 *Id.*

118 *Id.*

119 *Id.* § II.A, at 3.

120 *Id.*; *Swiss Bank Program*, *supra* note 109.

121 Foster, *supra* note 113; Nathan J. Richman, *Final Swiss Bank Program Entity Resolution Complete*, 154 TAX NOTES 64 (2017). The DPAs with Category 1 banks yielded $4.439 billion dollars in penalties. *Swiss Bank—Penalties—Statistics*, U.S. TAX PROGRAM, http://www.ustaxprogram.com/penalty-statistics/ (last updated Jan. 27, 2016) (including UBS and Wegelin). There were about fourteen Category 1 banks. Jack Townsend, *List of 14 Swiss Banks Under Criminal Investigation (3/9/14)*, FED. TAX CRIMES (Mar. 9, 2014, 6:57 PM), http://federaltaxcrimes.blogspot.com/2014/03/list-of-14-swiss-banks-under-criminal.html.

122 I.R.C. §§ 1471–1474 (2012).

123 Grinberg, *supra* note 1, at 334.

124 I.R.C. § 1471(b).

125 FATCA provides that if an FFI or non-financial foreign entity (NFFE) does not meet the reporting requirements in § 1471(b), then the "withholding agent" of any "withholdable payment" to that FFI must deduct and withhold 30% of the amount of that payment. *Id.* § 1471(a). A "withholdable payment" generally includes "any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States," and "any

FFI, not just those related to U.S. account holders.[126] Thus, FATCA effectively punishes non-compliant FFIs by imposing an onerous 30% withholding tax on *all* U.S. source payments made to the FFI itself, regardless of the FFI's ability to pay or to claim a reduced tax rate under treaty, and regardless of whether such payments pertain to unreported U.S. accounts. Given the importance of the U.S. market to most FFIs, the threat of 30% FATCA withholding has proven to be an effective stick to force FFIs into compliance.[127]

FATCA performs two related functions. First, FATCA gives the United States more information about the offshore account holdings of U.S. taxpayers. Second, if taxpayers know that information about their offshore holdings is available to the United States, they are more likely to report and pay tax on the income. Thus, information corroboration and deterrence are two major justifications for the statute.

To avoid FATCA withholding, the FFI must satisfy the following reporting requirements. The FFI must (1) obtain information necessary to determine which of its accounts are U.S. accounts; (2) "comply with such verification and due diligence procedures" in performing such account identification; (3) report to the United States annually the information required by statute (which includes the name and other information of any U.S. account holder, the account number, the account balance, and information regarding gross receipts and withdrawals); (4) perform 30% tax withholding on any "passthru payments" made to non-complying FFIs or to any account holder that has not provided the information necessary to determine whether the account is a U.S. account;[128] (5) comply with IRS requests for further information; and (6) when foreign law prevents reporting of information to the IRS, obtain a waiver, and if not possible, close the account.[129]

The real-world implementation of FFI FATCA obligations has been accomplished using a series of intergovernmental agreements (IGAs) between

gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States." *Id.* § 1473.

126 *Id.* §§ 1471–1474.

127 *See* Grinberg, *supra* note 1, at 335–36, 336 n.109 (detailing that FATCA has a "coercive force" on FFIs).

128 This includes FFIs that don't comply with the I.R.C. § 1471(b) requirements, or to FFIs that have elected to be withheld upon rather than to withhold on their own "recalcitrant account holder[s]." I.R.C. § 1471(b)(1)(D), (b)(3).

129 *Id.* § 1471(b)–(c).

the United States and other countries.[130] The IGAs in force have been based on two models released by the United States in collaboration with foreign governments. Under Model 1, the FFI must report all required information to a designated domestic government agency, which then reports the information to the IRS.[131] Under Model 2, the FFI must register and report the information directly to the IRS.[132] IGAs were needed in part to ease reporting burdens on FFIs, but also because complying with FATCA could potentially put FFIs at risk of violating their own domestic laws.[133] Because IGAs constitute an agreement between the United States and the foreign jurisdiction, they protect FFIs from committing potential domestic law violations.

FATCA is revolutionary in that it harnesses foreign banks and other FFIs to help the United States enforce tax compliance, but it draws upon familiar mechanisms of information reporting and withholding.[134] Studies show that in sectors where withholding and information reporting are performed, compliance increases.[135] FATCA essentially uses a blend of withholding threat and corroborative information reporting to force taxpayers to comply. However, unlike domestic information reporting, FATCA reporting does not include just taxable payments, but also other extensive financial information such as bank account balances and transactions.[136] The implementation of FATCA has been subject to a number of delays, time extensions, and postponements.[137] It remains to be seen how these real-world implementation challenges may impact the law's effectiveness.

### *b. Obligations on Taxpayers*

#### *i. New Requirements*

In addition to obligations on FFIs, FATCA also imposes new offshore reporting requirements on taxpayers while strengthening pre-existing

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[130] *Resource Center: Foreign Account Tax Compliance Act (FATCA)*, U.S. DEP'T TREASURY, https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx (last updated Oct. 11, 2017, 3:18 PM).

[131] *Id.*; *see also FATCA Information for Governments*, INTERNAL REVENUE SERV., https://www.irs.gov/businesses/corporations/fatca-governments (last updated Aug. 27, 2017).

[132] *See* sources cited *supra* note 131.

[133] Morse, *Ask for Help, Uncle Sam*, *supra* note 7, at 530.

[134] *See* sources cited *supra* note 27.

[135] *See* Lederman, *Reducing Information Gaps*, *supra* note 27, at 1735–36; *see also generally* sources cited *supra* note 27.

[136] I.R.C. § 1471(c) (2012).

[137] *See generally* Byrnes, *supra* note 55, §§ 1.16–.18 (highlighting certain FATCA milestones, deadlines, and problem areas).

requirements. Taxpayers who hold interests in foreign financial assets over certain thresholds (which start as low as $50,000) must now file Form 8938, the Statement of Foreign Financial Assets, with their tax return, disclosing the maximum value of such interests during the taxable year.[138] Reportable assets include interests in bank accounts, brokerage accounts, custodial accounts, stocks, insurance contracts with cash value, certain assets held through foreign entities, and other financial interests.[139] The Form 8938 filing requirement is in addition to the preexisting FBAR, which must now be filed electronically and is due at the same time as the tax return.[140]

FATCA coordinates the Form 8938 filing requirement with existing required filings of various other forms.[141] As discussed below, the law sets high penalties, long statutes of limitations, and other adverse consequences for failure to disclose assets on those forms or failure to pay taxes.

*ii. Penalties*

Failure to comply with FATCA may lead to severe civil and criminal penalties for individual taxpayers, and may extend the statute of limitations for auditing the tax return beyond the usual three years.[142] Failure to file Form 8938 or failure to disclose required information on that form draws a maximum $10,000 penalty.[143] A continuing failure that persists beyond ninety days after the IRS notifies the taxpayer of such failure draws an additional penalty of $10,000 every thirty days, capped at $50,000.[144] These penalties apply regardless of whether there is any actual unpaid tax owed. They are waived when the taxpayer can show that the failure is due to reasonable cause and not willful neglect; however, the IRS makes that determination on a case-

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138 I.R.C. § 6038D; I.R.S. Form 8938, Statement of Specified Foreign Financial Assets (2016). Individuals must report foreign financial assets on Form 8938 (and other forms) if the aggregate value of such assets exceeds $50,000 on the last day of the taxable year or $75,000 at any time during the taxable year ($100,000 and $150,000 for married taxpayers filing jointly). *See* Treas. Reg. § 1.6038D–2(a)(1) to (2) (as amended by T.D. 9752, 81 FR 8838). For U.S. taxpayers living abroad, the thresholds are higher: $200,000 on the last day of the taxable year or $300,000 at any time during the taxable year ($400,000 and $600,000 for married taxpayers filing jointly). Treas. Reg. § 1.6038D–2(a)(3) to (4).

139 I.R.C. § 6038D; Treas. Reg. § 1.6038D–3 (2014).

140 *See* sources cited *supra* notes 51–52 and accompanying text.

141 *See* sources cited *supra* note 138; *see also* Treas. Reg. § 1.6038D–3(c) to (d); I.R.S., Instructions for Form 8938, at 1 (2017) (coordinating Form 8938 filing requirement with requirements to file other forms).

142 I.R.C. § 6501(c)(8) (2012).

143 *Id.* § 6038D(d)(1).

144 *Id.* § 6038D(d)(2).

by-case basis based upon the facts and circumstances.[145] In addition, more severe criminal penalties may apply for fraud and other egregious reporting failures.[146]

In addition to these information-reporting penalties, FATCA also imposes an enhanced 40% accuracy-related penalty for *any* tax underpayments attributable to undisclosed foreign financial assets.[147] The 40% penalty is twice the usual 20% underpayment penalty that applies to other types of assets and it applies regardless of aggravating circumstances.[148] "Undisclosed foreign financial asset" is defined broadly to include not just bank accounts but also controlling interests in foreign entities, certain transfers to foreign persons, and certain transactions with respect to foreign partnerships and trusts.[149] The penalty will not be imposed if the taxpayer can show reasonable cause for her position and good faith.[150]

FATCA has not only implicated foreign financial accounts, but it also has made changes to disclosures of interests in certain foreign entities and foreign trusts, some of which create statutes of limitations issues.[151] For example, FATCA amended I.R.C. § 6677 to provide that a failure to file Form 3520 (which requires information reporting with respect to interests in and distributions from foreign trusts) will carry a penalty of $10,000 or 35% of the gross reportable amount, whichever is greater.[152] The penalty increases by $10,000 for every thirty-day period starting ninety days after the IRS notifies the taxpayer of a reporting failure, but these subsequent penalties are capped at the gross reportable amount in cases where that amount "can be determined by the Secretary."[153]

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145 *Id.* § 6038D(g); Treas. Reg. § 1.6038D–8(e)(1); *see also* Andrew Velarde, *News Analysis: Is the IRS Turning the Screws on Taxpayers in FBAR Exams?*, 88 TAX NOTES INT'L 305 (2017) (noting that IRS is classifying almost every taxpayer subject to FBAR audit as willful for purposes of penalty imposition, and quoting a practitioner as indicating that "[t]he line between negligence and willfulness to evade taxes seems to have been forgotten").

146 I.R.C. § 7201 (tax evasion); *id.* § 7203 ("Willful failure to file returns, supply information or pay tax"); *id.* § 7206 ("Fraud and false statements").

147 *Id.* § 6662(j). Tax underpayments include both taxable proceeds from undeclared foreign transactions that are deposited in foreign accounts as well as interest earned on those accounts.

148 *Id.* § 6662(b)(7), (j).

149 *Id.* § 6662(j).

150 *Id.* § 6664.

151 *See infra* Section II.A.3.b.iii.

152 I.R.C. § 6677(a), as amended by Foreign Account Tax Compliance Act, Pub. L. No. 111-147, § 535(a)(1)–(2), 124 Stat. 71 (2010); *id.* § 6048. Thus, the provision in effect imposes a minimum penalty of $10,000.

153 *Id.* § 6677(a). This caps subsequent penalties at the gross reportable amount only where that amount can be determined by the Secretary.

The new FATCA penalties are in addition to the existing penalties for FBAR violations, which have become more salient since 2008. For individuals and financial institutions, there is a $10,000 penalty per non-willful FBAR violation.[154] The FBAR penalty will not be imposed if the violation was due to reasonable cause and the taxpayer files delinquent FBARs properly reporting the unreported amount.[155] The Internal Revenue Manual (IRM) provides that the tax examiner has some discretion in imposing the non-willful penalty—for example, if there is a non-willful violation that spans several years, the examiner may recommend a single $10,000 penalty.[156]

For willful FBAR violations, the penalty (which applies to individuals and FFIs) is capped at the greater of $100,000 or 50% of the balance in the account at time of violation.[157] Willfulness means "voluntary, intentional violation of a known legal duty," and the IRS bears the burden of showing willfulness.[158] The FBAR statute of limitations for assessment of the penalty is generally six years.[159]

*iii. Statutes of Limitation*

FATCA also expands the statute of limitations for foreign financial asset offenses beyond the usual rule for domestic offenses. The usual rule is that the IRS has three years from when the tax was filed to assess the tax, increasing to six years if the omission is more than 25% of the gross income.[160] However, FATCA extends the statute of limitations to six years if the taxpayer omits more than $5,000 of income attributable to a specified foreign financial asset that should have been reported, even if there was no 25% understatement.[161]

Moreover, FATCA suspends the statute of limitations for foreign financial asset reporting failures and certain additional offshore reporting failures as well; the statute does not even begin to run until certain required information has been reported on the prescribed form.[162] The forms subject to the suspended statute of limitations now include Form 8621 (PFICs), Form 5471

154 31 U.S.C. § 5321(a)(5) (2012).

155 I.R.S. IRM 4.26.16.6.4 (Nov. 6, 2015).

156 I.R.S. IRM 4.26.16.6.4.1 (Nov. 6, 2015).

157 31 U.S.C. § 5321(a)(5)(C).

158 I.R.S. IRM 4.26.16.6.5.1 (Nov. 6, 2015).

159 31 U.S.C. § 5321(b)(1).

160 I.R.C. § 6501(a), (e) (2012).

161 *Id.* §§ 6501(e)(1)(A)(ii), 6038D.

162 *Id.* FATCA added information reportable per § 6038D, § 1298(f) and the § 1295(b) election to the existing list of reporting failures that trigger the extended statute. I.R.C. § 6501(c)(8), as amended by Foreign Account Tax Compliance Act, Pub. L. No. 111-147, § 513(b), 124 Stat. 71 (2010).

(CFCs), Form 8865 (foreign partnership interests), Form 8858 (foreign disregarded entities), Form 5472 (25% foreign-owned U.S. corporations and foreign companies that are engaged in a trade or business), Form 926 (transfers of property to foreign corporations), Form 8938 (foreign financial asset disclosures under FATCA), and Form 3520-A (foreign trusts with U.S. owners).[163] Failure to report this information extends the statute of limitations for *all* items on the tax return unless the taxpayer can establish reasonable cause, in which case the statute is only suspended for the item(s) related to the failure to disclose.[164]

### *B. The Mechanisms That Drive Enforcement*

The descriptive typology presented in section A of this Part shows that while most tax commentary focuses on FATCA, FATCA is not the only aspect of offshore tax enforcement. Rather, offshore tax enforcement consists of an integrated family of overlapping strategies designed to punish offenders, bring noncompliant taxpayers back into compliance, facilitate foreign asset reporting and information procurement, and encourage tax compliance going forward.

The dominant view is that the key driver of increased offshore compliance is the emergence of third-party information reporting and corroboration under FATCA.[165] Yet, this is an oversimplification. Much of the information reported under FATCA consists of gross amounts and balances. This, along with reporting errors, may make the data difficult to use.[166] Moreover, because of implementation delays and time lags, FATCA will not necessarily help detect tax evasion from pre-FATCA years, although such evasion could certainly be detected through other means.[167] Thus, the offshore compliance story goes beyond simple information exchange and reporting.

In fact, information reporting aside, there are two additional interlocking mechanisms via which enforcement has been effective: (1) the creation of a system of "cascading compliance" whereby the information extracted by one initiative is used to push taxpayers and facilitators to cooperate under another

[163] I.R.C. § 6501(c)(8) (suspending the statute of limitations for information reportable under §§ 1295(b), 1298(f), 6038, 6038A, 6038B, 6038D, 6046, 6046A, and 6048). These forms can be found on the IRS website. *Forms, Instructions & Publications*, INTERNAL REVENUE SERV., https://www.irs.gov/forms-instructions (last updated Aug. 27, 2017).

[164] I.R.C. § 6501(c)(8)(A)–(B).

[165] *See* sources cited *supra* note 27 and accompanying discussion.

[166] Luca Gattoni-Celli, *"False Positives" in FATCA Data May Hamper Enforcement*, 84 TAX NOTES INT'L 387 (2016).

[167] *See supra* Section I.B (discussing pre-2008 enforcement initiatives).

and (2) the imposition of harsh penalties and open-ended statutes of limitations, along with uncertain standards.

### 1. *Cascading Compliance*

The offshore tax enforcement initiatives have effectively used information extracted from one actor to gather data about and threaten to punish other actors. This has created a "compliance cascade" effect that encourages more and more taxpayers and FFIs to confess and comply. Because the U.S. enforcement initiatives involve not just penalties but extraction of *information*, the initiatives do not just recoup revenue, but also may reveal information about other actors, thus generating follow-on compliance.

For example, the United States was able to extract significant information about taxpayer accounts, fund flows, and leaver lists through the Swiss Bank Program.[168] Offending taxpayers, although aware that the United States had some information, did not know exactly what information. The IRS and DOJ fueled taxpayer worries by actively publicizing DOJ prosecutions of taxpayers for offshore tax offenses in interviews, at conferences, and on their websites.[169] It simultaneously announced, promoted, and recommended the OVDPs as an option that taxpayers could choose. The possibility that the United States might use information garnered from the Swiss Bank Program to trace offending taxpayers, combined with the risk of criminal punishment, led many taxpayers to enter the OVDPs. The Government Accountability Office (GAO) has noted that the IRS's OVDPs deliberately pursue enforcement by using one program to generate compliance with respect to another.[170]

FATCA, too, employs cascading compliance. Banks and foreign governments, anxious to cooperate and to avoid the fate faced by many Swiss banks in the Swiss Bank Program, ceded to U.S. pressures to comply with FATCA, as evidenced by the network of IGAs now in force and the reporting

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[168] *See supra* Section II.A.2.b (discussing Swiss Bank Program).

[169] *See, e.g.*, *Swiss Bank Program*, *supra* note 109; *Offshore Compliance Initiative*, U.S. DEP'T JUSTICE, https://www.justice.gov/tax/offshore-compliance-initiative (last updated Dec. 29, 2016) [hereinafter *Offshore Compliance Initiative 2016*].

[170] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-318, OFFSHORE TAX EVASION: IRS HAS COLLECTED BILLIONS OF DOLLARS BUT MAY BE MISSING CONTINUED EVASION (2013) [hereinafter 2013 GAO REPORT]. GAO described the IRS's OVDP enforcement strategy as follows: (1) identifying a population of evaders (for example through data leaks), (2) collecting additional information (e.g., through John Doe summonses) and building criminal cases, (3) encouraging participation in OVDPs by publicizing intent to pursue noncompliance, (4) actually pursuing noncompliance (e.g., through audit), and (5) using information collected from OVDPs to identify additional evasion. *Id.* at 6. This effectively describes cascading compliance.

that is occurring.[171] Once one country or institution caved, others did as well.[172] Similarly, taxpayers with foreign financial assets—even those who may not have been willful evaders—have felt pressure from the publicity and threats generated by the enforcement initiatives to comply with FATCA reporting.[173] Even so-called "quiet disclosures"—in which noncompliant taxpayers do not enter an OVDP but either amend prior returns and FBARs or comply going forward—are arguably an instance of cascading compliance. While the IRS disfavors quiet disclosures,[174] they may nonetheless show that compliance cascades are actually working to encourage compliance where none previously existed.

### 2. *High Penalties and Open Statutes*

Offshore tax enforcement also works by imposing high penalties and extended statutes of limitations. The standard deterrence model predicts that penalty size and the probability of detection are important variables in predicting and incentivizing compliance, and the United States has used both these instruments in designing offshore tax enforcement.[175] As discussed in section A of this Part, FATCA penalties on individuals are extremely high, often significantly higher than penalties for similar domestic offenses.[176] Abatement of penalties often hinges on subjective standards like "reasonable cause" or "good faith," which are uncertain. The consequences for FFIs that are not FATCA compliant are also high.[177]

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[171] I.R.S. Announcement 2016-27 (2016); Alison Bennett, *IRS to Countries: Hurry Up with FATCA Reporting Enforcement*, INT'L TAX MONITOR (BNA) (2016); J.P. Finet, *Ending the Reprieve on FATCA Implementation*, 84 TAX NOTES INT'L 237 (2016).

[172] *See* sources cited *supra* note 171.

[173] *See, e.g.*, Marie Sapirie, *News Analysis: The Personal Impact of Offshore Enforcement*, 71 TAX NOTES INT'L 199 (2013) (highlighting stories of taxpayers with offshore assets who may not have been willful evaders).

[174] *See Voluntary Disclosure: Questions and Answers*, *supra* note 79.

[175] Joel Slemrod & Shlomo Yitzhaki, *Tax Avoidance, Evasion, and Administration*, *in* 3 HANDBOOK OF PUBLIC ECONOMICS 1429, 1431 (Alan J. Auerbach & Martin Feldstein eds., 2002) (reviewing economic literature); James Alm et al., *Estimating the Determinants of Taxpayer Compliance with Experimental Data*, 45 NAT'L TAX J. 107 (1992); Janet G. McCubbin, *Optimal Tax Enforcement: A Review of the Literature and Practical Implications*, NAT'L TAX ASS'N PROCEEDINGS 16–17 (2003); Joel Slemrod & Shlomo Yitzhaki, *The Optimal Size of a Tax Collection Agency*, 89 SCANDINAVIAN J. ECON. 183, 185 (1987); Leandra Lederman, Auditing the Crowding Out Hypothesis 2–4, 12 (Oct. 27, 2016) (unpublished manuscript) (on file with author); *see also* Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 J. PUBLIC ECON 323, 324 (1972); Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968).

[176] *See supra* Section II.A.3.b.ii.

[177] *See supra* Section II.A.3.a.

Moreover, by extending the statutes of limitations for various offshore items, the United States has essentially increased the threat of detection. Like penalties, the ability to argue that the limitations period has run often hinges on uncertain standards such as reasonable cause.[178]

The magnitude of penalties imposed, increased duration of detection risk, and the uncertainty regarding how subjective standards apply to reduce exposure are factors likely to motivate taxpayers to properly disclose their foreign income and financial holdings.

### *C. Has the U.S. Approach Worked?*

Having described the interlocking components of offshore tax enforcement and how they work, we now ask whether the U.S. approach is good tax policy. These enforcement initiatives have elicited strong reactions. Proponents hail automatic information reporting regimes such as FATCA as a development that better allows for taxation of capital and lets countries benefit from FFIs serving as information-reporting agents of the government.[179] While some quibble about design specifics, the general consensus among proponents is that the OVDPs, FATCA, and automatic tax information exchange between countries are positive developments in advancing the goal of cross-border tax compliance, both in the United States and in other countries.[180]

IRS and DOJ representatives are, of course, sanguine about the efficacy of offshore tax enforcement. For example, recent IRS announcements have characterized the OVDPs as having brought in significant revenues and taxpayers.[181] Similarly, DOJ press releases and comments to tax practitioners have emphasized the seriousness of the offshore offenses and the success of DOJ criminal prosecutions and have advised taxpayers to enter OVDPs.[182]

Yet offshore tax enforcement has also come under serious criticism. Critics have disapproved of FATCA on privacy grounds,[183] noting that it unduly burdens accidental Americans and Americans living abroad, with some arguing that overseas Americans ought to be exempted from FATCA

178 *See supra* Section II.A.3.b.iii.
179 *See, e,g.*, Grinberg, *supra* note 1, at 347, 349, 353; Grinberg, *supra* note 7, at 328.
180 *See generally* sources cited *supra* note 7.
181 I.R.S. News Release IR-2016-137, *supra* note 100.
182 *See Offshore Compliance Initiative 2016*, *supra* note 169.
183 Christians & Cockfield, *supra* note 8, at 19; Cockfield, *supra* note 8, at 13–14.

reporting.[184] Critics have also argued that FATCA—and the IGAs that effectuate FATCA—may be illegal, unconstitutional, or may violate taxpayer rights.[185] Still others have pointed out that FATCA is costly and burdensome for FFIs and taxpayers.[186] Economists, too, have begun to study the possible collateral consequences of FATCA, including its impacts on compliance and evasion.[187] While that work is still unfolding, it will likely be important in illuminating both the effective elements as well as the weaknesses of the law.

In particular, the National Taxpayer Advocate (NTA), an independent organization within the IRS charged with advocating for taxpayer rights, has studied various aspects of the offshore tax enforcement initiatives and has voiced criticisms. For example, NTA has criticized the OVDPs as being regressive, undermining the general tax statutory scheme with respect to penalties imposed, and violating taxpayer rights.[188] NTA has also criticized FBAR and FATCA reporting as duplicative, costly, and burdensome for taxpayers, and has recommended elimination of the duplication and creation of

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184 Christians, *Putting the Reign Back in Sovereign*, *supra* note 8; J. Richard (Dick) Harvey Jr., *Worldwide Taxation of U.S. Citizens Living Abroad – Impact of FATCA and Two Proposals*, 4 GEO. MASON J. INT'L COM. L. 319, 319–20 (2013); Michael Kirsch, *Citizens Abroad and Social Cohesion at Home: Refocusing a Cross-Border Tax Policy Debate* 36 VA. TAX REV. 205, 244–47, 257–58 (2017) [hereinafter Kirsch, *Citizens Abroad*] (discussing need to address compliance concerns of U.S. citizens abroad); Michael S. Kirsch, *Revisiting*, *supra* note 8 (proposing to retain citizenship-based taxation but ameliorate the burdens on taxpayers living overseas); Mason, *supra* note 1, at 221. Specific solutions advanced include a same-country exception to reporting, or a broader move toward a residence-based, rather than a citizenship-based, system of taxation. *See also* Byrnes, *supra* note 55, §1.18[7] (explaining the "accidental American" phenomenon).

185 Christians, *Dubious Legal Pedigree of IGAs*, *supra* note 8; Christians, *Global Perspective*, *supra* note 8; Allison Christians, *What You Give and What You Get: Reciprocity Under a Model 1 Intergovernmental Agreement on FATCA*, CAYMAN FIN. REV., no. 31, 2013, at 24.

186 Behrens, *supra* note 8, at 221–23; Dizdarevic, *supra* note 8; Byrnes, *supra* note 55, §1.19; *see also* Robert W. Wood, *FATCA Carries Fat Price Tag*, FORBES (Nov. 30, 2011, 6:12 AM), http://www.forbes.com/sites/robertwood/2011/11/30/fatca-carries-fat-price-tag/#a48572a489ad; *cf. FATCA and CRS: How Ready Are You?*, THOMSON REUTERS, https://tax.thomsonreuters.com/wp-content/pdf/onesource/fatca-crs-readiness-survey.pdf (last visited Apr. 1, 2018).

187 *See, e.g.*, Dhammika Dharmapala, *Cross-Border Tax Evasion Under a Unilateral FATCA Regime* (CESifo, Working Paper No. 5863, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2778453; Joel Slemrod, *Tax Compliance and Enforcement: New Research and Its Policy Implications* (Ross School of Bus., Working Paper No. 1302, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2726077.

188 1 NAT'L TAXPAYER ADVOCATE, 2014 REPORT TO CONGRESS 79–93 (2014) [hereinafter 2014 NTA REPORT]; 2013 NTA REPORT, *supra* note 95; 1 NAT'L TAXPAYER ADVOCATE, 2012 REPORT TO CONGRESS 134–53 (2012).

a same-country reporting exception for Americans living abroad.[189] Further, NTA has criticized the FBAR penalties as disproportionate.[190]

Academic commentators and policy advocates aside, taxpayers and those who represent them have also voiced frustration at FATCA's burdens. For example, the ABA Section on Taxation has submitted comments on how to reform the OVDPs to reduce burdens on taxpayers.[191] Lobbying groups for overseas Americans have also pushed for a "same-country exception" to FATCA, whereby Americans living in a foreign country would not have to report information with respect to financial accounts in that country.[192] A group of Americans living in Canada has sued Canada in the Federal Court of Canada for violating the Constitution Act of 1867 and the 1982 Canadian Charter of Rights and Freedoms by releasing financial information and breaching financial privacy.[193] While the Federal Court of Canada dismissed the plaintiffs' challenge to the U.S.–Canada IGA in 2016 and declined to enjoin the transmission of bank account data under the IGA, the suit remains ongoing with respect to constitutional issues.[194] Some U.S. taxpayers have filed lawsuits challenging the constitutionality of FATCA and the FBAR requirements and the legality of various aspects of the OVDPs and the streamlined programs.[195] While these lawsuits have so far not enjoyed success, they are indicative of the controversial nature of the programs in question.

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[189] 1 NAT'L TAXPAYER ADVOCATE, 2015 REPORT TO CONGRESS 353–62 (2015) [hereinafter 2015 NTA REPORT]; 2014 NTA REPORT, *supra* note 188, at 331–401; 2013 NTA REPORT, *supra* note 95, at 238–48.

[190] 2014 NTA REPORT, *supra* note 188, at 331–40. *See generally* Tessa Davis, *The Tax-Immigration Nexus*, 94 DENVER L. REV. 195, 207, 243 (2017) (noting the importance of "proportionality" in considering immigration consequences of tax policy).

[191] Joseph Disciullo, *ABA Tax Section Comments on OVDP, Streamlined Programs*, 149 TAX NOTES 515 (Oct. 26, 2015).

[192] Letter from Charles M. Bruce, Legal Counsel, Am. Citizens Abroad, Inc., to Robert B. Stack, Deputy Assistant Sec'y for Int'l Tax Affairs, U.S. Dep't of the Treasury (Apr. 29, 2016), https://www.americansabroad.org/media/files/files/9d44e9cd/Treasury_Ltr_Same_Country_ACA_160429_FINAL.PDF.

[193] Jim Atkins, *US Expats Launch FATCA Legal Challenge*, IEXPATS (Sept. 2, 2014), http://www.iexpats.com/us-expats-launch-fatca-legal-challenge/; J.P. Finet, *Canadian Court Rejects Injunction Request in FATCA Case*, 149 TAX NOTES 36 (Oct. 5, 2015).

[194] *See* Finet, *supra* note 193; *see also* ALLIANCE FOR DEFENCE CANADIAN SOVEREIGNTY, http://www.adcs-adsc.ca/ (last visited Apr. 7, 2017) (describing status of lawsuit).

[195] *See, e.g.*, Crawford v. Dep't of Treasury, No. 16-3539, 2017 WL 3568494 (6th Cir. Aug. 18, 2017) (affirming the district court's dismissal of the case challenging the constitutionality of FATCA and FBAR requirements for lack of standing), *cert. denied*, 2018 WL 1568044 (2018); Maze v. IRS, 862 F.3d 1087 (D.C. Cir. 2017), *aff'g* Maze v. IRS, 206 F. Supp. 3d 1 (D.D.C. 2016); William Hoke, *Court Dismisses Suit Challenging IRS Offshore Disclosure Rules*, 83 TAX NOTES INT'L 396 (2016); William Hoke, *Lawsuit Challenges IRS Transition Rules for Offshore Disclosures*, 149 TAX NOTES 620 (2015).

## III. THE TROUBLING POLICY UNDERPINNINGS OF THE U.S. APPROACH

In short, there have been significant criticisms of offshore tax enforcement, but these complaints have not, for the most part, struck a chord with policymakers or with most tax academics. This Article weighs in on the side of critics of offshore tax enforcement, but argues that these critics have not gone far enough in articulating the underlying concerns driving their criticisms. The U.S. approach is not flawed simply because it is poorly designed. Rather, the design flaws are symptomatic of two policy priorities that the United States has implicitly embraced in pursuing enforcement: (1) a focus on equalizing compliance by taxpayers with domestic assets and those with harder-to-detect offshore assets (domestic–offshore parity) by imposing harsher requirements and penalties on the latter; and (2) attention to revenue and enforcement.

These are worthwhile goals. However, in pursuing them, the United States has paid insufficient attention to other important policy concerns. For example, the United States has failed to make adequate distinctions *among* taxpayers with offshore holdings (intra-offshore distinctions). It has also not paid attention to the high externalized costs of enforcement and the potential impacts of those costs on various taxpayer populations. The result is a costly enforcement approach that risks imposing potentially unfair distributive consequences on the wrong populations. Ironically, as others have pointed out, the United States ultimately may not even have achieved its original enforcement goals.

### *A. Domestic–Offshore Parity vs. Intra-Offshore Distinctions*

A key concern of the United States has been to correct enforcement inequities between taxpayers with only domestic assets and those hiding assets offshore.[196] The worry is that offshore assets are easier to hide, so taxpayers with offshore assets have an unfair advantage over those operating domestically. The 2008 UBS and LGT leaks made these detection and enforcement disparities more salient.[197]

The United States sought to attain domestic–offshore enforcement parity by implementing initiatives that generated compliance cascades and imposed high penalties and extended statutes of limitations for covered offshore tax offenses. The theory is that because these offshore assets have a lower probability of detection, compliance can be equalized by raising penalties and

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[196] *See* Sheppard, *supra* note 8 (outlining the history of FATCA's enactment).

[197] *See supra* Section I.C.

statutory assessment periods, and by increasing income reporting through compliance cascades.[198] In pursuing this strategy, however, the United States paid insufficient attention to another important policy consideration: making fair and appropriate intra-offshore distinctions among differently situated offshore taxpayers. As a result, the United States may actually have imposed disproportionate burdens and sanctions on taxpayers who have offshore assets but were not in the original target population.[199]

### 1. *Expats, Immigrants, and Accidental Americans*

As discussed in Part I, the population of taxpayers who may have committed offshore tax offenses is heterogeneous. It may include willful tax cheats but also less willful populations, and it may include both "big time" and minor offenders.

GAO and NTA studies of OVDP participation demonstrate this heterogeneity, even among large-dollar offenders: In a 2013 study of OVDP participation, GAO found that about half of 2009 OVDP revenues came from 378 cases in which taxpayers received offshore penalties of $1 million or greater (roughly 6% of closed cases).[200] It found that many of these taxpayers had resided overseas for extended periods (for some, prior to becoming U.S. citizens), and of these taxpayers, many had opened their offshore accounts with money earned abroad.[201] Some OVDP entrants were immigrants who were reportedly unaware of their filing obligations.[202] Others were immigrants who had moved assets to Switzerland to protect them from instability in their home countries.[203] The GAO estimated that about 47% of the large-penalty taxpayers had inherited their offshore accounts (some jointly held) from family members who were not U.S. citizens or residents.[204] About 40% used complex trusts and other arrangements.[205] Along similar lines, the NTA has observed that some

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198 *See supra* note 175 and accompanying text.

199 *See generally* Lewis J. Greenwald & David H. Kaplan, *The Exceptional Importance of Getting U.S. International Tax Compliance Right*, 63 TAX NOTES INT'L 683 (2011) (noting exceptionally harsh rules concerning international tax compliance); *see also* sources cited *supra* note 8; Allison Bennett, *U.S. DOJ Cracking Down on Offshore Disclosure Tax Cheats*, Daily Tax Rep. (BNA) (Nov. 15, 2016).

200 2013 GAO REPORT, *supra* note 170, at 15. Even though the GAO only studied thirty "large-penalty" cases out of the 2009 OVDP, it seems likely that these heterogeneous intentions, backgrounds, and actions will exist for smaller-balance OVDP participants and for the 2011 and 2012 OVDPs, as well as in the population of non-participating offshore taxpayers more generally. *Id.*

201 *Id.* at 16.

202 *Id.*

203 *Id.*

204 *Id.*

205 *Id.* at 17.

OVDP participants are relatively "benign" U.S. immigrants or residents with family abroad, and has given the example of one U.S. green card holder who entered the OVDP and chose not to opt out because she feared a criminal conviction that might later bar naturalization.[206]

Despite this real-life heterogeneity, the United States has not really distinguished among these different populations of offshore offenders in designing and pursuing enforcement. This failure stems in part from the fact that U.S. worldwide taxation of citizens and residents does not distinguish among citizens, green card holders, and substantially present U.S. residents in imposing its compliance requirements.

### 2. *The Case for Intra-Offshore Distinctions*

Is there a principled reason to distinguish between different populations of offshore offenders in carrying out offshore tax enforcement? If an individual defined to be a U.S. tax resident under the law fails to declare and pay tax on $10,000 of offshore income, should her immigration status, place of residence, or length of time as a U.S. tax resident really matter in deciding how harshly to enforce and punish? This Article argues that there are a number of reasons why these distinctions matter.

#### a. *Sources of Capital and Differential Levels of Culpability*

First, in terms of intent, there is arguably a difference between financial capital purposefully moved and hidden offshore and capital that originates offshore. Contrast four taxpayers who are out of compliance with their tax obligations:

A. A U.S. taxpayer who fails to pay tax on U.S. income, and then removes assets from the United States and hides them in a haven country with no taxes (where the asset then generates new untaxed income).

B. A U.S. taxpayer who removes previously taxed assets from the United States and hides them in a haven country with no taxes (where the asset then generates new untaxed income).

C. A U.S. taxpayer who works abroad, pays foreign taxes on income earned overseas, invests that income overseas, and pays foreign

[206] *See* 2013 NTA REPORT, *supra* note 95, at 228–41; 2014 NTA REPORT, *supra* note 188, at 90.

taxes on subsequently generated investment income, but who fails to declare and pay U.S. taxes on such overseas income.

D. A U.S. taxpayer who inherits offshore assets upon properly paying the foreign country wealth transfer tax, pays foreign taxes on income generated by those inherited assets, but fails to declare their existence to the United States and pay U.S. tax on income they generate.

There is a strong argument that the behavior in *A* is worse than in *B*, *C*, or *D*, and that the behavior in *B* is worse than in *C* or *D*.[207] Scenario *A* involves three bad acts: not paying tax on original capital, purposefully hiding that capital offshore, and not paying U.S. or foreign taxes on the income it generates. Scenario *B* involves two bad acts: purposefully hiding post-tax capital offshore, and not paying U.S. or foreign taxes on income it generates. In contrast, the latter two scenarios involve taxpayers who are fully compliant with overseas taxes and who may lack purposeful intent to hide taxes. Such taxpayers may have committed the single bad act of failing to pay the relevant taxes to the United States. However, the current offshore tax enforcement scheme by and large places all four taxpayers in the same category of "offshore offenders," and has not adequately distinguished between them with respect to enforcement and penalties.[208] Moreover, the high penalties for offshore offenses may have been crafted with the egregious behaviors of the taxpayers in Scenarios *A* and *B* in mind, rather than the less purposeful misconduct of the taxpayers in Scenarios *C* and *D*.

#### *b. Less Risk of Double Non-Taxation*

Relatedly, in addition to implicating fewer bad acts, U.S. taxpayers such as those in Scenarios *C* and *D* may pose less risk of double non-taxation. For example, the income generated by foreign assets held by a green card holder who is a citizen of another country may already have been subject to taxation

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[207] These four scenarios might even be evaluated differently under different international tax policy metrics: Proponents of territorial taxation and a capital import neutrality standard might support non-imposition of tax on foreign income of U.S. taxpayers as a design matter. However, even they would likely say that the act of secretly moving assets offshore is a more serious matter.

[208] For example, while taxpayers of type *C* and *D* may elect to remediate their noncompliance under the streamlined OVDP, there is no guarantee that the United States will not audit these submissions and find them willful and criminally liable. In fact, there is reason to think that some such taxpayers entered into the regular OVDP for just this reason. *See infra* Section III.A.3.a. There is also no guarantee that taxpayers of type *C* and *D* will be able to plead "reasonable cause" to mitigate harsh penalties and statutes of limitations consequences. *See supra* Section II.A.3.b (discussing penalties and extended statutes of limitations for offshore offenses).

in that country.[209] Similarly, an American living overseas may be subject to residence-based tax jurisdiction in the other country.[210] These cases differ from the paradigmatic instance of the willful evader who hides assets in a tax haven and pays tax nowhere. For cases in which foreign taxes have been paid, the U.S. taxpayer may be eligible for a tax credit that offsets foreign taxes paid, even if she fully reports her offshore income to the United States. She may also be able to reduce her tax liability under a treaty. Thus, high compliance burdens placed on these populations may not actually generate much revenue for the United States.[211]

#### c. *Differential Enforcement Elasticities and Behavioral Responses*

FATCA and the other offshore enforcement initiatives impose significant compliance costs on all U.S. taxpayers with offshore holdings, not just evaders. But differently situated taxpayers are likely to have varying abilities to avoid these compliance costs going forward, which suggests that a tailored approach may be required.

##### i. *Sticky Financial and Work Histories*

While a common response to complaints about compliance costs is to point out that taxpayers can avoid those costs by ceasing to hold assets offshore, this is not an option for all taxpayers. Expatriates, accidental Americans, and inbound immigrants are likely to have offshore work, family, and financial lives or histories that require setting up bank accounts or accumulating other financial assets in another country. The fix for these populations is not as simple as to stop holding assets offshore (or, for that matter, to engage in even more undetectable and creative ways to evade taxes). Instead, because their financial assets are more closely tied to their histories and movement of their actual human capital, it may be harder for them to substitute out of FATCA's reach and costs by either holding purely domestic assets or by finding alternative (nonreportable) ways to hold assets. For example, many Americans abroad have reported being turned away by banks or other financial institutions

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209 There is no reason to think that green card holders are disproportionately from tax haven countries.

210 Others have so noted. *See, e.g.*, Harvey, *supra* note 184, at 338–39; Kirsch, *Revisiting*, *supra* note 8, at 161–62. Note that whether the income from offshore assets has already been taxed is a different question than whether assets moved abroad were themselves post-tax assets. Even willful offshore tax evaders may have moved post-tax assets overseas.

211 I.R.C. §§ 901 *et seq.* (2012). If there were a tax treaty between the United States and the foreign country, the country of source might cede taxing jurisdiction.

as customers as a result of FATCA.[212] For these taxpayers, this means real and persistent difficulties in gaining access to financial services to accompany their everyday work lives.

Over the long run, these taxpayers may bear disproportionate reporting and compliance burdens, precisely because it is likely harder for them to "substitute out." In particular, these populations will likely have to bear the nontrivial costs of finding and paying for competent tax preparation assistance and advice on an ongoing basis, even if their incomes and taxes owed are not particularly high.

#### *ii. Differential Access to (and Use of) Advice*

It is also possible that expatriates, recent immigrants, and accidental Americans on balance have less access to sophisticated legal representation and tax advice than high-net-worth individuals seeking to avoid taxes. Inferior legal representation means less robust audit defense as well as less information about lower-cost or lower-risk substitutes for simple asset stashing. Thus, just as they may be less able to opt out of their financial and personal histories, some taxpayer populations may also be less able to use alternative planning methods to avoid FATCA compliance obligations and may be more likely to bear FATCA's costs over the long run.

#### *iii. Sticky Holdings Beyond Bank Accounts*

While most commentary about FATCA has largely focused on foreign bank accounts, the legislation's reach goes further. The FATCA reporting and compliance provisions require reporting not just of foreign bank accounts, but also interests in shares, mutual funds, securities accounts, foreign trusts and estates, certain credit card and debit card accounts, life insurance policies with cash value, and other items.[213] Financial "holdings" such as a credit card with a credit balance or other debit card with positive cash value or certain retirement accounts may also be reportable.[214] Offshore compliance has also expanded to include more inclusive reporting of interests in certain foreign entities and foreign trusts.[215] Some of these additional reporting requirements are

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[212] *See generally* Charles M. Bruce, *U.S. Passes on Same-Country Exemption. Too Bad*, 154 TAX NOTES 1431 (2017); *see also infra* note 273 and accompanying text.

[213] *See supra* Section II.A.3.b.i; I.R.C. § 6038D; Treas. Reg. § 1.6038D–3 (2014); *see also* I.R.C. § 1471; Treas. Reg. § 1.1471–5 (as amended by T.D. 9657, 79 FR 12849 2014, and T.D. 9809, 82 FR 2177, 2017).

[214] I.R.C. § 6038D; Treas. Reg. § 1.6038D–3; *see also* I.R.C. § 1471; Treas. Reg. § 1.1471–5.

[215] *See* sources cited *supra* note 213.

nonobvious and have ensnared unwitting populations, such as holders of Canadian mutual funds and retirement accounts.

The reason for extending FATCA reporting to these assets is clear: For a willful evader, they are too easy a substitute for secret offshore accounts, and leaving these assets nonreportable would make enforcement ineffective. The problem is that some of these assets (such as life insurance policies or retirement accounts) are also more likely to be held by taxpayers who actually live or have lived abroad. And some of these taxpayers may be less able to easily divest of such assets. For these taxpayers, FATCA's broad enforcement reach may simply generate more burdens and traps for the unwary.

#### *d. Possible Knowledge Disparities*

DOJ and IRS representatives have often argued that at this point, years after the original 2008 UBS scandal, any taxpayer who remains noncompliant with respect to offshore reporting must necessarily be willful, given widespread and growing publicity about offshore tax offenses.[216] This, however, is not necessarily true. While it is certainly true that a well-advised taxpayer who continues to hold undeclared and untaxed assets in a Swiss bank account is likely willful, a recent U.S. expat, who prior to moving overseas had only domestic assets, may have had no reason to know about offshore reporting developments. Similarly, a recent immigrant may not necessarily have been apprised of enforcement developments since 2008. Accidental Americans who may have been young at the time of the UBS saga may also not have full knowledge about the tax rules and reporting requirements.

Therefore, despite U.S. assertions to the contrary, it is actually quite possible that certain groups may be less aware of offshore reporting requirements than U.S. authorities seem to think, particularly groups whose movements across borders are fluid (for example, those who may be newcomers to the United States or may have recently moved abroad). Over the long term, it is possible these groups may continue to be ensnared by harsh penalties and stringent reporting rules built on the oversimplified assumption that all ongoing offenders must be willful. Even if these taxpayers have been

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[216] Bennett, *supra* note 199 (quoting Caroline Ciraolo, former Principal Deputy Assistant Attorney General for DOJ Tax Division as saying that "the government is becoming more skeptical of people who say they weren't aware of their tax responsibilities"); Lee A. Sheppard, *News Analysis: Did You Really Mean to Hide Those Foreign Accounts? Part 3*, 152 TAX NOTES 155 (2016) (quoting IRS special trial attorney and division counsel John McDougal as saying, "It's hard to get less willful over time.").

negligent, negligence is not the same as willfulness and ought to be properly distinguished.[217]

### *e. Uneven Collateral Consequences*

Finally, it is important to make intra-offshore distinctions because certain taxpayers may suffer disproportionate collateral consequences as a result of reporting failures and the offshore tax enforcement initiatives.[218]

With respect to immigrants, for example, the NTA and GAO have noted that some recent immigrants and green card holders have applied for amnesty under the regular OVDPs.[219] Some of these taxpayers may have chosen the regular OVDP because they wanted assurance that they would not be criminally prosecuted as that might bar a future citizenship application.[220] However, entry into even the regular OVDP may present risks for a green card holder hoping to naturalize. One of the questions on the naturalization application, Form N-400, asks:

> Q. 22: "Have you EVER committed, assisted in committing, or attempted to commit, a crime or offense for which you were NOT arrested?"

Another asks:

> Q. 26: "Have you EVER been placed in an alternative sentencing or rehabilitative program (for example, diversion, deferred prosecution, withheld adjudication, deferred adjudication)?"[221]

It is possible, though unclear, that participation in the regular OVDP would require a yes response to either or both of these questions, even if the taxpayer

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[217] IRM 4.26.16.6.3.1 (Nov. 6, 2015); William Hoke, *Practitioners Question Use of OVDP over Streamlined Program*, 153 TAX NOTES 632 (2016) (quoting an IRS representative as saying, in the context of OVDP, that even "gross negligence" is sufficient grounds for entering streamlined rather than regular OVDP); Lee A. Sheppard, *News Analysis: Did You Really Mean to Hide That Foreign Account? Part 4*, 85 TAX NOTES INT'L 241 (2017) (distinguishing negligence from willfulness).

[218] Davis, *supra* note 190, at 200; *see also* Kawashima v. Holder, 565 U.S. 478 (2012) (holding that U.S. green card holders' conviction under I.R.C. § 7206(1) and (2) for willfully making and subscribing a false tax return and aiding and assisting in the preparation of a false return were aggravated felonies for which they could be deported); *cf.* Joshua D. Blank, *Collateral Compliance*, 162 U. PA. L. REV. 719, 788–89 (2014) (analyzing circumstances in which collateral nonmonetary sanctions can promote voluntary tax compliance and the risks of such sanctions and discussing the risks of deportation of green card holders for tax offenses).

[219] 2013 GAO REPORT, *supra* note 170, at 22; 2013 NTA REPORT, *supra* note 95, at 228–41; 2014 NTA REPORT, *supra* note 188, at 89–90.

[220] *See* 2014 NTA REPORT, *supra* note 188, at 90.

[221] USCIS Form N-400, Application for Naturalization, U.S. Citizenship and Immigration Services, https://www.uscis.gov/n-400 (emphasis omitted).

has been spared criminal prosecution. If the taxpayer was truly willful but avoided criminal prosecution by entering an OVDP, the first question would presumably require a yes response. If the OVDP constitutes a "diversion" alternative sentencing program (whereby the offender is diverted out of the criminal justice system and into a rehabilitation or amnesty program), then the second question would require a yes response as well.[222]

The OVDPs were likely not designed to purposely create roadblocks to naturalization for green card holders. However, failure to consider this issue may create potential difficulties for this population. A well-thought-out enforcement approach should address these collateral risks.[223]

### 3. *The U.S. Mismanagement of Intra-Offshore Distinctions*

The observations above—which are largely based on common sense—suggest that there may be good reasons to draw rational intra-offshore distinctions among different taxpayer populations. Unfortunately, a survey of the offshore enforcement initiatives shows that the United States has made few attempts to adequately manage and address these distinctions. It is likely that some actors whose misconduct was inadvertent have borne disproportionately high costs and consequences as compared with more serious offenders.

#### a. *Questionable OVDP Outcomes*

One place where the United States has not appropriately sorted among taxpayers with offshore issues is the OVDPs, which have been critiqued as distributionally unfair.

##### i. *Regressivity*

Perhaps the most troubling problem with the OVDPs is their regressivity. There is significant variation in the size of offshore accounts among OVDP entrants: A 2013 GAO study estimated that of 10,439 cases closed under the 2009 OVDP, the bottom 10% had account balances of less than $79,000, and the top 10% had balances over $4 million.[224] The median offshore account

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222 *See also* Davis, *supra* note 190 (making this point with respect to tax crimes more generally).

223 *See id.* at 243–46 (arguing that tax and immigration law should be more sensitive to the collateral risks that tax foot faults may create for green card holders).

224 2013 GAO REPORT, *supra* note 170, at 12.

balance was about $568,735 and the mean balance was $1,923,310.[225] Thus, accountholders both small and large entered the program.

These accountholders bore offshore penalties incommensurate with the size of their offenses: The NTA has studied the OVDPs, and notes that in the 2009 OVDP, the median offshore penalty paid by those with the smallest accounts (who are more likely to be nonwillful, or at least non-egregious) was almost *six times* the median unreported tax liability, while for those with the largest accounts, it was only about three times the unreported tax.[226] That is, as compared to large account holders, those with smaller accounts paid a disproportionately harsh offshore penalty relative to the actual tax owed. Moreover, the NTA found that unrepresented OVDP participants paid a proportionately larger penalty relative to participants navigating the OVDPs with representation, regardless of account size.[227]

These problems worsened in the 2011 OVDP: The median offshore penalty for taxpayers with the smallest accounts increased to eight times the unreported tax and taxpayers without representation continued to pay proportionately more than all taxpayers other than the bottom 10%.[228] Thus, the NTA finds that "the offshore penalty became increasingly more disproportionate for those with small accounts who were most likely to have been benign actors."[229]

As the NTA notes, such regressivity in OVDPs "undermine[s] the statutory scheme," which is supposed to apply harsher penalties to willful as opposed to nonwillful violations and to punish large-dollar offenses more severely.[230] Moreover, other features of the 2009 OVDP—such as arbitrary and unreasonable IRS interpretations, IRS unwillingness to explain its interpretations, IRS delays (which may have caused some benign actors to accept disproportionately harsh penalties in order to resolve their cases), and IRS one-sided and unreviewable interpretations of the program rules—may have violated taxpayer rights.[231]

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225 *Id.* at 13.

226 2014 NTA REPORT, *supra* note 188, at 86.

227 *Id.*

228 *Id.* at 86–87.

229 *Id.* at 86.

230 *Id.* at 79.

231 *Id.* at 79–93 (including "the rights to pay no more than the correct amount of tax, challenge the IRS's position and be heard, appeal an IRS decision in an independent forum, and to a fair and just tax system"); *see* 1 NAT'L TAXPAYER ADVOCATE, 2018 OBJECTIVES REPORT TO CONGRESS 43–50 [hereinafter 2018 NTA REPORT] (arguing that secrecy and lack of transparency in OVDPs violates taxpayers' right to be informed); *see also* Maze v. IRS, 862 F.3d 1087 (D.C. Cir. 2017), *aff'g* Maze v. IRS, 206 F. Supp. 3d 1 (D.D.C. 2016);

More recently, commentators have suggested that the OVDPs may have drawn taxpayers who need not have entered the programs at all, and who should instead have been in the streamlined program because they were not at risk for criminal prosecution.[232]

### *ii. Quiet Disclosures and Offenders "At Large"*

Quiet disclosures refer to instances when a noncompliant taxpayer chooses to file amended returns and late delinquent or amended FBARs without entering a voluntary disclosure program, or by reporting accounts and income going forward, without amending prior years' returns.[233] The IRS regards quiet disclosures as problematic because they are unfair to those who come into compliance by participating in the OVDPs and paying the required penalties.[234] As Professor Leandra Lederman has observed, the threat of higher sanctions against those who do not participate needs to be followed through to incentivize OVDP participation and create fair outcomes.[235]

IRS estimates suggest that there have been several hundred quiet disclosures, while GAO estimates suggest that there were more like 10,595.[236] In addition, the number of taxpayers reporting offshore assets by checking the relevant box on Schedule B of Form 1040 nearly doubled to 516,000 between tax years 2007 and 2010, increasing from 1% of all taxpayers to 2.5% of all taxpayers.[237] As GAO notes, for the years 2003 to 2010, "Both the increase in the number of foreign accounts reported on Form 1040, Schedule B and the increase in FBAR filings are significantly larger than the approximately 39,000 taxpayers [at the time] that came forward in one of IRS's offshore programs."[238] While there may be legitimate reasons for the increases, the data does suggest that some taxpayers who have not come in through the OVDPs have come in quietly.

The question of whether quiet disclosures are problematic is complicated. Arguably, quiet disclosures may be appropriate for taxpayers with *de minimis* foot faults because they obviate the need to enter onerous, costly, and

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Gubser v. IRS, 680 Fed. App'x 333 (5th Cir. 2017); Andrew Velarde, *Appeal Filed in OVDP Transition Rules Suit*, 83 TAX NOTES INT'L 1131 (2016).

232 Hoke, *supra* note 217.

233 2013 GAO REPORT, *supra* note 170, at 2.

234 *Id.* at 23.

235 Lederman, *supra* note 7, at 501–02.

236 2013 GAO REPORT, *supra* note 170, at 24–25.

237 *Id.* at 26–27.

238 *Id.* at 26.

regressive OVDP procedures. But for willful taxpayers with higher dollar offenses, allowing quiet disclosures is unfair to taxpayers who have voluntarily disclosed past offenses. To date, U.S. authorities have not talked about quiet disclosures in a way that reflects an appreciation of these nuances.

#### *iii. Streamlined Program Misuse*

Another problem stems from misuse of the streamlined disclosure programs, which are designed to impose smaller penalties for truly nonwillful taxpayers.[239] While about 65,000 taxpayers entered the streamlined programs, there have been concerns that some entrants were actually willful, despite claiming otherwise.[240] The DOJ recently announced that it is examining streamlined filings to pursue and prosecute taxpayers who entered the program by falsely claiming nonwillfulness to avoid penalties.[241] This move, paired with uncertainty over what constitutes "willful" conduct, may have a potentially chilling effect on taxpayer willingness to use the streamlined program.[242] Yet, failure to police the streamlined program for accuracy allows program abuse and unfair outcomes. Thus, like quiet disclosures, streamlined program misuse presents complexities with respect to fairness across heterogeneous taxpayers with offshore issues.

#### *iv. Lack of Follow Up*

A 2016 Treasury Inspector General for Tax Administration (TIGTA) study also found that the IRS undertook little follow-up action regarding taxpayers who either were denied access to or withdrew from the OVDP.[243] TIGTA has suggested that the IRS should mine this data to locate and punish noncompliant taxpayers.[244] Lack of follow up represents another instance of some tax offenders "escaping" while others suffered disproportionate consequences.

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239 *See supra* Section II.A.2.a.ii.

240 *See supra* note 102 and accompanying text.

241 Bennett, *supra* note 199; Sheppard, *supra* note 216.

242 *See, e.g.*, Hoke, *supra* note 217 (noting some practitioners' discomfort with having to determine willfulness); Sheppard, *supra* note 216 (discussing risks of using streamlined program for taxpayers whose conduct is, in fact, willful).

243 TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra* note 100, at 7; *see also* Sheppard, *supra* note 216 (noting that the DOJ is investigating taxpayers who were cleared for OVDP but did not follow through).

244 *See supra* note 243.

### *b. FATCA's Likely Impacts*

OVDPs aside, FATCA's reporting and disclosure requirements are likely to have uneven impacts on different taxpayer populations and may be another instance of failure to make appropriate intra-offshore distinctions.

#### *i. A Wide Reporting Net*

FATCA applies to a broad swath of taxpayers, not just deliberate offshore tax cheats. For example:

- Even taxpayers who have previously been completely compliant in reporting taxable income from foreign assets are now subject to the additional forms and filing requirements imposed by FATCA.
- Americans who live and work overseas must report assets under FATCA (subject to slightly higher thresholds) even though their U.S. tax owed might be reduced or eliminated by the foreign tax credit or foreign earned income exclusion.
- An immigrant who becomes a U.S. resident for tax purposes (either through green card or through the permanent residence test) must begin reporting all reportable foreign financial assets regardless of tax owed.
- An immigrant living in the United States who transitions from nonresident tax status to resident tax status (for example, when transitioning from Form 1040NR filing while on a student visa to Form 1040 filing on a work visa, or via a "closer connections" determination under a tax treaty) must start reporting all reportable foreign financial assets.
- A U.S. taxpayer who inherits foreign assets must undertake a combination of Form 3520 and Form 8938 reporting, and may have to report foreign financial assets going forward.

As discussed, inbound immigrants and Americans living abroad are more likely to have inelastic offshore engagements or financial histories, and are more likely to have retirement accounts, life insurance, and other holdings that must be reported.[245] Some of these populations will be less able to easily divest from these assets to avoid reporting burdens (either by repatriating them to the

[245] *See* 1 NAT'L TAXPAYER ADVOCATE, 2016 OBJECTIVES REPORT TO CONGRESS 49 (2016) [hereinafter 2016 NTA OBJECTIVES REPORT] (noting that "[f]urther review of updated and expanded data from FY 2010 through the present continues to demonstrate the weight of FATCA is being felt not by tax evaders, but by U.S. taxpayers who likely would be compliant regardless").

United States or hiding them more thoroughly).[246] Moreover, some of these assets are more likely to have originated offshore and have been subject to taxation in the other country. Yet, FATCA imposes reporting obligations in *all* of these cases.

FATCA's wide net would not be a significant problem if the costs of compliance were not high. However, as section B of this Part shows, FATCA compliance costs are in fact significant.[247]

### *ii. Uniformly Harsh Penalties on Heterogeneous Taxpayers*

As noted, failure to comply with FATCA's reporting obligations triggers harsh penalties and lengthened statutes of limitations, often without regard to the actual level of culpability.[248] Some of these penalties and lengthened limitations periods apply without regard for aggravating circumstances.[249] Under the standard deterrence model, it makes sense to impose high penalties and long statutes of limitations to compensate for the increased difficulty of detecting offshore holdings and to equalize enforcement against offshore populations.[250]

The problem, however, is that offshore taxpayers are heterogeneous. Therefore, a fair system should vary penalties and statutes of limitations to account for different levels of intent and wrongdoing. High penalties may make sense if all taxpayers are equally willful, but are less appropriate if some taxpayers have more benign motives or have made accidental mistakes. Some of the international reporting provisions do nominally contain carve-outs for reasonable cause that allow mitigation of penalties. However, some of FATCA's harsh penalty and statues of limitations rules are not subject to mitigation with respect to the unreported asset.[251] Moreover, there is no assurance upfront that any taxpayer will be excused for reasonable cause or

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[246] *Cf.* Lisa Simone et al., *Transparency and Tax Evasion: Evidence from the Foreign Account Tax Compliance Act (FATCA)*, Stanford Univ. Graduate Sch. of Bus., Research Paper No. 17-62 (September 2017), at 29–32, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3037426 (finding some evidence of investors moving assets from FATCA-signing havens to nonsigning havens that provide more secrecy and some evidence of increased investment out of nonsigning havens).

[247] *See infra* Section III.B.

[248] *See supra* Sections II.A.3.b.ii–iii.

[249] *See supra* Sections II.A.3.b.ii–iii.

[250] *See supra* note 175 and accompanying text (discussing standard deterrence model).

[251] *See supra* Section II.A.3.b.iii; *see also* 1 NAT'L TAXPAYER ADVOCATE, 2017 REPORT TO CONGRESS 314–24 (2017) [hereinafter 2017 NTA REPORT] (noting lack of uniformity in reasonable cause exceptions to initial and continuation penalties for failure to file international information returns under various Code provisions).

good faith.[252] In particular, if taxpayers lack good legal representation, they may not enjoy forbearance even if the law formally allows it.

### c. *Insufficient Punishment for Major Offenders*

Finally, it is questionable whether major offenders have been sufficiently sanctioned. While the United States has publicized prosecutions of offshore offenders, the number of actual prosecutions remains small, particularly in relation to numbers of taxpayers entering OVDPs.[253] The small number of prosecutions, paired with regressive OVDP outcomes, raises questions of whether the worst offenders have been held sufficiently accountable given the costs imposed on everyone else. Of course, the United States has had to extend some leniency to offenders to gather information and generate the "compliance cascades" discussed in this Article.[254] However, this is problematic if compliance has cascaded on less culpable populations.

Banks that facilitated offshore tax crimes have also borne fairly light consequences. As noted, the DOJ entered into DPAs and NPAs with many Swiss banks in exchange for information and cooperation.[255] Apart from Wegelin and Credit Suisse, offending Swiss banks have largely escaped prosecution. Moreover, the Swiss Bank Program has not been replicated for banks in other countries, some of which undoubtedly also facilitated offshore tax evasion. With few exceptions, banks in other countries have not been prosecuted or sanctioned.[256]

Deferred or nonprosecutions of corporate entities are commonly justified based on political or systemic risk concerns.[257] However, the use of these

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[252] It bears noting that in the context of FBAR examinations and penalties, practitioners have recently commented that the IRS is now presuming that any FBAR failures are willful and is subjecting nearly all taxpayers to the severe penalties that apply to willful FBAR violations, rather than the smaller penalty for nonwillful violations. Velarde, *supra* note 145.

[253] *Offshore Compliance Initiative 2015*, *supra* note 71.

[254] *See* Allyson Versprille, *IRS Expands Offshore Tax Avoidance Efforts Past Switzerland*, INT'L TAX MONITOR (BNA) (2016); *see also supra* Section II.B.1.

[255] *See supra* Section II.A.2.

[256] Two notable exceptions are Cayman National Securities Ltd. and Cayman National Trust Co. Ltd., both of which pled guilty to conspiracy to hide funds in Cayman bank accounts. *See Two Cayman Islands Financial Institutions Plead Guilty in Manhattan Federal Court to Conspiring to Hide More Than $130 Million in Cayman Bank Accounts*, U.S. DEP'T JUSTICE (Mar. 9, 2016), https://www.justice.gov/opa/pr/two-cayman-island-financial-institutions-plead-guilty-manhattan-federal-court-conspiring-hide.

[257] The DOJ's recent attempt to impose a large fine on Deutsche Bank is an example of how markets may adversely react to a high penalty on a large financial institution. Evelyn Cheng, *How US Regulators May Be Creating Panic Around Deutsche Bank*, CNBC (Sept. 30, 2016, 10:38 AM), http://www.cnbc.com/2016/09/30/how-us-regulators-may-be-creating-a-panic-around-deutsche-bank.html; *see* Spriha Srivastava & Luke

DPAs and NPAs has also been critiqued on the ground of undue leniency, unfairness, inappropriate insertion of prosecutors as regulators, and other grounds.[258] Thus, we should at least ask the question of whether banks and other serious offenders have been adequately punished, particularly in light of the high costs that have been imposed on other actors.

## *B. Compliance and Enforcement vs. Taxpayer Costs*

The second potentially problematic policy commitment embraced by the United States is a hyperfocus on revenue and compliance that largely ignores the high externalized costs that its initiatives have inflicted on various actors. These high costs render the U.S. failure to make intra-offshore distinctions more troubling: If compliance were merely inconvenient, the fact that it affects heterogeneous taxpayer populations would be less of a concern. But offshore tax compliance is costly, and the magnitude of these costs paired with their potentially unfair incidence is concerning and merits scrutiny and consideration. Moreover, these costs likely outstrip the expected returns from offshore enforcement.[259]

### *1. The Returns from Offshore Tax Enforcement*

The cost to the United States of individual offshore tax evasion has been estimated at between $40 billion and $70 billion per year.[260] The important question is how much of this cost can be recouped through offshore tax enforcement.

The Joint Committee on Taxation has estimated that FACTA will collect about $8.714 billion in revenues between 2010 and 2020.[261] Recently, the IRS commissioner also noted that the OVDPs have brought in about $10 billion and 100,000 taxpayers into compliance to date.[262] The Swiss Bank Program

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Graham, *Reaction: Deutsche Bank Shares Rise After Reaching Settlement with DOJ*, CNBC (Dec. 23, 2016, 9:08 AM), http://www.cnbc.com/2016/12/23/deutsche-bank-says-its-reached-a-72-billion-deal-with-the-department-of-justice.html.

258 *See* sources cited *supra* notes 37–38.

259 Byrnes, *supra* note 55, § 1.19 ("Since the enactment of FATCA the IRS has received approximately $10.0 billion nearly entirely from FBAR penalties and not from tax collection.").

260 JANE GRAVELLE, CONG. RESEARCH SERV., R40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION 1 (2015).

261 JOINT COMM. ON TAXATION, JCX-5-10, ESTIMATED REVENUE EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN SENATE AMENDMENT 3310, THE "HIRING INCENTIVES TO RESTORE EMPLOYMENT ACT" UNDER CONSIDERATION BY THE SENATE (2010).

262 I.R.S. News Release IR-2016-137, *supra* note 100.

has reportedly collected about $6 billion in penalties from Category 1 and Category 2 Swiss banks.[263]

### 2. *The High Costs of Offshore Tax Enforcement*

As commentators such as the NTA have observed, the projected revenue gains from offshore tax enforcement will likely be smaller than its costs, many of which have been externalized on other countries, taxpayers, and FFIs.[264] However, estimating the costs of offshore tax enforcement is tricky, particularly because Congress enacted FATCA without a cost-benefit analysis. Both FATCA implementation costs and the costs of the other initiatives must be considered.

#### a. *High FATCA Implementation Costs*

##### i. *Costs to FFIs*

FFIs have borne significant FATCA compliance costs.[265] Many have had to build technology platforms and upgrade computer and compliance systems to identify U.S. taxpayers.[266] Costs to FFIs also include manpower, training, legal, and other administrative costs.

There is reason to believe that FATCA's compliance costs are likely to exceed revenues raised.[267] One estimate places FATCA costs at $8 billion a year, far in excess of the $800-million-a-year approximate revenue gain.[268]

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[263] *See* sources cited *supra* note 121 and accompanying text.

[264] 2013 NTA REPORT, *supra* note 95, at 241–44 (noting that "[b]y most measures, FATCA-related costs equal or exceed projected FATCA revenue"); *see also* Byrnes, *supra* note 55, § 1.19.

[265] 2013 NTA REPORT, *supra* note 95, at 241–42 (noting that "[t]he FATCA reporting regime places significant burdens on FFIs and withholding agents"); Amanda Athanasiou, *News Analysis: Small Swiss Banks Struggling for Survival*, 79 TAX NOTES INT'L 566 (2015); Teri Sprackland & Stephanie Soong Johnston, *"FATCA Fatigue" Hampering Common Reporting Standard*, 79 TAX NOTES INT'L 1085 (2015) (noting that "[t]he Foreign Account Tax Compliance Act has taken so much time and money that many [financial institutions'] management lack the enthusiasm to tackle the new [common reporting] standard, judging from the survey results").

[266] *See, e.g.*, Jaime Arora & Shamik Trivedi, *FATCA Reporting Said to Require Compliance Expertise*, 137 TAX NOTES 357 (2012); Denise Hintzke, *1 Year Later: FATCA Reporting Challenges and Opportunities*, 79 TAX NOTES INT'L 65 (2015) (noting difficulties of obtaining client data from different IT systems).

[267] Byrnes, *supra* note 55, § 1.19 (citing estimates, surveys, and statements by accounting firms, government officials, and consulting firms and noting that "FATCA is proving to be enormously expensive for financial institutions to implement and administer"; also noting that "[a]s predicted, the cost of compliance for foreign institutions dwarfs the tax revenue the United States is collecting").

[268] Kyle Pomerleau, *Foreign Account Tax Compliance Act (FATCA) Goes into Force Today*, TAX FOUND. (July 1, 2014), http://taxfoundation.org/blog/foreign-account-tax-compliance-act-fatca-goes-force-today; *see also* Wood, *supra* note 186.

One JP Morgan bank executive recently estimated FATCA compliance costs at \$100 million per bank for major banks.[269] The CEO of Bank of Nova Scotia also indicated in a 2013 interview that the bank had already spent about \$100 million on FATCA compliance.[270] A 2016 Thomson Reuters FATCA survey of senior executives contains more modest cost estimates: 40% of survey respondents planned to spend between \$100,000 and \$1 million on FATCA compliance, with only 4% planning to spend between \$10 million and \$20 million.[271] Thus, compliance costs may be lower for smaller banks. Once initial cost outlays have been made, the ongoing maintenance costs to FFIs may decrease going forward.

In addition to being difficult to estimate, we also do not know the incidence of these FFI costs. It seems likely that FFIs will find ways to pass these costs on to customers, both U.S. and non-U.S.[272] For example, various U.S. expatriates have reported instances of foreign banks refusing them as customers.[273] It is also possible that banks may pass costs on to customers in the form of higher fees.

### *ii. Costs to Foreign Governments*

Foreign governments have also had to incur compliance costs. In particular, in jurisdictions that have adopted Model 1 IGAs, FFIs turn U.S. accountholder information over to domestic authorities, which in turn give the data to the United States.[274] Countries such as New Zealand and Australia have estimated FATCA compliance costs to be high.[275] Moreover, it is possible that

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269 Wood, *supra* note 186.

270 John Greenwood, *Electronic Spying "A Big Issue" for Banks, Scotia CEO Waugh Says*, FIN. POST (Oct. 23, 2013, 5:48 PM), http://business.financialpost.com/news/fp-street/electronic-spying-a-big-issue-for-banks-scotia-ceo-waugh-says.

271 *FATCA & CRS Readiness Survey*, THOMSON REUTERS (2016), https://tax.thomsonreuters.com/wp-content/pdf/onesource/fatca-crs-readiness-survey.pdf.

272 Dharmapala, *supra* note 187, at 24.

273 Jacqueline Bugnion, *Concerns About the Taxation of Americans Resident Abroad*, 148 TAX NOTES 861 (2015) (noting how banks and other FFIs refuse to accept American clients for bank accounts, investment and mutual fund accounts, joint accounts, and mortgages); Giles Broom & Allyson Versprille, *U.S. Ambassador Tells Swiss Banks to Open Doors to Americans*, INT'L TAX MONITOR (BNA) (Oct. 19, 2016); *see also* 2018 NTA REPORT, *supra* note 231, at 54 (noting this "banking 'lock-out'" phenomenon); William Hoke, *Credit Suisse Reportedly Freezing Accounts over FATCA Concerns*, 84 TAX NOTES INT'L 896 (2016).

274 *FATCA Information for Governments*, INTERNAL REVENUE SERV., https://www.irs.gov/businesses/corporations/fatca-governments (last updated Aug. 27, 2017).

275 Explanatory Memorandum, Tax Laws Amendment (Implementation of the FATCA Agreement) Bill 2014 (estimating that Australia's preferred option for FATCA compliance would entail a startup cost of AUD\$255 million and an ongoing cost of \$227.2 million over ten years, for a total of \$382.68 million over ten years); INLAND RECOVERY, TREASURY, SINGLE STAGE BUSINESS CASE, FOREIGN ACCOUNT TAX COMPLIANCE

foreign governments and countries may incur indirect costs as a result of FATCA. As Professor Dhammika Dharmapala has described, under certain assumptions, FATCA may cause residents of foreign countries to engage in increased cross-border tax evasion (because FATCA increases the costs of investing through their home country FFIs while leaving the cost of investing through U.S. financial institutions unchanged).[276]

As with FFI costs, it is difficult to predict the incidence of these costs. As detailed below, it is also difficult to predict what foreign governments will do with the FATCA data they obtain. This decision will have consequences as well.[277]

### *iii. FATCA Costs to the United States*

The United States has also borne and will continue to bear FATCA implementation costs going forward. TIGTA reported in 2013 that the United States incurred \$16.6 million in developing the Foreign Financial Institution Registration System, which is \$2.2 million over budget.[278] Although many of FATCA's compliance costs are externalized onto others, the United States will have to incur continuing costs to process and use FATCA data.[279] Much of the data collected via FATCA is likely to be quite raw. It may not adequately distinguish between solely held and joint accounts, for example, nor does it tell the United States the correct amounts of actual income inclusions.[280] The

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ACT (FATCA) PROJECT (2014), http://www.treasury.govt.nz/downloads/pdfs/b14-info/b14-2828155.pdf (estimating whole-of-like cost to Inland Revenue (excluding FFI costs) of FATCA implementation to be NZ\$6.146 million excluding depreciation and capital charges); Herbert Smith Freehills LLP, *The Cost of Complying with FATCA—Similar Initiatives to Follow?*, LEXOLOGY (June 3, 2013), http://www.lexology.com/library/detail.aspx?g=a74e2969-7fe3-4931-999b-7caaf60c5588 (HMRC estimates "one off cost under the IGA could be around £0.9bn – £1.6bn, with an ongoing cost of £50 million – £90 million a year"); Gareth Vaughan, *NZ Banks, Fearing NZ \$100 mln Bill, Work with Australian, Canadian and British on Changing "Unworkable" US Foreign Account Tax Compliance Act*, INTEREST.CO.NZ (Sept. 6, 2011, 4:21 PM), http://www.interest.co.nz/news/55211/nz-banks-fearing-nz100-mln-bill-work-australian-canadian-and-british-changing-unworkable- (estimating NZ\$100 million cost for the banking industry).

[276] Dharmapala, *supra* note 187, at 24.

[277] *See infra* Section III.B.2.c.ii (discussing taxpayer privacy considerations).

[278] TREASURY INSPECTOR GEN. FOR TAX ADMIN., No. 2013-20-118, FOREIGN ACCOUNT TAX COMPLIANCE ACT: IMPROVEMENTS ARE NEEDED TO STRENGTHEN SYSTEMS DEVELOPMENT CONTROLS FOR THE FOREIGN FINANCIAL INSTITUTION REGISTRATION SYSTEM (2013); *see also* TREASURY INSPECTOR GEN. FOR TAX ADMIN., No. 2014-20-094, WHILE THE FINANCIAL INSTITUTION REGISTRATION SYSTEM DEPLOYED ON TIME, IMPROVED CONTROLS ARE NEEDED (2014).

[279] Dolores W. Gregory, *Official: Data Exchange Threatens to Swamp Tax Authorities*, INT'L TAX MONITOR (BNA) (May 10, 2016).

[280] For example, IGAs in force report the full value of accounts held jointly with a non-U.S. person, as well as gross dividend and interest payments into the accounts, regardless of whether the U.S. holder is responsible for the tax reporting. *See FATCA Resource Center*, U.S. DEP'T TREASURY, https://www.treasury.

United States will likely have to incur additional costs to process and use the FATCA data.[281] If there are inconsistencies between the data obtained from FFIs and that reported on taxpayer returns, the United States may have to do some form of audit or follow-up inquiry, which would be another cost.

As discussed below, some of these costs to the United States are a form of agency cost, in which the incentives of the principal (the United States) and the agent charged with carrying out the principal's mission (the FFIs) do not align.[282] Given the steep penalties for noncompliance, FFIs and foreign governments may have an incentive to over-include or over-report, which could generate additional costs to the United States to sort through the data. This is borne out by recent reports, which indicate that there may be problematic false positives in the FATCA data.[283]

#### b. *Compliance Costs to Individual Taxpayers*

Governments and financial institutions aside, individual taxpayers also bear nontrivial compliance costs.

##### i. *Costs Associated with FATCA Compliance*

Taxpayers with offshore assets are subject to high costs and burdens from FATCA compliance. The offshore disclosure rules are complex and the consequences of noncompliance serious. There are a multitude of required forms and disclosures, some duplicative.[284] While there are dollar thresholds below which reporting is not required, these thresholds are quite low, even for Americans living abroad, but especially for those living in the United States.[285]

In fact, the FATCA reporting thresholds are low enough that compliance burdens are not imposed only on high-net-worth taxpayers, but also on ordinary taxpayers who may simply have some savings in a bank, retirement account, or foreign mutual fund.[286] The dollar thresholds for FBAR reporting are even lower ($10,000).[287] Even if a taxpayer ultimately falls below the

gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx (last updated Dec. 19, 2017); *see also* 2013 NTA REPORT, *supra* note 95, at 244 (noting technology that the United States will have to develop to effectively use FATCA data).

281 *See* 2013 NTA REPORT, *supra* note 95, at 244.

282 *See infra* Section III.C.2 (discussing agency costs).

283 Gattoni-Celli, *supra* note 166.

284 *See supra* Section II.A.3.b.i.

285 *See supra* note 138.

286 *See supra* note 138.

287 *See supra* note 52 and accompanying text.

reporting threshold, she would need to spend time to figure out the law or pay a professional advisor to make this determination. Anecdotal evidence suggests that charges for professional services for offshore tax compliance are high, whether due to risk exposure to preparers, time spent, or a small pool of qualified experts (resulting in the ability to capture rents due to preparer undersupply).[288] For Americans living abroad, in particular, a limited pool of experts, treaty issues, and the need to compute the foreign-earned income exclusion and foreign tax credit may particularly necessitate costly tax preparation assistance, even if little or no tax is ultimately owed.[289] In short, offshore compliance is burdensome in terms of professional fees as well as time spent complying.[290]

Furthermore, as discussed, the potential consequences for mistakes and reporting failures for offshore assets are potentially far more severe than those in the domestic context.[291] Many of those penalties and extended statutes of limitations apply regardless of exacerbating circumstances. And although penalties may be reduced or eliminated for reasonable cause, this outcome is not assured.[292]

Compliance with the offshores tax rules may also give rise to anxiety and psychic costs to taxpayers because the rules are complex and their application uncertain. Moreover, the penalty for getting the rules wrong is high. Psychic burdens on taxpayers may persist whether or not the law is actually enforced.[293]

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[288] *See, e.g.*, Bugnion, *supra* note 273 (noting high costs of compliance for Americans living abroad).

[289] I.R.C. §§ 901, 911 (2012); *see also* Allison Christians, *Regulating Return Preparers: A Global Problem for the IRS.*, 75 TAX NOTES INT'L 391 (2014) (discussing some of the challenges in regulating return preparers in the cross-border context).

[290] *See, e.g.*, Bugnion, *supra* note 273; Disciullo, *supra* note 191; 2016 NTA OBJECTIVES REPORT, *supra* note 245, at 48–51.

[291] *See supra* Sections II.B.2 and III.A.3.b.ii.

[292] *See supra* Sections II.B.2 and III.A.3.b.ii; *see also* 2017 NTA REPORT, *supra* note 251 (noting lack of uniformity in reasonable cause language in the offshore penalties and recommending that "[p]roviding uniformity to and simplifying the application of the reasonable cause exception will promote the taxpayers' *right to pay no more than the correct amount of tax* and [their *right*] *to a fair and just tax system*, and improve the administration of the penalty regime by the IRS").

[293] In fact, theoretical literature on the economics of crime posits that high penalty schemes with low detection probability may be welfare maximizing because this approach reduces enforcement costs. *See* Becker, *supra* note 175; Serge-Christophe Kolm, *A Note on Optimum Tax Evasion*, 2 J. PUB. ECON. 265, 266 (1973) (describing this outcome as "hang tax evaders with probability zero").

### *ii. Costs of OVDP Participation*

Taxpayers who enter an OVDP may also incur significant costs in addition to actual offshore penalties because those procedures are difficult to navigate without legal representation. As noted by the NTA, taxpayers who entered OVDP without representation paid disproportionately severe penalties compared to those with representation.[294] While we do not know the exact costs to taxpayers of OVDP representation, they are likely nontrivial.

One might argue that taxpayers who evaded taxes should not now complain about high compliance costs. However, as discussed, not all OVDP participants were willful offenders; some were arguably not willful at all, and (as discussed) the OVDPs generated regressive outcomes.[295] Given the distributional problems with the program, the high costs of OVDP participation look more problematic. Moreover, OVDP participation often involves costs of legal representation, which are captured by taxpayer representatives rather than inuring to the fisc.

### *c. Other Costs*

In addition to the quantifiable dollar costs of compliance, there are numerous other indirect costs that ought to be considered.

### *i. Taxpayer Substitution and Deadweight Losses*

If taxpayers find more effective ways to avoid U.S. taxes in response to FATCA, this may prove costly to the United States. For example, sophisticated taxpayers may replace simple asset stashing with more complex structuring that is harder to detect. Others may relinquish their U.S. citizenship to avoid the U.S. tax regime and its accompanying costs (which may include not just taxes owed, but also costs of obtaining competent tax advice, possible costs of being denied access to financial services, and psychic costs).[296] In fact, the data show that the number of Americans giving up their citizenship is at an all time

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[294] *See supra* notes 227–28 and accompanying text.

[295] *See supra* notes 226–30 and accompanying text.

[296] *See* Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 82 Fed. Reg. 36,188 (Aug. 3, 2017); Yian Q. Mui, *Why Americans Are Giving Up Citizenship in Record Numbers*, WASH. POST (June 1, 2016), https://www.washingtonpost.com/news/wonk/wp/2016/06/01/why-americans-are-giving-up-citizenship-in-record-numbers/?utm_term=.f629e0cfd2d1; Jethro Mullen, *Record Number of Americans Dump U.S. Passports*, CNNMONEY (Feb. 8, 2016, 9:27 AM), http://money.cnn.com/2016/02/08/news/americans-citizenship-renunciation/.

high, and commentators point to FATCA a significant driver.[297] On the flip side, immigrants thinking about moving to the United States may decide to choose other options instead (for example, staying home or moving to a country with lower tax compliance costs). These types of taxpayer behavioral substitutions will likely reduce U.S. revenue collections going forward and may also generate welfare losses for taxpayers and the United States.

#### *ii. Taxpayer Privacy and Other Collateral Consequences*

Finally, there are other collateral consequences that might result from offshore tax enforcement. For example, a recent survey of Americans living abroad suggests that some have experienced indirect burdens as a result of FATCA, including having a bank account closed, being unable to open a bank or financial account, family stress and conflict with non-American spouses, and denial of job opportunities.[298]

Another important collateral consequence is the impact on taxpayer privacy, including privacy of inbound immigrants in their home countries or of Americans living abroad. Much of the current move toward transparency and disclosure in international tax has assumed that governments not only are able to safeguard taxpayer data but are also benign. However, there is no guarantee that governments will not use taxpayer data in deliberately or accidentally harmful ways.[299] For example, we do not know how foreign governments who have entered into Model 1 IGAs will use the taxpayer information procured from FFIs for their own (tax or nontax) purposes.[300] Depending on the political

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[297] *See supra* note 296; *see also 2016 Fourth Quarter Published Expatriates – New Annual Record*, INT'L TAX BLOG (Feb. 8, 2017), http://intltax.typepad.com/intltax_blog/2017/02/2016-fourth-quarter-published-expatriates-new-annual-record.html; *2017 Second Quarter Published Expatriates – Second Highest Ever*, INT'L TAX BLOG (Aug. 2, 2017), http://intltax.typepad.com/intltax_blog/2017/08/2017-second-quarter-published-expatriates-second-highest-ever.html; *2017 Third Quarter Published Expatriates – A Total of 1,376*, INT'L TAX BLOG (Nov. 1, 2017), http://intltax.typepad.com/intltax_blog/2017/11/2017-third-quarter-published-expatriates-a-total-of-1376.html (noting that "[i]n the first three quarters of 2017, there has already been more published expatriates than there was for the entire year of 2015 (4,279)").

[298] *See FATCA: A Banking Burden Abroad*, DEMOCRATS ABROAD (June 10, 2016), https://www.democratsabroad.org/fatca_burden; *see also* Byrnes, *supra* note 55, § 1.18[7][b]; *supra* note 273.

[299] *See generally* William Byrnes, *How May the United States Leverage Its FATCA IGA Bilateral Process to Incentivize Good Tax Administrations Among the World of Black Hat and Grey Hat Governments? A Carrot & Stick Policy Proposal*, 31 EMORY INT'L L. REV. 1033 (2017). Recently, employees of Argentina's tax agency were arrested for selling taxpayer data. *See* William Hoke, *Police Arrest Data Traffickers at National Tax Agency*, 89 TAX NOTES INT'L 637 (2018).

[300] Byrnes raises this point in the context of considering U.S. reciprocity with other governments. *See* Byrnes, *supra* note 55, § 1.20[3] ("A legitimate question is whether it is prudent for the U.S. government to trust the governments of the 117 countries that scored a 50 or below on Transparency International's corruption index with taxpayer financial information derived from U.S. bank accounts? Reciprocity may

realities and norms in various countries (including the United States), the data may be put to uses distinct from revenue collection. Some of these uses may be harmful to taxpayers. These downsides of transparency and information exchange have received insufficient attention from tax scholars, but their risks are real and are likely to become clearer over time.[301]

### 3. *Cost Considerations and Social Welfare*

In short, more work is needed to quantify the costs of offshore tax enforcement to financial institutions, taxpayers, and governments. However, the evidence we do have suggests that these costs are nontrivial. These costs should be weighed against the gains from offshore tax enforcement, in evaluating our system of enforcement. For example, in situations when costs are well in excess of benefits generated, it might be advisable to allow some level of evasion to exist, given costly enforcement and finite resources.[302]

In the context of offshore tax enforcement, the cost to raise a dollar of revenue is likely high, once externalized costs on various actors have been taken into account. Furthermore, it is possible that the incidence of those costs may fall on U.S. firms and taxpayers over the long run. These externalized costs should be accounted for in thinking about the enforcement calculus. Once the likely costs of offshore tax enforcement are considered, it is far from obvious that offshore tax enforcement as currently constituted is a good policy choice, even if it may generate revenue and induce compliance.

Of course, one must be careful not to understate the benefits of offshore tax enforcement. For example, offshore tax enforcement may have helped prevent reductions in taxpayer morale and increases in noncompliance, which may have resulted from the public finding out about widespread offshore evasion

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encourage nefarious governments' behavior by providing U.S. financial information to feed corruption and suppression of political rivals."). However, concerns about political suppression and other misuses are also salient with respect to whether to trust such governments with their own taxpayers' financial information.

301 Mindy Herzfeld, *News Analysis: Will Information Exchange Lead to Information Misuse?*, 84 TAX NOTES INT'L 537 (2016); *see also* Oei & Ring, *supra* note 1 (discussing some of these risks).

302 A significant body of economic literature suggests that the goal of the tax administrator should be to maximize a social welfare function in light of budget constraints, rather than to raise revenue per se. Slemrod & Yitzhaki, *supra* note 175, at 1447 ("In models with heterogeneous citizens, the standard objective function is a social welfare function which has as arguments the utility level of each citizen . . . where the shape of the social welfare function implicitly determines the social value placed on the distribution of utilities as opposed to the sum of utilities."); McCubbin, *supra* note 175, at 17. Raising revenue and maximizing social welfare are different because a dollar of revenue transferred from the taxpayer to the government imposes an offsetting cost to the taxpayer, but revenue can only be taken at a cost to both government and taxpayer (either an administrative cost or an efficiency cost).

and feeling taken advantage of. The U.S. offshore tax enforcement measures also spurred like-kind measures in other countries, such as mini-FATCA laws and the Common Reporting Standard. Even after accounting for these benefits, however, FATCA's costs are nonetheless significant and may be problematic in their distribution. A welfare-maximizing tax authority should seek to more thoroughly understand these costs to better understand their social welfare impacts.

### *C. Further Observations*

This Article has argued that offshore tax enforcement has several design flaws that derive from the troubling underlying policy priorities that the United States has implicitly embraced: (1) domestic–offshore parity and (2) an attention to revenue and compliance while paying insufficient attention to the costs of enforcement and their distribution. As such, offshore tax enforcement may impose high costs on the wrong taxpayers.

This section offers two further observations that may help explain how these costs and distributive concerns have been created and why they persist.

#### *1. A Predictable Hierarchy of Interests*

The notion that offshore tax enforcement may impose high costs on unintended populations is not surprising and is in fact predictable. These initiatives were created and enacted against a backdrop in which attention was on willful evaders. At the same time, the other affected populations—immigrants, expatriates, and accidental Americans—were not well positioned to raise concerns. Immigrants tend to lack a political voice, Americans living abroad were not physically present, and accidental Americans by definition did not even know they were American. These populations were thus not well organized to lobby for their interests or to protest unfair treatment at the outset. They are also relatively small groups, which has likely made them easy to ignore or discount.

Wealthy tax evaders, too, were not in a position to protest the harshness of the enacted law. Evaders who were caught were unlikely to be in a position to chime in, and those not caught were unlikely to want to be visible. The complaints of the tax bar have also been easy to ignore.

Thus, offshore tax enforcement represents a unique context in which neither the most nor arguably least culpable were popular, represented, or present enough to effectively question the design of the new enforcement initiatives. As such, it should surprise no one that the law as enacted may have been less than perfectly attenuated, and may adversely impact multiple taxpayer groups.

More recently, the expatriate lobby has become more organized, lobbying Congress for better treatment (for example, for a same-country reporting exception, simplified reporting requirements, or FATCA repeal).[303] Expatriates now enjoy higher reporting thresholds than taxpayers residing in the United States, and were given access to the streamlined OVDP in 2012.[304] But immigrant groups have been less visible and organized in standing up for their concerns. Much recent criticism of FATCA and the other offshore enforcement initiatives has been leveled on behalf of expatriates and accidental Americans, not immigrants.[305] However, as this Article has shown, inbound immigrants are affected by the law in distinctive and troubling ways due to their personal and financial histories and may suffer unique collateral consequences.[306]

The hierarchy of interests that has unfolded is not altogether surprising. First, the United States focused on enforcement parity and perceived fairness toward "ordinary" American taxpayers holding domestic assets. Subsequently, as the expatriate lobby became more organized, attention has slowly turned to the concerns of expatriates and accidental Americans. But the concerns and distinctive situations of immigrants have, on the whole, received the least attention, and may thus be the least salient to policymakers.

Ultimately, then, what we observe is a classic phenomenon: Laws, originally written to catch bad actors who have power to avoid or otherwise effectively confront the law, end up primarily ensnaring actors who are less culpable or sophisticated, less equipped to deal with the law's complexity, less able to effectively lobby, and less able to substitute out of the law's grasp through planning. Offshore tax enforcement's facial effectiveness under some metrics may mask the fact that the compliance cascades, high-penalty regimes,

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303 Disciullo, *supra* note 191; Andrew Velarde, *Will FATCA Same Country Exception Become the Rule?*, 152 TAX NOTES 1073 (2016); *see infra* note 322.

304 *See supra* notes 91–93, 138. The streamlined program was opened to taxpayers residing in the United States in 2014. *See supra* note 96 and accompanying text.

305 *See, e.g.*, Christians, *Global Perspective*, *supra* note 8, at 196; Kirsch, *Citizens Abroad*, *supra* note 184, at 244–48; Kirsch, *Revisiting*, *supra* note 8, at 210–17; Mason, *supra* note 1, at 236–37. Some of this criticism appears grounded in an interest in justifying continued citizenship-based taxation, given the burdens created by the recent enforcement and administrative initiatives for U.S. citizens abroad. *See, e.g.*, Kirsch, *Revisiting*, *supra* note 8.

306 *See also* Davis, *supra* note 190, at 197.

and open-ended statutes could actually be most costly to and effective at ensnaring the wrong people.

### 2. *Agency Costs*

A second underexplored dynamic that may exacerbate the costs of offshore tax enforcement is agency costs deriving from principal-agent problems. Agency costs arise when one party (the agent) has the power to act on behalf of the other (the principal), but where the agent's interests may not be aligned with those of the principal.[307] In the presence of asymmetric information, this creates moral hazard on the part of the agent and will give rise to agency costs if left unchecked.[308] Agency costs may reduce social welfare.

Principal-agent problems occur in the offshore tax enforcement context in a few different ways. First, principal-agent problems may arise in FATCA reporting by FFIs. Recently, there have been complaints that some of the data provided to the United States by FFIs and foreign governments may contain false positives, which may make it hard to use.[309] This is not surprising because given the harsh FATCA withholding penalty, FFIs will have an incentive to report overinclusively. Such overdisclosure creates information overload and is a form of agency cost to the United States.

Second, given the law's complexity, many taxpayers with offshore issues must rely on the assistance of tax advisors either to enter an OVDP or to comply with FATCA. Here, principal-agent problems may exacerbate the already high costs of enforcement and compliance to the United States and taxpayers respectively. For example, in some situations it may be in the interests of tax advisors to channel taxpayers into the regular OVDP rather than to streamlined programs, so as to collect a higher fee or to mitigate professional risks, raising questions about whether some taxpayers are overpaying penalties.[310] Similar dynamics may also shape the advice an advisor may dispense with respect to tax reporting. Depending on how the incentives align, a tax advisor may recommend an over- or underinclusive reporting approach—for example, overreporting when trying to generate more fees or to mitigate professional risks, or underreporting when trying to offer

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[307] Michael C. Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (defining the concept of agency costs).

[308] *Id.*

[309] Gattoni-Celli, *supra* note 166.

[310] Hoke, *supra* note 217.

services or tax positions that are comparable to that of a competitor.[311] Such advice might not completely align with the best interests of the United States. For example, if a preparer recommends overdisclosure, this may render reported information more costly to use. If the preparer recommends underdisclosure, this would undermine enforcement.

Third, agency costs may arise with respect to information gathered from OVDP participants, banks in the Swiss Bank Programs, and taxpayers, facilitators, and banks that have been prosecuted. These actors may be a useful source of information about other offshore evasion, but they may provide information that is overinclusive, inaccurate, or distortionary if this is in their best interests (for example, to avoid prosecution or to reduce penalties imposed).

These dynamics in offshore tax enforcement's design have scarcely been probed in the tax literature. More work is needed to understand and quantify the impact of principal-agent dynamics in offshore tax compliance and enforcement. To the extent that agents are capturing value and imposing costs on the United States and its taxpayers, reforms should be enacted to minimize these costs.

This Article does not suggest that the United States has no regard for intra-offshore distinctions or externalized costs whatsoever. The point, rather, is that in the push for enforcement, some of these considerations seem to have taken a back seat. Proponents of offshore tax enforcement rightly point out that the U.S. interest in increasing collections, remedying domestic–offshore inequities, and ramping up offshore enforcement to reduce offshore evasion are important concerns.[312] But critics are also right to point out that the competing considerations of making appropriate taxpayer distinctions and minimizing administrative and efficiency costs have been given insufficient weight, with

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[311] We may also see high costs and penalties to taxpayers affecting the behaviors of taxpayer representatives and causing them to charge high fees or give overly conservative advice.

[312] *See also* Annette Alstadsæter et al., *Tax Evasion and Inequality* 3 (NBER, Working Paper No. 23772, 2017), https://gabriel-zucman.eu/files/AJZ2017.pdf (finding "the probability of hiding assets offshore rises sharply and significantly with wealth" and suggesting that once tax evasion is taken into account, measures of inequality increase substantially); Niels Johannesen et al., Taxing Hidden Wealth: The Consequences of U.S. Enforcement Initiatives on Evasive Foreign Accounts (Mar. 2017) (unpublished manuscript), https://www.gsb.stanford.edu/sites/gsb/files/acct_05_17_slemrod.pdf (finding that increased enforcement increased foreign account reporting to the IRS, increased wealth disclosed, and increased dividends, interest, and capital gains disclosed by individuals who began reporting but did not participate in an OVDP). *See generally* sources cited *supra* note 7.

the result that the U.S. approach may impose high costs on the wrong taxpayers.[313]

The choices that the United States has made with respect to competing policy priorities goes some way toward explaining the "left hand not talking to right hand" flavor of the debates between critics and defenders of offshore tax enforcement. This Article is not the first to be critical of the U.S. approach, but it is the first to explicitly identify the fundamental policy priorities that underlie the United States' enforcement choices and to spell out the competing policy metrics that are indirectly being advanced by critics. The ongoing fight over offshore enforcement is, at its core, about which set of normative priors one holds dearer, and how to weigh each against the other.

## IV. A GENTLER WORLD? A FRAMEWORK FOR REFORM

What is to be done? One possibility is for the United States to repeal FATCA and start from scratch, although this outcome seems unlikely. Short of total repeal, the United States should undertake reforms that address the two underlying problems this Article has articulated: poorly managed intra-offshore distinctions and high costs and burdens.

### *A. Potential Repeal of FATCA*

FATCA is a controversial law, with high costs and uncertain overall social welfare and distributional effects. Repeal would significantly reduce the inequities, burdens, and costs that the law has inflicted on various populations. The question is whether the United States would be able to make willful offshore tax cheats comply with their tax obligations if FATCA is eliminated altogether.

There is reason to think that some taxpayers might comply even without FATCA—the increased electronic availability of bank account information, the decline of bank and jurisdictional secrecy that is occurring independent of FATCA, and the proliferation of data leaks that have implicated various taxpayers with secret offshore holdings may all act as deterrents against evasion.[314] Further, complete repeal would not necessarily leave the United

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313 *See generally* sources cited *supra* note 8.

314 2013 NTA REPORT, *supra* note 95, at 49 (noting that many taxpayers burdened by FATCA would be compliant regardless); 2016 NTA OBJECTIVES REPORT, *supra* note 245, at 49 (noting that FATCA's heavy consequences are "being felt not by tax evaders but by U.S. taxpayers who likely would be compliant regardless" and that "U.S. taxpayers under the FATCA umbrella who must file Form 8938 . . . are generally at least as compliant as the overall U.S. taxpayer population"); 1 NAT'L TAXPAYER ADVOCATE, 2016 REPORT TO

States toothless. The United States could leave heightened penalties and lengthened statutes of limitations in place as a deterrent against offshore evasion, but eliminate FATCA's onerous and duplicative information reporting requirements.

Practically speaking, however, repeal seems unlikely.[315] FATCA was not repealed as part of the 2017 tax reform, and the law has arguably become entrenched through its network of IGAs in force and other factors.[316] FATCA-like ideas have also at this point proliferated worldwide, as other countries have their own mini-FATCA laws modeled on the U.S. approach, and as the Organisation for Economic Co-Operation and Development (OECD) proceeds to implement its "Common Reporting Standard," an information standard for the automatic exchange of information between countries.[317]

### *B. Taking Intra-Offshore Distinctions Seriously*

Short of complete repeal, there are nonetheless steps the United States could take to advance the policy considerations that up to this point have been ignored. There are a number of possible reforms that would give intra-offshore distinctions more weight, while still encouraging offshore tax compliance.

#### *1. Commensurate and Graduated FATCA Penalties*

Practitioners and others have argued that FATCA's offshore penalties are too uniformly severe and ought to be better tailored to account for heterogeneous taxpayer situations and motivations.[318] In particular, the 40% penalty, which applies to *any* understatement attributable to an undisclosed

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CONGRESS (2016), 228 (discussing burdens that result from assuming that all international taxpayers "should be suspected of fraudulent activity until they can prove otherwise"); Susan Cleary Morse et al., *Cash Businesses and Tax Evasion*, 20 STAN. L. & POL'Y REV. 37, 50 (2009) (finding that most interviewees regarded credit card receipts as taxable and reportable revenue, possibly due to electronic nature of the payment); Oei & Ring, *supra* note 1 (discussing the proliferation of data leaks).

[315] *But see* Byrnes, *supra* note 55, § 1.15 (describing political pushback that has occurred against FATCA, including attempts at repeal).

[316] *See* Tax Cuts and Jobs Act, H.R. 1, Pub. L. No. 115-97 (2017); Robert Goulder, *For FATCA Repeal, It's Now or Never*, FORBES (Nov. 29, 2017, 3:46 PM), https://www.forbes.com/sites/taxanalysts/2017/11/29/for-fatca-repeal-its-now-or-never/#d1585933ed15.

[317] OECD, STANDARD FOR AUTOMATIC EXCHANGE OF FINANCIAL ACCOUNT INFORMATION IN TAX MATTERS 9–10 (2014).

[318] *See supra* Sections II.A.3, II.B.2, and II.C; *see also* 2017 NTA REPORT, *supra* note 251, at 314–24 (critiquing design of certain continuation penalties); *see also, e.g.*, Jeanne Sahadi, *You've Never Seen Penalties Like These*, CNNMONEY (June 4, 2015, 10:40 AM), http://money.cnn.com/2015/04/01/pf/taxes/irs-penalties/index.html; Kirsh, *Revisiting*, *supra* note 8, 216–18 (suggesting penalty relief for certain "unaware citizens" rather than repeal of citizenship taxation).

foreign financial asset regardless of negligence or substantiality, is twice the usual 20% penalty imposed for negligent understatements, "substantial" understatements of income tax liability, or other "substantial" misvaluations.[319] The only way to avoid this penalty is to show reasonable cause, an uncertain standard.[320]

A flat draconian penalty that places the burden of showing reasonable cause on the taxpayer is inappropriate for an offender population likely to have widely varying levels of willfulness. For example, one might argue that a newly arrived immigrant who has erroneously failed to report and pay tax on offshore income should be subject to a less severe penalty, even if she is unable to meet a reasonable cause showing.[321] Penalties might be redesigned to account for levels of familiarity with the U.S. tax and disclosure system (for example, based on length of time spent in the United States). Alternatively, the penalty structure could be revised to apply only to willful failures, and to place the burden on the IRS to show willfulness.

### *2. Same-Country Exceptions and Thresholds*

Another possible reform that has been proposed by others is a same-country exemption for Americans living abroad that would allow FFIs to treat the accounts of overseas Americans as domestic accounts.[322] A same-country exemption, which has been supported by the NTA, would reduce reporting

[319] I.R.C. § 6662(b)(7), (j) (2012).

[320] *Id.* § 6664; *cf.* Jarnagin v. United States, 134 Fed. Cl. 368 (2017) (finding, in the context of FBAR penalties, that taxpayers did not have a reasonable cause defense to FBAR penalties even though they had "little involvement" in their tax return preparation, and instead relied on a bookkeeper to manage business finances and provide information to tax accountants); Andrew Velarde, *Reasonable Cause Is Front and Center in FBAR Case*, 156 TAX NOTES 151 (2017) (quoting an attorney as noting that "[t]he government's argument in [the *Jarnagin*] case is a great example of its application of heightened scrutiny in evaluating reasonable cause defense to FBAR and other international penalties").

[321] *See also* Davis, *supra* note 190, at 245–46 (suggesting modified FATCA and FBAR reporting for green card holders, including a grace period, to reduce likelihood of immigration-relevant tax foot faults); *cf.* Kirsch, *Revisiting*, *supra* note 8, at 216–17.

[322] Bruce, *supra* note 212 (noting Treasury's recently published final and temporary regulations, which reject a same-country exemption); Christians, *Putting the Reign Back in Sovereign*, *supra* note 8, at 1407–08; *FATCA / "Lockout" of Americans Abroad by FFIs / Will "Same Country" Exemption Help?*, AM. CITIZENS ABROAD, (Apr. 29, 2016), https://www.americansabroad.org/media/files/files/9d44e9cd/Treasury_Ltr_Same_Country_ACA_160429_FINAL.PDF; *Same-Country Exception for Accounts of US Taxpayers Residing Abroad*, AM. CITIZENS ABROAD (Oct. 28, 2013), https://www.americansabroad.org/media/files/files/5d6f2a3a/same-country-exception-letter.pdf; *"Same Country" Exemption—Treasury Department Should Insert This Exemption into Final FATCA Regulations*, AM. CITIZENS ABROAD (Aug. 10, 2016), https://www.americansabroad.org/media/files/files/20c8d17a/treasury-letter-same-country-aca-2016-08-10.pdf; *see* 2016 NTA OBJECTIVES REPORT, *supra* note 245, at 52 (same-country exemption); 2015 NTA REPORT, *supra* note 189, at 353 (same).

costs and burdens on FFIs. It might also make it less likely that a bank would turn away American customers.[323]

Unfortunately, in final and temporary proposed regulations issued in January 2017, Treasury rejected commenter requests for a same-country exemption, stating in the preamble:

> The U.S. federal income tax system largely relies on voluntary compliance, and third party information reporting of the financial accounts of U.S. taxpayers is used to encourage voluntary compliance. . . . The information reporting required by FATCA is intended to address the use of foreign accounts to facilitate tax evasion, and also to strengthen the integrity of the voluntary compliance system by placing U.S. taxpayers with accounts held with FFIs in a comparable position to U.S. taxpayers with accounts held with U.S. financial institutions. This is the case even for U.S. taxpayers resident abroad . . . . The Treasury Department and the IRS have also decided that the risk of U.S. tax avoidance by a U.S. taxpayer holding an account with an FFI exists regardless of whether the U.S. taxpayer holds an account in his or her foreign country of residence or another foreign country.[324]

Treasury's analysis misses the point: There is, of course, a risk of evasion regardless of whether the U.S. taxpayer is holding an account in her home country or in a separate haven.[325] However, Americans living and working abroad are simply not the high-risk evader population that FATCA was originally intended to ensnare.[326] The point, which Treasury's analysis misses, is that Americans abroad (unlike those who simply stash assets in havens) are more likely to have lives connected with their financial capital and more likely to suffer real-life consequences resulting from "lockout" from financial services.[327] Moreover, they are more likely to have actual dollar tax liability reduced or eliminated by the foreign tax credit or foreign earned income exclusion.[328] Therefore, although the risk of tax avoidance certainly exists for that population, there is reason to think that the risk is likely smaller than for willful tax cheats. FATCA imposes high and distinctive harms on Americans living abroad, with potentially not much revenue gain—harms that can be

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323 *See supra* note 322.

324 T.D. 9809, I.R.B. 2017-5 (Jan. 30, 2017).

325 *Cf.* Bruce, *supra* note 212 (arguing that requiring taxpayers to make an election to use same-country exemption may help prevent evasion).

326 Some may owe little or no taxes after the foreign earned income exclusion and foreign tax credit have been accounted for.

327 Bruce, *supra* note 212.

328 I.R.C. §§ 301, 312 (2012).

lessened through granting a same-country exemption. Treasury should therefore revisit its decision to reject calls for a same-country exemption.

Another possible extension is to have a same-country exemption for certain green card holders or Americans who are dual citizens of other countries as well.[329] Like Americans abroad, foreign citizens who have recently arrived in the United States for work and are tax residents under the "substantial presence" test might also suffer real-life consequences of "lockout" if their FFI account in their home country is shut down. The United States could also consider whether reporting thresholds might be raised on the side of individual reporting for such green card holders or dual citizens Americans with ties abroad, in the same way that they have been for Americans abroad.[330]

### 3. *Circumscribe Categories of Reportable Assets*

The United States currently requires FATCA reporting not only of offshore bank accounts, but also a variety of other financial interests, including insurance policies with cash value, credit and debit cards, retirement accounts, mutual funds, and corporate or partnership interests.[331] The rationale for this is that these types of holdings may be easy substitutes for direct ownership of offshore bank accounts; therefore, taxpayers' ability to employ these more complex interests to hide assets must be stymied.

The problem, of course, is this wider net is likely to ensnare immigrants and overseas Americans who are more likely to hold interests in these types of financial assets in the course of everyday life and who may be stickier in their holdings than willful evaders. The fact that these assets may be reportable (and how they should be reported) is also somewhat less obvious, which may lead to filing errors and other costs.[332]

Because these broad reporting rules are likely to impose harsh impacts on populations other than willful evaders, the United States should consider which

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329 *Cf.* Davis, *supra* note 190, at 245–46 (suggesting a reporting grace period for green card holders).

330 *See supra* note 138. As an example of alternative threshold design possibilities, J. Richard (Dick) Harvey, Jr. has suggested adjusting thresholds for the foreign earned income exclusion, for passive income, and for tax filing for citizens living overseas. Harvey, *supra* note 184, at 338–40. *See also* Mason, *supra* note 1, at 236–37 (suggesting simplifying reforms for U.S. citizens abroad).

331 *See supra* note 213. It also strengthened reporting requirements for certain foreign entities. *See supra* notes 162–64 and accompanying text.

332 U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-18-19, WORKPLACE RETIREMENT ACCOUNTS: BETTER GUIDANCE AND INFORMATION COULD HELP PLAN PARTICIPANTS AT HOME AND ABROAD MANAGE THEIR RETIREMENT SAVINGS 34–46 (2018) [hereinafter 2018 GAO REPORT] (noting challenges and costs individuals face in correctly reporting foreign retirement accounts).

of these rules are truly necessary, particularly for taxpayers (such as certain green card holders and long-term residents) who have actual substantive connections overseas, as well as for Americans living abroad. Mechanisms that could be used to lighten the compliance impact of these rules include higher thresholds, or same-country exceptions for certain types of assets, or lighter penalties or shorter statutes of limitations for nonwillful mistakes related to those assets.[333] For example, FATCA's lengthened statutes of limitations for certain income omissions and offshore holdings may inflict unduly harsh consequences on taxpayers who have made genuine mistakes or have inadvertent interests in certain types of foreign financial assets.[334] Similarly, harsh FBAR and FATCA penalties for offshore holdings that are not obviously reportable (such as life insurance or annuity contracts with a cash value) may be inappropriate and should be lightened.

#### 4. *Remedying OVDP Regressivity*

The United States should also consider how to remedy the regressive outcomes that have occurred in the ODVPs. As discussed, there has been a good deal of potential unevenness and unfairness in OVDP administration.[335] The United States should consider correcting those inequities by revisiting the most egregious cases and reversing the most inequitable outcomes. At the same time, to the extent the OVDPs are still active, the United States should continue to work to ensure that the largest and most egregious offenders are held appropriately accountable.[336]

#### 5. *A Nuanced Approach Toward Quiet Disclosures and Streamlined Program Participation*

Relatedly, the use of quiet disclosures and the streamlined voluntary disclosure program raise complex issues of cost and burden distribution.[337]

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[333] *Cf. id.* at 44 (explaining the IRS discussion about a possible same-country exception but noting that the "IRS decided the ability to review a taxpayer's foreign retirement data each year through filing a Form 8938 would allow regulators to evaluate whether contributions, earnings, and distributions were being identified and reported accurately"); *see also* Christians, *Putting the Reign Back in Sovereign*, *supra* note 8, at 1408 (suggesting exemption certain high-tax jurisdictions from FATCA); Harvey, *supra* note 184, at 338–39 (proposing *de minimis* passive income exemption and increase in earned income exclusion).

[334] *See supra* notes 162–64 and accompanying text; *see also* Monica Gianni, *PFICs Gone Wild!*, 29 AKRON TAX J. 29 (2014).

[335] *See supra* Section III.A.3.a.i.

[336] Sheppard, *supra* note 217 (quoting practitioner as saying that in 2017 "[n]ow almost no one enters OVDP").

[337] *See supra* Sections III.A.3.a.ii–iii.

Egregious offenders, who employ these approaches rather than going through the regular OVDPs, present clear cases of unfairness. However, in some cases—for example, when the offenses are not particularly serious—quiet disclosures or going through the streamlined program may well be the socially desirable approach.

*Quiet Disclosures.* The IRS's official position on quiet disclosures is that they undermine fairness and are to be discouraged.[338] But this is not universally true for all taxpayer populations. For those just learning about their offshore obligations or those with minor offenses, a simple amendment to a tax return or late filing of a disclosure form might actually make sense. For example, a taxpayer with an offshore bank account of $200,000 earning 0.5% interest might have omitted just over $1,000 of interest income, which (assuming a 30% tax rate) might generate $300 of tax. For that taxpayer, a quiet disclosure may represent a revenue gain going forward, while not imposing thousands of dollars of legal representation fees and penalties to enter an OVDP. The fact that the OVDPs have had regressive outcomes on small and unrepresented account holders supports this observation.[339]

*Streamlined Disclosure Programs.* Likewise, the IRS has threatened to investigate taxpayers who entered the streamlined program to pay lower penalties, but whose behavior was in fact willful.[340] However, there is a plausible argument that even if some borderline-willful taxpayers have slipped through the cracks and avoided large offshore penalties by going through the streamlined program, this is not necessarily undesirable if it persuades some "marginal"[341] offenders to comply going forward rather than going deeper into hiding. In other words, it is potentially beneficial from a welfare perspective to allow some degree of less serious evasion to go unpunished.

The United States should therefore attenuate its treatment of both quiet disclosures and streamlined program participants. Allowing some quiet disclosures and permitting some borderline-willful taxpayers to remain in the streamlined program would help place offshore tax offenders with less serious offenses on the same footing as taxpayers with purely domestic issues. The latter are allowed to simply amend erroneous tax returns going back three years (for example, to include income accidentally omitted), paying regular

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338 Travis A. Greaves & T. Joshua Wu, *Quietly Finding a Home in the Voluntary Disclosure World*, 148 TAX NOTES 207 (2015); Sheppard, *supra* note 216.

339 *See supra* Section III.A.3.a.i.

340 *See supra* Section III.A.3.a.iii.

341 By "marginal," I mean taxpayers whose behaviors are not the worst, but who may well be willful.

interest and penalties.[342] Taxpayers with offshore holdings whose offenses are relatively minor ought to be able to take this approach as well.

These questions regarding what to do about those who have come in via quiet disclosures and the streamlined program will likely remain material in the short to medium term, as the United States continues to conduct "streamlined program" audits and to investigate offshore tax cheats by analyzing data in its possession.[343] It is important that the United States attenuate its approach to this group of taxpayers to achieve fair and rational enforcement results.

Each of the suggestions above carries a number of design possibilities, and implementing them will necessitate some degree of line drawing and other judgment calls. Although specifics will need to be hammered out, reform is certainly possible. There is much to be gained from considering these types of interventions, so the fact that there are likely to be concrete design challenges should not prevent them from being considered.

### *C. Reducing Costs and Burdens*

In addition to making appropriate intra-offshore distinctions, the United States should more generally also pursue reforms that reduce the costs and burdens of offshore compliance. If burdens were lower, this could potentially make failures to appropriately sort between different offshore taxpayers less consequential.

#### *1. Eliminate Duplicative Reporting*

As suggested by the NTA and others, the IRS could eliminate duplicative reporting.[344] Critics have correctly pointed out that the FBAR and FATCA reporting forms (Form 8938) contain significant information overlap but the law requires two separate filings.[345] This is confusing, raises compliance costs, and unnecessarily raises taxpayers' penalty exposure. The IRS has recently moved the FBAR filing deadline to conform to the April 15 due date for Forms

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[342] For domestic taxpayers, the statute of limitations for noncompliance beyond three years will have run except in cases of gross income omissions or tax fraud. I.R.C. § 6501 (2012).

[343] *See, e.g.*, Robert W. Wood & Scott B. Weese, *In Choosing OVDP or Streamlined, Consider IRS Streamlined Audits*, 156 TAX NOTES 241 (2017).

[344] 2014 NTA REPORT, *supra* note 188, at 343 (suggesting that the United States eliminate duplicative reporting); *see also* Harvey, *supra* note 184, at 339–40; Kirsch, *Citizens Abroad*, *supra* note 184, at 246–47; Kirsch, *Revisiting*, *supra* note 8, at 213–14.

[345] *See* sources cited *supra* note 334; *see also Comparison of Form 8938 and FBAR Requirements*, INTERNAL REVENUE SERV., https://www.irs.gov/businesses/comparison-of-form-8938-and-fbar-requirements (last updated Sept. 5, 2017).

8938 and tax returns.[346] This is a good first step; a better one would be to eliminate pointless and duplicative reporting altogether. While some have pointed out that the FBAR and FATCA disclosures serve two separate purposes—financial regulation and tax compliance—the information could be shared between agencies rather than burdening taxpayers with two separate filings.

### 2. *Move from Gross Reporting to Form 1099-Style Reporting*

The United States should also move toward a system of income-stream reporting, rather than the current gross-asset reporting system under FATCA. Domestic information reporting of interest and dividends reports *taxable income* to the IRS, not gross amounts. When the payor of interest, dividends, or other payments issues a Form 1099-INT or Form 1099-DIV, the payee gets a copy telling her what to report on the tax return.[347] In the offshore context, however, account holders are not told the exact amount of income inclusion reported to the IRS. Instead, financial institutions report the information specified in the relevant IGA, which may include taxpayer identities, *gross* account balances, and total interest payments, irrespective of whether those amounts are taxable income to the taxpayer.

Gross-asset reporting creates compliance costs for taxpayers and enforcement costs to the United States, such as the cost of auditing false positives due to FFI reporting errors, the cost of flagging suspected taxpayer errors that turn out to be correct, and the potential costs of having to verify actual income amounts.[348] The current approach also gives the United States and foreign governments unnecessarily large amounts of financial information about affected taxpayers.[349] It would be easy for the United States to reduce these costs by redesigning FATCA reporting to more closely resemble domestic-style information reporting. FATCA already forces FFIs and other offshore entities to obtain U.S. tax forms from account holders to determine

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[346] *New Due Date for FBARs*, U.S. DEP'T TREASURY (Dec. 16, 2016), https://www.fincen.gov/news/news-releases/new-due-date-fbars-0. The FBAR due date used to be June 30. *See* I.R.S. News Release IR-2016-90 (last updated Aug. 12, 2017).

[347] *See* I.R.S., Instructions for Forms 1099-INT and 1099-OID (2017) (noting obligation to provide statement to payment recipient); I.R.S., Instructions for Form 1099-DIV (2017) (same).

[348] 2013 NTA REPORT, *supra* note 95, at 245–46 (noting that "the IRS should develop a timely and effective mechanism for addressing information reporting errors of FFIs" because "[i]ndividuals and entities impacted by such inaccuracies run the risk of substantial penalties").

[349] *See generally* 2018 GAO REPORT, *supra* note 332, at 44 ("IRS officials stated that the agency's goal is to build a database with Form 8938 information on individual taxpayers with foreign assets."); Hoke, *supra* note 299 (discussing the arrest of Argentina tax agency employees for selling taxpayer information).

residency.[350] There is no reason why FFIs should not simply report interest or dividends paid on bank accounts and stock holdings on Forms 1099, rather than reporting the account itself and its inflows and outflows. This change to traditional 1099 reporting would make compliance and enforcement simpler and less intrusive.

### 3. *Reducing Agency Costs*

More generally, the United States should undertake reforms that minimize the principal-agent dynamics and agency costs that this Article has described.[351]

For example, commentators have observed that foreign banks have an incentive to overreport on U.S. accounts due to harsh withholding tax consequences.[352] They may also have an incentive to turn away customers with U.S. ties.[353] Tax policymakers should consider how these tensions might be better managed. Lighter penalties on FFIs for reporting failures or higher reporting thresholds could reduce the incentive to overreport or to reject U.S. customers. Another possibility would be to impose a proportionate penalty on FFIs that report excessive false positives.

Principal-agent costs might also be controlled with respect to taxpayer representatives and tax preparers. Return preparers and representatives may have an incentive to mis-channel taxpayers to the regular OVDP rather than the streamlined program (or vice versa), or to over- or underreport foreign financial assets on taxpayer tax returns. They may also charge high fees due to heightened penalty risk in the cross-border compliance context. These behaviors create agency costs for taxpayers in the form of inappropriate risk exposure or higher fees and for the United States in the form of higher enforcement and administration costs.

The United States might consider taking steps to better regulate offshore tax preparers to ensure consistent representation and ethical standards.[354] Simplifying foreign asset reporting and making penalties more commensurate

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[350] *See* I.R.S. Form W-9, Request for Taxpayer Identification Number and Certification (2014); I.R.S. Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals) (2017).

[351] *See supra* Section III.C.2.

[352] Gregory, *supra* note 279; *see also supra* note 348 (NTA noting the risk of erroneous reporting).

[353] *See* sources cited *supra* note 273.

[354] *See* Christians, *supra* note 289 (describing some of the challenges associated with preparer regulation).

would reduce the ability of tax lawyers and advisers to capture rents and impose agency costs on taxpayers and the United States. If taxpayers can report foreign assets themselves, or if there is a larger pool of representatives assisting with foreign asset reporting due to simplification of procedures or penalty risk reduction, this will likely result in less rent capture by agents.

## CONCLUSION

Offshore tax enforcement is a uniquely complicated exercise. The challenge facing the United States—as articulated by many proponents of offshore enforcement—has been to catch and enforce the law against egregious and willful high-net-worth tax evaders and hold them accountable just like taxpayers with purely domestic financial affairs. The United States has taken an enforcement-oriented approach in tackling this challenge, but in doing so, it has ensnared and imposed costs on several other populations as well. While such populations may not be entirely blameless, many are likely less willful, less well advised, less elastic, and generally more sympathetic than the willful evaders who were the original enforcement targets. The imposition of the stringent, high-penalty, and wide-ranging enforcement and reporting initiatives on these latter populations should be regarded as overkill, particularly if the most culpable populations have the highest ability to avoid the offshore enforcement regimes.

This Article has made some reform suggestions that would put more weight on intra-offshore distinctions and on minimizing the compliance, administrative, efficiency, and agency costs of offshore tax enforcement. Given the complex nature of the enforcement challenge, none of these solutions is likely to be perfect. The question is whether the United States can reach a better equilibrium of policy tradeoffs while still maintaining an effective approach.

The answer to this question will only become more important going forward. As more FATCA data is reported to the United States, the United States will face the question of how to use the data. There may be some temptation to pursue the lowest-hanging fruit—such as the simplest or least well-represented cases—to make examples of some taxpayers or to generate revenue. But in the interests of making fair and appropriate intra-offshore distinctions, the United States should avoid this temptation. The United States ought to focus on the most egregious cases, and moderate its approach for less willful populations.

Whatever the flaws of FATCA, they are likely to be replicated as other countries enact their own mini-FATCA laws modeled on the U.S. approach, and as countries implement the OECD's "Common Reporting Standard."[355] It is imperative that all countries take a hard look at the costs and inequities these types of cross-border reporting laws may impose on immigrant and emigrant populations, and consider how they may be attenuated while still catching offshore tax cheats.

355 *See supra* note 317 and accompanying text.