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Piercing the Veil of Secrecy: Securing Effective Exchange of Information to Remedy the Harmful Effects of Tax Havens

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ABSTRACT

The enforcement of tax laws abroad has long posed problems for authorities. However, that enforcement becomes increasingly more problematic when the information necessary for proper enforcement is located within an impenetrable system whose sole purpose is to protect that information from tax authorities in other countries. Although much effort has been expended to remedy the harmful effects of tax havens, few strategies have succeeded. But with the prospects of a record federal deficit and an ever-increasing tax gap, U.S. authorities have begun to look for new ways to strengthen the enforcement of U.S. tax laws abroad. The most prominent of these proposals is the Stop Tax Haven Abuse Act, which invokes the use of a presumption strategy to remedy the lack of information problem. Nevertheless, this Act will most likely fall short of successful regulation. Most importantly, the Act represents a one-sided attempt to regulate a problem that is truly international. Moreover, even if the Act passes, it will provide the Internal Revenue Service few new tools to assist with the collection of taxes. Another issue with the proposed Act is that it invokes a presumption strategy, which may be viewed as an easy run-around for the lack of an automatic exchange provision in the bilateral agreements that currently control the exchange of tax information with foreign authorities. This Note summarizes and analyzes the current regulatory framework and proposes a strategy for the unification of existing regulatory regimes to provide a more effective system for combating the harmful effects of tax havens.

TABLE OF CONTENTS

I. INTRODUCTION

Commentators have long viewed tax havens as a type of "necessary evil" that facilitate tax competition among nations, leading to increased mobility and efficiency in international capital markets.[1] But in light of the recent economic downturn, many are starting to question whether tax havens should be subject to a stricter regulatory scheme because the harmful consequences significantly outweigh any benefits the tax havens might produce.[2] While tax havens claim to offer potential investors financial privacy, limited regulation, and low tax rates, these jurisdictions have also become sanctuaries for tax evasion, financial fraud, and money laundering.[3]

The issue of tax havens is not solely one of promoting financial integrity and stability, but also one of balancing the federal budget. Facing a record deficit of $1.4 trillion for the 2010 fiscal year, the U.S. government is bound to start looking for alternative ways of increasing revenue and narrowing the federal deficit.[4] Effective regulation of tax havens can facilitate the enforcement of U.S. tax laws abroad and reduce the current annual tax gap of $345 billion.[5] Experts estimate that the total loss from offshore tax evasion alone is close to $100 billion annually, including $70 billion from individuals and $30 billion

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1. Michael Keen, *Preferential Regimes Can Make Tax Competition Less Harmful*, 54 NAT'L TAX J. 757, 759–61 (2001) (concluding that low-tax jurisdictions may actually be preferable for achieving optimal competition).

2. *See, e.g.*, Larry Elliot, *Brown Plans Global Scrutiny of Tax Havens*, GUARDIAN (London), Mar. 22, 2009, at 1; Rachel Keeler, *Tax Havens and the Financial Crisis: From Offshore Havens to Financial Centers, Banking Secrecy Faces Scrutiny*, DOLLARS & SENSE, May–June 2009, at 21, *available at* http://www.dollarsandsense.org/archives/2009/0509keeler.html; Steve LeVine, *Anti-Secrecy Regulation of Tax Havens*, BLOOMBERG BUSINESSWEEK (Mar. 9, 2009), http://www.businessweek.com/blogs/money_politics/archives/2009/03/anti-secrecy_re.html.

3. STAFF OF S. COMM. ON HOMELAND SEC. & GOVERNMENTAL AFFAIRS, PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY 1 (2006) [hereinafter SENATE REPORT ON TAX HAVEN ABUSES].

4. Lori Montgomery, *Record U.S. Deficit Projected This Year*, WASH. POST, Jan. 27, 2011, at A01.

5. *See, e.g.*, U.S. DEP'T OF THE TREASURY, UPDATE ON REDUCING THE FEDERAL TAX GAP AND IMPROVING VOLUNTARY COMPLIANCE 2 (2009), *available at* http://www.irs.gov/pub/newsroom/tax_gap_report_-final_version.pdf (providing an estimate of the tax gap as of 2005). The tax gap consists of the difference between the amount of taxes owed and the amount collected. *The Tax Gap: What Is the Tax Gap?*, TAX POL'Y CENTER, http://www.taxpolicycenter.org/briefing-book/background/tax-gap/what-is.cfm (last visited Dec. 26, 2011). The primary form of noncompliance is underreporting, i.e., not reporting one's full tax liability, and the largest sub-component of underreporting involves individual income tax, representing more than 50 percent of the total tax gap. U.S. DEP'T OF THE TREASURY, *supra*, at 3.

from corporate tax evasion.[6] Even with such disparaging effects, tax havens have remained relatively untouched from a regulatory perspective. In fact, tax havens are flourishing more than ever. Offshore tax havens hold trillions of dollars in assets—including more than half of all banking assets and a third of foreign investments by multinational corporations.[7] Although tax havens account for only 3 percent of the world's Gross Domestic Product (GDP), more than half of world trade passes through them.[8] Between 1982 and 2003, the economies of these countries grew at an annual average rate of 2.8 percent, more than twice the rate of the rest of the world (1.2 percent).[9] On average, the citizens of these small countries are wealthier than those of most of the Western World, which may incentivize other countries to create their own tax havens.[10]

Despite the failed attempts to regulate tax havens in the past, the U.S. government has launched new initiatives that signal its intent to finally develop an effective solution to remedy the harmful practices made possible by the existence of tax havens.[11] The current administration has already instigated a political crusade aimed at closing loopholes in the U.S. Tax Code, and legislators have advanced several proposals that address international tax issues.[12] In 2009,

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6. *See, e.g.*, Joe Guttentag & Reuven Avi-Yonah, *Closing the International Tax Gap*, *in* BRIDGING THE TAX GAP: ADDRESSING THE CRISIS IN FEDERAL TAX ADMINISTRATION 99, 101 (Max B. Sawicky ed., 2006) (estimating lost U.S. tax revenues through offshore tax evasion by individuals at $40–$70 billion annually).

7. Nicholas Shaxson, *The Truth About Tax Havens: Part 2*, GUARDIAN (London) (Jan. 9, 2011), http://www.guardian.co.uk/business/2011/jan/09/truth-about-tax-havens-two.

8. Bruno Gurtner, *Tax Evasion: Hidden Billions for Development*, *in* SOCIAL WATCH REPORT 2004: FEAR AND WANT, OBSTACLES TO HUMAN SECURITY 24 (2004), *available at* http://www.socialwatch.org/sites/default/files/pdf/en/taxevasion2004_eng.pdf.

9. Joanne Ramos, *A Survey of Offshore Finance: Places in the Sun*, ECONOMIST, Feb. 22, 2007, at 4 (citing research by James Hines of the University of Michigan Law School).

10. *See The World Factbook: Country Comparison: GDP Per Capita*, CENT. INTELLIGENCE AGENCY, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html (last visited Dec. 26, 2011) (ranking countries based on their GDP per capita; countries commonly classified as tax havens—Liechtenstein, Jersey, the Cayman Islands, and Andorra—are among the highest-ranking).

11. For a short overview of some recently passed legislation that affects the regulation of transactions with offshore tax havens, see Jane G. Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, ECON. LEGIS. (Sept. 13, 2010), http://economic-legislation.blogspot.com/2010/09/tax-havens-international-tax-avoidance.html (introducing the more lengthy report by senior specialist Jane Gravelle). The proposals include The Incorporation Transparency and Law Enforcement Assistance Act, S. 569, 111th Cong. (2009) (requiring states to disclose beneficial owerns of corporations formed in their jurisdiction) and The Fraud Enforcmeent Recovery Act, S. 386, 110th Cong. (2007) (expanding money- laundering provisions to also cover tax evasion).

12. Gravelle, *supra* note 11. The Obama Administration push for UBS to disclose information regarding American citizen offshore accounts provides an

when President Barack Obama launched a plan to address the problem of tax havens, he described the U.S. tax system as "a broken tax system" that is "full of corporate loopholes that make[ ] it perfectly legal for companies to avoid paying their fair share."[13] In addition to proposals for restructuring parts of the domestic tax laws, legislators have also launched the Stop Tax Haven Abuse Act, which is currently pending in the Senate and the House of Representatives.[14] These new suggestions will be an addition to the bilateral agreements that are currently the primary vehicle employed by the United States in its efforts to facilitate information exchange with tax havens.

Part II of this Note explores the detrimental economic effects that result from the existence of tax havens and examines common characteristics of tax havens. This background section also emphasizes some current methods being used for tax evasion to provide an understanding of how these can best be addressed. Part III provides an overview of the current regulatory scheme aimed at reducing the total number of tax havens and analyzes the strengths and weaknesses of the different approaches. It also explains how the current regulatory framework is inadequate and sets forth reasons why the Stop Tax Haven Abuse Act will do little to remedy these shortcomings. This Act employs a novel approach in the fight against tax havens, however, as this Note demonstrates, it also suffers significant shortcomings that prevent it from embodying a complete and effective solution. This Note argues that there are inherent deficiencies in the previous efforts to reduce the harmful effects of tax havens and that the Stop Tax Haven Abuse Act is only a part of the solution to a problem that requires multinational effort. Moreover, the Act's use of presumptions to remedy the lack of efficient information exchange could conceivably harm U.S. multinational corporations. Finally, Part IV proposes improvements designed to increase the effectiveness of the existing regulation and

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interesting example of how the current administration is increasing pressure on tax havens to incentivize disclosure. *See infra* Part II.C.1 (discussing the fallout from the recent UBS scandal).

13. Press Release, The White House, Remarks by the President on International Tax Policy Reform (May 4, 2009), *available at* http://www.whitehouse.gov/the_press_office/Remarks-By-The-President-On-International-Tax-Policy-Reform.

14. *See* Press Release, Senate Comm. on Homeland Sec. & Governmental Affairs, Levin, Coleman, Obama Introduce Stop Tax Haven Abuse Act (S. 681) (Feb. 17, 2007), *available at* http://hsgac.senate.gov/public/index.cfm?FuseAction=Press.MinorityNews&ContentRecord_id=6897a4d5-1fca-43ea-a689-922492ebb69a. The Act has been reintroduced two times after failing to pass during each congressional session, and is currently pending in both the Senate and the House. For the current status of the Act, see *S. 1346: Stop Tax Haven Abuse Act*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=s112-1346 (last visited Dec. 26, 2011) and *H.R. 2669: Stop Tax Haven Abuse Act*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=h112-2669 (last visited Dec. 26, 2011).

elaborates on how the bilateral agreements and the Stop Tax Haven Abuse Act will fit into a multinational regulatory system. This section suggests that the primary tool for regulating information exchange with tax havens should be bilateral agreements with automatic exchange provisions that cover a broader scope than the current agreements in force. This Part also explores alternative multinational solutions where the United States and other governments could reduce the use of tax havens to shelter income and, accordingly, substantially limit the use of tax havens.

II. TAX HAVENS AND THE HARM THEY CREATE

A. *What Is a "Tax Haven"?*

1. The OECD Definition

Depending on the choice of definition, between thirty and seventy tax havens exist; however, both the terminology, as well as the precise definition, varies between regulatory authorities.[15] The most widely used definition is the one created by the Organisation for Economic Co-operation and Development (OECD). The OECD lists four principal requirements for a country to be classified as a tax haven.[16] The first factor requires that the jurisdiction have *no, or only nominal, tax rates*.[17] However, a low taxation level by itself is not conclusive evidence, especially since many "high-tax" countries have passed legislation providing low taxes for certain industries.[18] The

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15. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, NOU 2009:19, TAX HAVENS AND DEVELOPMENT 19 (2009) (Nor.), *available at* http://www.cmi.no/publications/file/3470-tax-havens-and-development.pdf. Although tax havens are most commonly thought of as "offshore" jurisdictions, such as the Cayman Islands or the Bahamas, tax havens take a variety of forms. They can be independent nations or simply a geographical area that has retained some freedom in promulgating independent laws. *See id.* In fact, according to the Financial Secrecy Index, the State of Delaware is the most "secretive" jurisdiction of all. *Financial Secrecy Index: 2009 Results*, TAX JUST. NETWORK, http://www.financialsecrecyindex.com/2009results.html (last visited Dec. 26, 2011). The Tax Justice Network is an independent organization that works to analyze and explain significance of taxation and the harmful effects of tax evasion, tax competition, and tax havens. *About Tax Justice Network*, TAX JUST. NETWORK, http://www.taxjustice.net/cms/front_content.php?idcatart=103&lang=1 (last visited Dec. 26, 2011).

16. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE 22 (1998), *available at* http://www.oecd.org/dataoecd/33/0/1904176.pdf.

17. *Id.* at 22–23.

18. These tax breaks are typically the result of strong lobbyist or other types of political pressure to make certain national industries attractive for investment. Examples include the tax-exempt shipping industry in Norway. Press Release,

principal difference is that tax havens use low tax rates as the primary means of attracting foreign capital, whereas in other countries, these arrangements are typically limited to a small subset of the economy to allow that sector to remain competitive.[19] The second requirement to qualify as a tax haven is the *"ring-fencing" of regimes*,[20] that is, the regime must have a two-part tax system where residents are subject to one tax and legal system, while foreign investors or companies are subject to a separate system.[21] Many tax havens also impose a requirement that a foreign investor cannot be domiciled, or that a company cannot have any business within the jurisdiction.[22] Additionally, some ring-fencing laws prohibit qualifying investors and companies from using local currency to avoid unnecessary fluctuations in the price of the currency.[23] The result of ring-fencing is to separate economic cause and effect, thereby insulating the tax haven's economy from adverse consequences from its tax policies.[24] For example, many tax havens impose income tax on foreign income of their residents, while simultaneously having laws that prevent the same treatment on foreign nationals exiled in the tax haven.[25] Implicitly, this allows tax havens to pass laws that primarily affect other countries, and it creates potential for harmful spillover effects.[26] The third requirement is lack of transparency in the operation of the

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Norwegian Ministry of Fin., Proposed Amendments to the Norwegian Special Tax Regime for Shipping Companies (Oct. 5, 2007), *available at* http://www.regjeringen.no/en/dep/fin/press-center/press-releases/2007/Proposed-Amendments-to-the-Norwegian-Spe.html?id=484806. Additionally, holding companies in Ireland, Denmark, Sweden, and the Netherlands are subject to little or no tax on capital gains earned on foreign investment. FREDERIK ZIMMER, INTERNASJONAL INNTEKTSSKATTERETT 48–49 (4th ed. 2009).

19. *See* ZIMMER, *supra* note 18, at 48–49.

20. OECD, *supra* note 16, at 26.

21. *Id.* at 26–27.

22. *Id.* at 27. Previously, there was an additional requirement of *no substantial activity* because the lack of such activities suggests that a jurisdiction may be attempting to attract investments that are purely tax driven. This requirement, however, was removed in 2001 at the request of President George W. Bush, largely because evidence tends to show that some American states are more likely to be classified as a tax haven using this criterion because they are essentially centers for incorporation with the true business of the company being conducted elsewhere. *See* *Tax Haven Criteria*, OECD, http://www.oecd.org/document/23/0,3343,en_2649_33745_30575447_1_1_1_1,00.html (last visited Dec. 26, 2011).

23. OECD, *supra* note 16, at 28.

24. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 55.

25. RONEN PALAN, RICHARD MURPHY & CHRISTIAN CHAVAGNEUX, TAX HAVENS: HOW GLOBALIZATION REALLY WORKS 31 (2010).

26. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 16.

legislative, administrative, or legal system through laws that guarantee secrecy within the jurisdiction.[27] The OECD describes non-transparency as a "broad concept" that includes favorable application of laws and regulations, negotiable tax provisions, and the failure to provide access to administrative systems.[28] The fourth requirement is that the jurisdiction must have a *lack of efficient exchange of information* with tax authorities in other countries.[29] In June 2000, OECD identified thirty-five states as tax havens under these criteria.[30] Although all four factors are essential for identifying tax havens, this Note primarily focuses on the fourth factor, the lack of efficient exchange of information, to remedy the problems with tax havens.

2. Other Characteristics of a Tax Haven

In addition to the requirements set forth in the OECD definition, several other characteristics also tend to be present in tax havens.[31] Successful tax havens tend to have modern communication and transportation facilities, political and economic stability, and availability of skilled professional services.[32] Tax havens often require

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27. OECD, *supra* note 16, at 27–28.

28. *Id.* at 27.

29. *Id.*

30. The thirty-five countries are: Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, British Virgin Islands, Cook Islands, Dominica, Gibraltar, the Maldives, Marshall Islands, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Samoa, Seychelles, St. Lucia, St. Kitts and Nevis, Grenada, Guernsey, Isle of Man, Jersey, Liberia, Liechtenstein, St. Vincent, the Grenadines, Tonga, Turks and Caicos, U.S. Virgin Islands, and Vanuatu. OECD COMM. ON FISCAL AFFAIRS, REPORT TO THE 2000 MINISTERIAL COUNCIL MEETING: TOWARDS GLOBAL TAX CO-OPERATION: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES 17 (2000), *available at* http://www.oecd.org/dataoecd/25/27/44430257.pdf. Many have criticized the OECD for failing to include its own members in the list of tax havens, which is why countries commonly believed to be tax havens, such as Ireland and Switzerland, are not included in this list. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 21. For an overview of tax haven countries under other definitions, see JANE G. GRAVELLE, CONG. RESEARCH SERV., R40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION 3 tbl.1 (2009).

31. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 21.

32. *See, e.g.*, Dhammike Dharmapala & James R. Hines, Jr., *Which Countries Become Tax Havens?* 1, 7–13 (Nat'l Bureau of Econ. Research, Working Paper No. 12802, 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=952721 (finding that tax havens often have a developed legal system, political stability, and a relatively low rate of corruption); Tun Nin Wu, Tax Havens: Theory and Operation of a Modern National Economy 7 (1999) (unpublished manuscript), *available at* http://www.gwu.edu/~ibi/minerva/Fall1999/Wu.Tun.pdf (noting that a tax haven must have "political and economic stability," as well as "competent professional advisers, such as accountants and lawyers").

companies to incorporate and appoint local residents as directors and officers, leading to situations where certain individuals hold seats on hundreds of corporate boards.[33] The presence of local directors and officers gives the company the appearance that it is being operated out of the tax haven, which is rarely the case because many tax havens prohibit corporations from doing any business locally.

3. The Veil of Secrecy

Generally, the hallmark traits of a tax haven are the lack of informational exchange with other countries and the presence of legally mandated secrecy. The purpose of corporate and financial secrecy laws is to make it difficult for outside law enforcement, creditors, and others to ascertain whether an individual owns or controls offshore assets.[34] However, secrecy by itself is not unusual. All countries retain a certain degree of secrecy to protect private and public interests in society. Where tax havens differ is with the implementation of the secrecy laws and with the extent of that protection. First, tax havens apply secrecy rules to activities that take place in *other* states, where the owner is domiciled or substantive activity of a corporation actually takes place, which has the effect of regulating conduct that occurs outside the tax haven's borders.[35] Second, the secrecy rules prevent the proper application of disclosure rules in the jurisdiction where a company's or investor's activities actually take place.[36] Tax havens further strengthen the veil of secrecy with special laws that reinforce a "vow of silence" for employees of banks and financial institutions in those jurisdictions.[37] Furthermore, many tax havens lack official registers that contain corporate information or that are substantially limited in the scope of information they contain, especially for companies that do not actually transact any business in the jurisdiction.[38] Nonetheless, the most

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33. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 87.

34. SENATE REPORT ON TAX HAVEN ABUSES, *supra* note 3, at 9.

35. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 16.

36. *See id.* at 49–50 (noting that tax havens offer the ability to avoid disclosure to home authorities).

37. For example, the Federal Law on Banks and Savings Banks in Switzerland makes it a criminal offense for a bank or any of the bank's employees to disclose information regarding any individual, institution, public or private, with respect to any bank customer. *See* LOI FÉDÉRALE SUR LES BANQUES ET LES CAISSES D'ÉPARGNE [FEDERAL LAW ON BANKS AND SAVINGS BANKS] Nov. 2, 1934, RS 952, art. 47 (Switz.).

38. *See* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 29 (noting that the lack of registers is particularly prevalent for "exempted

important obstacle is not so much the lack of information as is a fundamental reluctance to share this information with authorities of other nations.[39] Most bilateral tax information exchange agreements are limited to criminal matters, and they often impose a dual criminality requirement, that is, the taxpayer must have committed a crime under both the laws of the country of residence and in the tax haven before the authorities will release any information.[40] This is often a very difficult burden to satisfy because tax havens tend to have lenient laws with respect to tax issues.

In the United States, foreign secrecy rules may also inhibit the efficacy of other federal laws. One example is the application of the federal securities laws, which are based on a principle of disclosure.[41] The specific disclosure that is required varies depending on the underlying activity; however, the Securities and Exchange Commission (SEC) requires certain information regarding a transaction when a company sells securities, information about persons seeking to acquire ownership of public companies, and information about directors, officers, and significant shareholders of public companies.[42] To the extent the disclosed information is complete and accurate, the investing public has information with which to make informed investment decisions. Without proper disclosure, parties involved in securities markets have access to disparate information, effectively eroding the trust investors have in U.S. securities markets. Secrecy laws make it difficult to obtain this information and to see what is happening internally within a company, thereby making it easy for such company to conceal the economic realities underlying a financial transaction.[43] Similarly, for the SEC and courts to enforce laws limiting insider trading, they must be able to identify the parties engaging in a transaction to determine whether insider trading is taking place.[44]

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companies," which mostly comprises foreign companies with operational activities located outside the tax haven).

39. *See Tax Haven Abuses: The Enablers, the Tools and Secrecy: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Governmental Affairs*, 109th Cong. 11 (2006) [hereinafter *Tax Haven Hearing*] (describing the many hurdles that exist for obtaining information in secrecy jurisdictions).

40. GRAVELLE, *supra* note 30, at 20.

41. *See* Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78a et seq. (2011)); Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. § 77a et seq. (2011)).

42. *Tax Haven Hearing, supra* note 39, at 29 (testimony of Gary M. Brown).

43. *Id.* at 9, 29.

44. *See generally* 17 C.F.R. § 240.10b-5 (2009) (prohibiting the employment of manipulative and deceptive devices in under the Securities Exchange Act). To make out a prima facie case for insider trading under Rule 10b-5, a plaintiff must show that the person charged with insider trading was either a purchaser or a seller of the

B. *Methods of Tax Evasion*

Any taxpayer, whether an individual or a corporation, universally pursues two fundamental goals: to reduce taxable income and to defer tax liabilities.[45] One can achieve these goals through both legal and illegal actions, giving rise to the distinction between tax avoidance and tax evasion.[46] Tax avoidance is an issue for tax planning. It represents the use of *legal* resources to achieve the lowest possible tax burden or to defer a tax burden until a later time.[47] Tax evasion, on the other hand, is the act of not paying taxes that one is legally required to pay.[48] It involves reducing a tax burden by *illegal* means.[49] In general, individual tax avoidance tends to fall in the evasion category, while corporate tax avoidance can arise from either avoidance or evasion.[50] Tax evasion is often caused by a lack of information, and the most appropriate remedies include increasing available resources for enforcement, as well as various mechanisms to facilitate disclosure of information.[51] On the other hand, changes to the U.S. Tax Code may be an efficient method to remedy tax avoidance.[52] Although there is a distinction between evasion and avoidance, for simplicity, this Note will only use the term tax evasion. However, implicit in this term are the effects of both evasion and avoidance, because the line is often

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security. *See* Sec. & Exch. Comm'n v. Tex. Gulf Sulphur Co., 401 F.2d 833, 847 (2d Cir. 1968).

45. *See* WILLIAM A. KLEIN ET AL., FEDERAL INCOME TAXATION (15th ed. 2009). The following section has benefited significantly from the report by Jane G. Gravelle, a senior economist in the Government and Finance Division of the Congressional Research Service, giving an overview of the most prevalent methods for tax evasions and avoidance, as well as the differences between the two. *See generally* GRAVELLE, *supra* note 30, at 7–11, 19–21.

46. Denis Healey, former UK Chancellor of the Exchequer, once described the relationship in the following way: "The difference between tax avoidance and tax evasion is the thickness of a prison wall." *Holes in the Net: Tax Avoidance*, ECONOMIST, May 6, 2006, at 59. But for a different view regarding the criminality of tax avoidance, see Gregory v. Helvering, 293 U.S. 465, 469 (1935) ("The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.").

47. *See* Menahem Pasternak & Christophe Rico, *Tax Interpretation, Planning, and Avoidance*, 23 AKRON TAX J. 33, 35 (2008) ("Economic tax avoidance . . . occurs when an individual or firm . . . changes consumption or production decisions in response to taxation."); *see also* BLACK'S LAW DICTIONARY 1599 (9th ed. 2009) ("The act of taking advantage of legally available tax-planning opportunities in order to minimize one's tax liability.").

48. GRAVELLE, *supra* note 30, at 1.

49. *See* BLACK'S LAW DICTIONARY 1599 (9th ed. 2009) ("The willful attempt to defeat or circumvent the tax law in order to illegally reduce one's tax liability.").

50. GRAVELLE, *supra* note 30, at 2.

51. *Id.*

52. *Id.*

blurry and because both will be instrumental in any regulatory attempts to limit the abusive practices that take place in tax havens.

1. Individual Tax Evasion

Growing international financial globalization has greatly facilitated individual tax evasion. Today, individuals can directly purchase foreign investments such as stock and simply neglect to report the income or, for a minimal fee, open an offshore account to conceal assets from taxing authorities.[53] People can invest funds abroad through the Internet without reporting to tax authorities, whether to the United States or another jurisdiction.[54] This lack of reporting allows the taxpayer to circumvent tax liabilities both for income earned abroad, as well as taxes due on domestic assets. Additionally, a taxpayer may be able to use funds in offshore accounts by having a bank issue an anonymous credit card.[55] In such a transaction, the only risk that a taxpayer will face is that of currency fluctuations, which can be cheaply hedged through the use of derivatives.

Individuals can also use structures such as foreign-held trusts or shell corporations to avoid taxation. These structures primarily take advantage of U.S. tax laws that exempt interest income and capital gains of non-residents from taxation.[56] People use trusts to shelter income from taxes, while still retaining control over and use of the assets in the trust.[57] Similarly, because these income streams are not subject to a withholding tax in the United States, taxpayers are able to defer tax liability even if they choose to report the income.[58] Through the use of trusts, an individual can separate the record holders from the beneficial owners. The trustee is the "formal" owner of the trust and makes decisions on investment and on when to distribute funds from the trust, however, the grantor is the "beneficial" owner and must technically refrain from exercising control over the trust.[59] The trust

53. *Id.* at 19.

54. *Id.* at 19–20.

55. *See Abusive Offshore Tax Avoidance Schemes – Talking Points*, INTERNAL REVENUE SERV., http://www.irs.gov/businesses/small/article/0,,id=106568,00.html (last updated Jan. 27, 2011) (listing the most popular methods for repatriating foreign-held assets, including credit cards).

56. GRAVELLE, *supra* note 30, at 19.

57. *Id.* at 20. The taxation of trusts is governed by Subchapter J of the Tax Code. I.R.C. §§ 641–692 (2006). Usually, the beneficiary will owe income taxes on any funds distributed, and the trust itself will be taxed on the retained portion, but is allowed a deduction for the amount of the distribution. §§ 641–643.

58. GRAVELLE, *supra* note 30, at 19.

59. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 40–41.

may also use a trust protector to act as an intermediary between the grantor and the trustee, for the purpose of acting on behalf of the grantor.[60] The general idea is that so long as the beneficiary has not received any distributions, the beneficiary is not yet the "owner" of the trust assets, and has no reporting obligations as an owner under the U.S. Tax Code.

2. Corporate Tax Evasion

Similar to individual tax evasion, corporate tax evasion can also take several different forms. The Tax Code imposes taxes on all income earned both within the United States, as well as a residual tax on foreign income.[61] As a consequence, corporations may reduce taxes both by U.S. parent companies shifting profits to low-tax jurisdictions, as well as foreign companies shifting profits from U.S.-based subsidiaries.[62] Another part of the Tax Code that helps facilitate tax evasion is a provision that allows U.S. multinational companies to only pay taxes on income earned by foreign subsidiaries when the income is repatriated to the U.S. parent as dividends.[63] Moreover, to remedy issues relating to double taxation the Tax Code allows a credit for foreign income taxes paid on any income that is repatriated to the U.S. parent.[64] Because the limit is imposed on an overall basis, the excess credits may actually offset U.S. tax liability on income earned in tax havens.[65] Consequently, U.S. companies with foreign subsidiaries can reduce taxes on domestic income if they simply allocate enough income to these jurisdictions.[66] Instead of this credit system, many other countries simply exempt income earned abroad.[67]

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60. GRAVELLE, *supra* note 30, at 20.

61. For an explanation of the taxing of residual income, see *infra* note 67.

62. GRAVELLE, *supra* note 30, at 7.

63. *Id.*

64. *Foreign Tax Credits Audit Guidelines*, IRM 4.61.10.1 (May 1, 2006) (summarizing the relevant Code sections allowing for foreign tax credits).

65. *Id.* For example, if a U.S. corporation has income of $10 million in a foreign jurisdiction (subject to 10 percent tax rate) and $1 million in another foreign jurisdiction (subject to 28 percent tax rate), the foreign company will not be liable for any taxes in the second jurisdiction because the $1 million tax credit is more than enough to offset the $280,000 tax liability due on U.S. income). *See infra* note 67.

66. *See* IRM 4.61.10.1 (outlining the procedures for calculating tax on income due abroad); *supra* note 65.

67. GRAVELLE, *supra* note 30, at 7. To avoid double taxation of foreign-earned income, the OECD has created a Model Tax Convention containing guidelines for determining which country has primary entitlement to tax revenues. *See* OECD, Articles of the Model Convention with Respect to Taxes on Income and on Capital (2003) [hereinafter Model Tax Convention], *available at* http://www.oecd.org/dataoecd/52/34/1914467.pdf. The Model Convention recommends two different strategies for determining where the primary tax obligation is owed. For companies,

Corporations may also reduce their tax liabilities through strategic allocation of debt. Because interest payments are deductible under the U.S. Tax Code, a corporation may shift profits to a tax haven by borrowing more in a high-tax jurisdiction than in the tax haven.[68] A subset of this method is commonly referred to as "earnings stripping," a method that first received significant attention after a number of U.S. firms inverted, that is, moved the parent company offshore while retaining U.S. operations in a subsidiary.[69] To reduce taxable earnings through this method, a foreign parent could, for example, lend to its U.S.-based subsidiary or an unrelated foreign borrower not subject to tax on interest earned in the United States could lend to a U.S. company.[70] The lender will charge excessively high rates in order to increase the deduction the borrower may take, and this strategy is especially effective when companies set up shell subsidiary companies. Evidence tends to support that U.S. multinational companies use allocation of debt to shift profits by allocating more interest to high-tax jurisdictions, however, research does not yield the same results with respect to earnings stripping, largely because the prevalence of earnings stripping by foreign parents of U.S. subsidiaries is much more difficult to analyze because only certain parts of the firm's accounts are available for review.[71]

Another method of shifting profits from a high-tax jurisdiction to a low-tax one is through transfer pricing, a practice that involves the manipulation of pricing of goods and services that are sold between

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the primary tax collector is the source of the income, that is, the country where the income is *earned* (source principle). *Id.* art. 7, para. 1 ("[T]he enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment."). Individuals, subject to certain exceptions, should pay taxes to the *country of residence* (residence principle). *Id.* art. 15, paras. 1–2. However, if an individual or a company is liable to both countries, bilateral tax agreements will usually ease the burden of taxation. There are three primary methods for doing so: the credit method, the deduction method, and the exemption method. *See, e.g.*, Thomas Dickescheid, *Exemption vs. Credit Method in International Double Taxation Treaties*, 11 INT'L TAX & PUB. FIN. 721, 721 (2004). The credit method allows a taxpayer to deduct taxes paid abroad from resident tax liabilities. BRIAN J. ARNOLD & MICHAEL J. MCINTYRE, INTERNATIONAL TAX PRIMER 36 (2d ed. 2002). The deduction method treats taxes paid abroad as costs incurred through the business, correspondingly reducing the taxable profit. *Id.* at 32. The exemption method means that the country refrains from taxing foreign-sourced capital or income that, pursuant to a treaty, may be taxed in the other country. *Id.* at 33–34. The OECD Model Tax Convention provides for the use of the credit or the exemption method, but does not recognize the less beneficial deduction method. Model Tax Convention, *supra*, art. 23.

68. GRAVELLE, *supra* note 30, at 8.

69. *Id.* at 9.

70. *Id.* at 8.

71. *Id.* at 9.

affiliates.[72] Transfer pricing relates to the distribution of income and costs for transactions conducted by related parties.[73] To correctly reflect income, prices of goods and services sold between related companies should be priced as though they were being sold to an unrelated third party.[74] A company can shift profits by lowering the price of goods and services sold subject to a higher tax rate, and by raising the price of purchases subject to a lower tax rate. This effect is further enhanced when the parties appear to be independent from each other and the true common identity is kept hidden by the operation of secrecy laws.

C. *What Are the Harmful Effects of Tax Havens?*

1. Loss of Tax Revenue

A jurisdiction becomes a tax haven for one primary reason—to attract capital.[75] Traditionally, this has also been the most significant motivation for regulating tax havens. The highly competitive tax regimes that exist in low-tax jurisdictions erode the tax bases of high-tax countries, this erosion in turn distorts trade and investment patterns.[76] By offering lower tax rates, investors' after-tax returns increase, thereby incentivizing investors to transfer capital to low-tax jurisdictions.[77] Offshore tax havens hold an estimated $1.5 trillion in U.S. assets, resulting in an estimated annual loss to the U.S. Treasury

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72. *See, e.g.*, *Country-by-Country Reporting: How to Make Multinational Companies More Transparent*, TAX JUST. BRIEFING (Tax Justice Network, Brussels, Belg.), Mar. 2008, at 2–3 ("The US Senate has cited estimates that the US tax authorities lose over $50 billion a year just to transfer pricing abuse."). For an example of how transfer pricing has been used in practice, see Felicity Lawrence & Ian Griffiths, *Revealed: How Multinational Companies Avoid the Taxman*, GUARDIAN (London), Nov. 6, 2007, http://www.guardian.co.uk/business/2007/nov/06/19 (describing three major banana suppliers' use of transfer pricing to achieve tax rates as low as 8 percent on profits).

73. Ad Hoc Group of Experts on Int'l Cooperation in Tax Matters, *Developments with Regard to the OECD Transfer Pricing Guidelines*, U.N. Doc. ST/SG/AC.8/2001/CRP.4 (July 5, 2001).

74. *See id.* at 2 (explaining this practice, which is commonly known as the arm's length principle).

75. *E.g.*, Timothy V. Addison, Note, *Shooting Blanks: The War on Tax Havens*, 16 IND. J. GLOBAL LEGAL STUD. 703, 711 (2009).

76. *See* OECD, *supra* note 16, at 8.

77. The basic model for net income is: Revenue – (Cost of Goods Sold + General Expenses) – Depreciation & Amortization – Interest Expense – Tax. *See, e.g.*, TIM KOLLER, MARC GOEDHART & DAVID WESSELS, VALUATION: MEASURING AND MANAGING THE VALUE OF COMPANIES 165 exhibit 7.2 (2005). *But see* Mihir A. Desai et al., *Do Tax Havens Divert Economic Activity?*, 90 ECON. LETTERS 219, 220 (2006) (noting that the tax burden on companies in OECD countries has fallen little over the past twenty-five years).

of $40–70 billion in uncollected individual income taxes.[78] Moreover, the Internal Revenue Service (IRS) estimates that corporate tax evasion through the use of tax havens adds an additional $30 billion to the total estimated loss of tax revenue.[79] As Senator Carl Levin noted, "With a $345 billion annual tax gap and a $248 billion annual deficit, we cannot tolerate a $100 billion drain on our Treasury each year from offshore tax abuses."[80] Not only does this gap shift the burden to taxpayers who are in compliance with tax laws, but it also creates a revenue shortfall depriving the U.S. government of much needed funds.[81] Moreover, when some companies engage in harmful tax practices, those companies have a competitive advantage over those that do not engage in similar tactics, essentially compromising the competitiveness of markets.[82] Additionally, tax havens may damage the typical taxpayer's confidence in the integrity of tax systems. Senator Levin noted, "Secrecy breeds tax evasion. Tax evasion eats at the fabric of society."[83] He continued, "[T]ax havens have, in effect, declared war on honest U.S. taxpayers, by giving tax dodgers the means to avoid their tax bills and leave them for others to pay. These schemes are shrouded in the secrecy of tax havens because they can't stand the light of day."[84]

Tax havens may also cause an overall reduction in aggregate global welfare.[85] A common argument in favor of tax havens is based

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78. Gutentag & Avi-Yonah, *supra* note 6, at 101 A conservative estimate suggests that offshore tax havens and secrecy jurisdictions hold $11–12 trillion of high-net-worth individuals' assets worldwide. *The Price of Offshore*, TAX JUST. BRIEFING (Tax Justice Network, Brussels, Belg.), Mar. 2005, at 1.

79. GRAVELLE, *supra* note 30, at 16.

80. Press Release, Senate Comm. on Homeland Sec. & Governmental Affairs, *supra* note 14 (internal quotation marks omitted).

81. *Tax Haven Hearing*, *supra* note 39, at 2 (statement of Sen. Coleman). Ultimately, compliant taxpayers must cover this tax gap. If spending remains unchanged, the federal deficit must at one point be neutralized, and unless noncomplying taxpayers later cover previous deficits caused by noncompliance, that deficit must in part be covered by compliant taxpayers.

82. Lord Wallace of Saltaire, Letter to the Editor, *Outrage from Classic Free-Riders*, FIN. TIMES, Mar. 14, 2008, at 16.

83. *Tax Haven Hearing*, *supra* note 39, at 9 ("Ultimately . . . that tax gap must be made up by average, honest taxpayers whose faith in the fairness of our tax system is eroding.").

84. *Id.*

85. *See* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 55 (noting the Commission's strong belief "that the positive effects of tax havens outlined above are in [no] way sufficient to compensate for the damaging impact"); Michael Littlewood, *Tax Competition: Harmful to Whom?*, 26 MICH. J. INT'L L. 411, 449 (2004) ("[T]he countries operating such regimes are effectively engaged in a 'race to the bottom,' that they consequently derive little or no benefit from their regimes, and that they, in fact, suffer a loss as a result of their regime."). *See generally* Joel B. Slemrod & John D. Wilson, *Tax Competition with Parasitic Tax Havens* 24–25 (Ross Sch. of Bus., Paper No. 1033, 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?

on free market economics. Economists argue that free market competition between countries facilitates tax competition, which in turn will increase global efficiency.[86] However, the efficient market hypothesis is based on the premise that such competition involves no transaction costs.[87] In order to take advantage of a different regulatory regime under this theory, an individual would have to be completely mobile and not incur any costs in relocating.[88] Although, in today's globalized society, capital is mobile such that an investor can reap many of the benefits of a favorable taxation regime without having to go through the process of physical relocation, the investor will unavoidably face some costs to fully take advantage of the more favorable regime.[89] A reduction in global welfare may also occur when, in response to the intense tax competition caused by the low rates in tax havens, non-tax havens lower their own rates.[90] Because non-tax havens offer a large amount of welfare services, a lowering of the tax rate may shift the economy from its equilibrium state. A common reason for high tax rates is a large demand for public goods, and therefore "a race to the bottom" could reduce the tax revenue available for providing such goods, thus reducing the combined utility of residents of that jurisdiction.[91] Similarly, private income may suffer in an economy in which foreign capital is the main source of revenue. GDP generally rises proportionally to the number of citizens who engage in productive behavior. When more people participate in rent-seeking activities and attempt to redistribute wealth to their benefit,

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abstract_id=902409 (demonstrating that low-tax regimes may have the effect of decreasing the availability of public goods).

86. *See* Keen, *supra* note 1, at 759–61 (listing some of the benefits of low-tax regimes).

87. *See, e.g.*, Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383, 387 (1970).

88. *See, e.g.*, Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1611 (2000) (summarizing Charles Tiebout's article that argued for the benefits of tax competition between nations).

89. For example, the investor may incur costs in opening foreign accounts, or in the case of a corporation, fees related to compensation of local officers, lawyers, or other professionals necessary for conducting business in that jurisdiction, however, these costs are overwhelmingly outweighed by the benefits.

90. *See* Avi-Yonah, *supra* note 88, at 1575–76, 1646 ("The mobility of capital has resulted in international tax competition, in which sovereign countries aim to attract both portfolio and direct investment by lowering their tax rates on income earned by foreigners. . . . [The tax competition] hurts both countries by costing them revenues, especially if the incentives cancel each other out. In this case it would be in both countries' interest to see competition eliminated if a cooperative solution could be found." (footnote omitted)).

91. *See supra* note 85.

less income is available for the remainder of the population.[92] What is even more disconcerting is that the primary benefits of the illicit cash flows are shared among a small number of individuals.[93] The offshore industry—composed of various professionals including attorneys, accountants, bankers, and trust administrators—aggressively promotes tax havens as a means to avoid taxes and also reaps the largest benefits.[94] All the while, many of these same professionals are either located in or do business in the United States.[95]

One prominent example of tax evasion in the last few years is the UBS scandal. The United States arrested a former employee of the prominent Swiss bank, UBS, on conspiracy charges for defrauding the IRS of $7.2 million in unpaid taxes on assets located in Switzerland and Lichtenstein worth approximately $200 million.[96] He pled guilty in June 2008.[97] During the investigation, the IRS discovered that UBS had intentionally helped U.S. citizens avoid taxation through their investments with the bank.[98] On June 30, 2008, the United States filed a petition to make UBS disclose the names of all its U.S. clients, who held an estimated total of $14 billion with UBS.[99] Included in the

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92. *See* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 11 (explaining how rent-seeking leads to a redistribution of a society's resources away from productive activities).

93. *See* Guttentag & Avi-Yonah, *supra* note 6, at 106 ("The financial benefits of tax haven operations, while funding a minimal level of government services, often flow primarily to professionals providing banking and legal services . . . rather than to the often needy residents of the tax havens.").

94. *Tax Haven Hearing*, *supra* note 39, at 3 (statement of Sen. Coleman).

95. *Id.* at 1.

96. STAFF OF S. COMM. ON HOMELAND SEC. & GOVERNMENTAL AFFAIRS, PERMANENT SUBCOMM. ON INVESTIGATIONS, 110TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 9 (2008) [hereinafter SENATE REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE]. This enforcement action represented the first time the United States initiated criminal action against a professional for facilitating tax evasion by a U.S. citizen. In the aftermath of this case, many have criticized the U.S. government's decision to prosecute Birkenfeld, arguing that it could have a "chilling effect" on whistleblowers. *See* Brent Kendall & Arden Dale, *Crying Foul, Ex-UBS Banker Starts Prison Time*, WALL ST. J., Jan. 9, 2010, at B3 ("This decision is not only grossly unfair and personally harmful to Mr. Birkenfeld, it will also have a radically chilling effect on the willingness of other bankers to step forward and expose fraud.").

97. *See* Transcript of Sentencing at 5–6, United States v. Birkenfeld, No. 08-60099-CR-ZLOCH (S.D. Fla. Aug. 21, 2009) (citing the defendant's previous guilty plea as background for the sentencing hearing); *see also* Press Release, U.S. Dep't of Justice, Banker Pleads Guilty to Helping American Real Estate Developer Evade Income Tax on $200 Million (June 19, 2008), *available at* http://www.justice.gov/tax/txdv08550.htm.

98. Press Release, U.S. Dep't of Justice, UBS Enters into Deferred Prosecution Agreement (Feb. 18, 2009), *available at* http://www.justice.gov/tax/txdv09136.htm.

99. *Banking Secrecy Practices and Wealthy American Taxpayers: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways & Means*, 111th Cong. 5 (2009) (statement of Rep. Neal) [hereinafter *Banking Secrecy Practices Hearing*]; Press Release, U.S. Dep't of Justice, Justice Department Asks Court to Serve IRS Summons for UBS Swiss Bank Account Records (June 30, 2008), *available at*

petition was a request for permission to "file an IRS administrative summons with UBS asking the bank to disclose the names of all of its U.S. clients who have opened accounts in Switzerland, but for which the bank has not filed forms with the IRS disclosing the Swiss accounts."[100] The U.S. government eventually reached a settlement with UBS that involved the exchange of 4,450 names of U.S. citizens and a restitution fee of $780 million.[101] The petition was the first attempt by the United States to "pierce Swiss bank secrecy by compelling a Swiss bank to name its U.S. clients."[102]

2. Fraud and Other Abusive Practices

The loss of tax revenue is not the only harmful economic consequence caused by tax havens. The financial secrecy and lack of efficient exchange of information provide cover for several other types of crimes and abusive practices, including money laundering, insider trading, embezzlement, Ponzi schemes, and illicit financial flows.[103] Although some offshore jurisdictions in recent years have improved their anti-money laundering laws, their significant dependence on foreign capital invites poor implementation of these reforms and may

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http://www.justice.gov/tax/txdv08579.htm; *see also* Memorandum in Support of *Ex Parte* Petition for Leave to Serve "John Doe" Summons at 1, No. 08-21864-MC-LENARD/GARBER (S.D. Fla. June 30, 2008).

100. SENATE REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE, *supra* note 96, at 3.

101. Lynnley Browning, *Deal on Names Crack Secrecy at Swiss Banks*, N.Y. TIMES, Aug. 20, 2009, at A1.

102. SENATE REPORT ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE, *supra* note 96, at 3.

103. *See* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 49 (noting that the secrecy reduces the cost of committing other financial crimes); Lynnley Browning, *Madoff Spotlight Turns to Role of Offshore Funds*, N.Y. TIMES, Dec. 31, 2008, at B1 (analyzing the role offshore funds played in the Madoff Ponzi scheme); Mitchell E. Herr, Partner, Holland & Knight LLP, Presentation Before the Canadian Autorité des Marchés Financiers, Tax Havens: Repercussions on Financial Market Integrity (Oct. 26, 2009), *available at* http://www.hklaw.com/File.aspx?id=3457&inline=1 (describing how tax havens facilitate the creation of ponzi schemes). Corporate insiders have a history of using offshore entities to trade in the company's stock, and the use of these offshore entities allows the insider to circumvent the disclosure requirements of U.S. securities laws. JOHN CHRISTENSEN, TAX JUSTICE NETWORK, THE SPECTRE OF TAX HAVENS: SECRECY, GLOBAL CRISIS AND POVERTY 2 (2009), *available at* http://www.oekosozial.at/uploads/tx_osfopage/Unterlage_Christensen.pdf. Lately, more events have prompted the United States' focus on eliminating the harmful effects of tax havens, and especially in the wake of 9/11 it became apparent that the veil of secrecy that tax havens provide is an easy way to channel funds for financing terrorism into the United States. *Tax Haven Hearing*, *supra* note 39, at 33.

encourage governments to turn a blind eye to illicit activities within their borders.[104]

More recently, commentators have suggested that tax havens played a significant role during the recent financial crisis.[105] The general lack of transparency in the global financial system was at the heart of the economic crisis, and without the veil of secrecy and the ability to set up complex corporate structures in tax havens, the crisis would have had a much smaller impact.[106] Many of the powerful financial institutions that stood at the center of controversy when the crisis unraveled have a long history of operating subsidiaries in tax havens.[107] Research suggests that U.S. commercial banks hide upwards of $1 trillion annually in tax havens.[108] The immediate consequence of this was that whenever a bank made a bad loan, it could simply move the bad loan to the books of an offshore subsidiary.[109] This explains why many of the securities comprised of collateralized mortgages ended up in tax havens.[110] Due to the secrecy laws that govern these jurisdictions, it was impossible to

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104. *See, e.g.*, SENATE REPORT ON TAX HAVEN ABUSES, *supra* note 3, at 11–12 (noting that several tax havens have improved their money laundering laws). This improvement could, in part, be caused by the increased focus of organizations such as the United Nations and the Financial Action Task Force (FATF). *See* THE FINANCIAL ACTION TASK FORCE [FATF], 20 YEARS OF THE FATF RECOMMENDATIONS, 1990–2010, at 9, 12–16 (2010), *available at* http://www.fatf-gafi.org/dataoecd/39/16/45556642.pdf (providing an overview of the work of the Financial Action Task Force and UN support to prevent money laundering).

105. *See* sources cited *supra* note 2.

106. *See* Sol Picciotto, *How Tax Havens Helped to Create a Crisis*, FIN. TIMES, May 5, 2009, at 9; *see also* Vanessa Houlder, *Harbours of Resentment*, FIN. TIMES, Dec. 1, 2008, at 11 ("The near-collapse of the west's banking industry has . . . brutally exposed the risks inherent in small countries with large financial sectors, and raised questions about the role of offshore centres in destabilising the system."). *See generally* GEOFFREY LOOMER & GIORGIA MAFFINI, OXFORD CTR. FOR BUS. TAXATION, TAX HAVENS AND THE FINANCIAL CRISIS (2009) (explaining briefly the role of tax havens in the financial crisis). *But see* Craig Boise & Andrew P. Morriss, Letter to the Editor, *It's Nonsense to Fault Offshore Financial Centres*, FIN. TIMES, Dec. 3, 2008, at 10 (arguing instead that the claim that tax havens are to blame for the financial crisis is based on a misunderstanding of the legal structures of tax havens).

107. In 2007, Citigroup had 427 subsidiaries in tax havens, Morgan Stanley 273, Bank of America 115, Lehman Brothers 57, JP Morgan Chase 50, Goldman Sachs 29, and AIG 18. BUS. & INVESTORS AGAINST TAX HAVENS, UNFAIR ADVANTAGE: THE BUSINESS CASE AGAINST OVERSEAS TAX HAVENS 4 (2010), *available at* http://businessagainsttaxhavens.org/wp-content/uploads/2010/07/TaxHaven.pdf. In comparison, Citigroup received a commitment of $245.4 billion in bailout money from the U.S. government. *CNNMoney.com's Bailout Tracker*, CNN MONEY, http://money.cnn.com/news/storysupplement/economy/bailouttracker (last visited Dec. 26, 2011).

108. Am. News Project, *Tax Havens: The Hidden Role in the Financial Crisis*, YOUTUBE (Jan. 7, 2009), http://www.youtube.com/watch?v=4m4TbRI_wr0.

109. *Id.*

110. *Id.*

determine the true value of many offshore companies.[111] This uncertainty affected the willingness of banks to lend between one another, essentially freezing up the overnight lending market.[112] Since none of the banks could reliably estimate the assets of the other, yet all the banks knew that other banks were sitting on bad investments, an information asymmetry arose that put an effective stop to transactions in short-term capital markets.[113] The information asymmetry also created a risk premium in the market where banks would compensate for the increased risks by charging higher interest rates.[114] Similarly, many large companies use subsidiaries in tax havens to separate highly volatile investments.[115] The accounting scandals at Enron, Worldcom, and Tyco were made significantly more damaging by complicated financial structures based in tax havens that allowed these companies to conceal latent liabilities.[116] Under the protection of an unbreakable corporate seal, the institutions were able to keep their main assets separate from the assets of the subsidiary. Furthermore, the growth of exotic derivatives and the rise of hedge funds have made it increasingly difficult to understand where financial risk truly lies, mostly because much of the risk is contained in tax havens with variable supervision.[117]

III. REGULATION OF TAX HAVENS: NATIONAL AND INTERNATIONAL APPROACHES

Although many different organizations have introduced projects to combat the destructive effects of tax havens, there is still no single

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111. *Id.*

112. *Id. See generally* Keeler, *supra* note 2, at 21 (describing how tax havens may have contributed to the financial crisis).

113. Am. News Project, *supra* note 108. For an explanation of how corporations used offshore tax centers to cut off liability for risky subsidiaries, see Andre P. Morriss, *Changing the Rules of the Game: Offshore Financial Centers, Regulatory Competition & Financial Crises*, 15 NEXUS 15, 20–22 (2009).

114. Am. News Project, *supra* note 108. The higher interest rate is an effect of the perceived higher default risk. Because lenders did not know exactly which lender held the bad loan, the lenders will increase the rates on all debt investments across portfolios to better hedge the risk of potential losses. This approach is akin to the rationale underlying the insurance industry—charging a fee from a large number of people will allow the excess to absorb any losses resulting from actual injury. *See generally* Robert Libby, *The Impact of Uncertainty Reporting on the Loan Decision*, 17 J. ACCT. RES. 35 (1979).

115. Am. News Project, *supra* note 108.

116. Ramos, *supra* note 9, at 4. For example, Enron had 441 shell companies located in the Cayman Islands. SENATE REPORT ON TAX HAVEN ABUSES, *supra* note 3, at 2.

117. Ramos, *supra* note 9, at 4.

comprehensive regulation aimed at controlling tax havens or the capital flows that go through them. Among the various international initiatives, there is a clear lack of accord on the degree of harm created by tax havens and on the best method to deal with the adverse economic effects they cause. Arguably, the most successful multinational initiative today has been the work of the OECD, and its work to develop a model tax agreement.[118]

A. *Regulatory Framework in the United States*

1. Bilateral Agreements

Although the IRS primarily relies on voluntary enforcement, the mere size of the tax gap demonstrates that some formal mechanisms for enforcement are necessary to maintain better compliance with the U.S. Tax Code.[119] Today, the main vehicles to facilitate the exchange of information from tax havens are bilateral agreements.[120] These bilateral agreements, known as Tax Information Exchange Agreements (TIEAs), primarily govern the exchange of information.[121] Over the past decade, the United States has entered into fourteen TIEAs with states classified as tax havens by the OECD. [122] Most of these are based on the OECD's model agreement.[123] Although bilateral agreements were initially believed

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118. The primary way countries deal with international tax issues is through bilateral agreements. These are not only restricted to information exchange, but govern other issues such as double taxation as well. For a brief overview of double taxation issues, see *supra* note 67 and also Guttentag & Avi-Yonah, *supra* note 6, at 105 (discussing the model Tax Information Exchange Agreement adopted by the OECD).

119. The IRS estimates the tax gap to be between $312 and $353 billion. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-06-208T, TAX GAP: MULTIPLE STRATEGIES, BETTER COMPLIANCE DATA, AND LONG-TERM GOALS ARE NEEDED TO IMPROVE TAXPAYER COMPLIANCE (2005).

120. *Tax Information Exchange Arrangements*, TAX JUST. BRIEFING (Tax Justice Network, Brussels, Belg.), May 2009, at 1–2.

121. *See Tax Information Exchange Agreements (TIEAs)*, OECD, http://www.oecd.org/document/7/0,3746,en_2649_33767_38312839_1_1_1_1,00.html (last visited Dec. 26, 2011) (providing a short description of the purpose of the agreements and recent agreements).

122. *See* David Spencer & J.C. Sharman, *International Tax Cooperation (Part 2)*, 19 J. INT'L TAX'N 26, 34 (2007) (listing the countries on the OECD list with which the United States maintains TIEAs).

123. *See* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 96 ("Recommendations from the OECD on the formulation of agreements in this area have been used as a model for treaties and agreements."). *See generally* OECD, Agreement on Exchange of Information on Tax Matters (2003), *available at* http://www.oecd.org/dataoecd/15/43/2082215.pdf [hereinafter Agreement on Exchange of Information on Tax Matters] (providing the most common model for Tax Information Exchange Agreements).

to provide a successful remedy for the detrimental effects caused by tax havens, the agreements themselves have not yielded the intended results. This is in part evident from the fact that the annual loss of tax revenue due to tax havens has increased since the enactment of the bilateral agreements.[124] Many also believe that lack of cooperation from local authorities is to blame for the failure of these agreements.[125] Because of inadequate governmental enforcement efforts, most of the suggested sanctions rely upon a form of self-enforcement.[126] A person who wants to transact in a tax haven would have to voluntarily disclose the transaction to the appropriate government agency.[127] However, using the underlying premise that many of the transactions in tax havens have a tax evasion motive, it is highly improbable that a person would voluntarily notify the authorities of these transactions. Thus, if these states were in fact being used to evade taxes, many of the OECD's penalties would have little or no effect.[128] The lack of effectiveness and perceived

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124. *See* RICHARD A. GREEN, TAX HAVENS AND THEIR USE BY UNITED STATES TAXPAYERS: AN OVERVIEW 32 (2002) (observing that the use of tax havens is growing); *The Price of Offshore*, *supra* note 78, at 1 (noting that the annual loss resulting from tax havens could exceed more than $255 billion); *see also* Fredrik Loennecken, *Skatteavtalene Fungerer Ikke*, E24.NO (Apr. 4, 2011), http://e24.no/makro-og-politikk/skatteavtalene-fungerer-ikke/20041504?view=print (Nor.) (noting, for example, that Norway only used TIEAs to request information in four cases in 2010, and received information from only two, despite maintaining more than thirty agreements with various tax havens). The fact that corporations today account for a much smaller percentage of total U.S. tax revenues compared to fifty years ago also provides some evidence of the failure of these agreements. *See* BUS. & INVESTORS AGAINST TAX HAVENS, *supra* note 107, at 3–4 (noting that corporate income tax today only accounts for 7.2 percent of federal tax revenues as opposed to 23.2 percent fifty years earlier, and attributing the change to corporations' access to offshore tax havens).

125. *See, e.g.*, Press Release, Senator Carl Levin, GAO Report Discloses Mixed Record on Use of Tax Treaties to Combat Offshore Tax Abuse (Oct. 7, 2011), *available at* http://levin.senate.gov/newsroom/press/release/gao-report-discloses-mixed-record-on-use-of-tax-treaties-to-combat-offshore-tax-abuse ("[T]he IRS initiates only a couple hundred specific requests for taxpayer information per year from other countries. I don't know if the IRS has been hardened by a historical lack of cooperation from other countries . . . ."); *see also* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-730, IRS'S INFORMATION EXCHANGES WITH OTHER COUNTRIES COULD BE IMPROVED THROUGH BETTER PERFORMANCE INFORMATION (2011).

126. *See* Press Release, Senator Carl Levin, *supra* note 125 (noting the historical lack of cooperation from tax haven governments).

127. This is primarily the result of lack of provisions for automatic exchange in the agreements. Additionally, even if authorities have a suspicion regarding a particular transaction or individual, there are strict requirements for when the tax haven is allowed to release information, essentially rendering the burden of proof on tax authorities very high. *See Banking Secrecy Practices Hearing*, *supra* note 99, at 18–19 (statement of Professor Avi-Yonah) (noting the strict requirements the IRS must comply with before they can obtain information regarding a particular individual).

128. Many have criticized the OECD's methods for dealing with tax havens, and argue that the OECD is an inappropriate organ for dealing with the problem since it is

unfairness has caused several states, including the United States, to withdraw support for the agreements.[129] Because of the lack of substantive effect, and because the OECD did not require any immediate action from the tax havens but merely a pledge, many tax havens have committed to the pledge but have subsequently had very little incentive to actually comply with the agreement's requirements.[130] In his testimony before the Subcommittee on Investigations of the Senate Committee on Security and Governmental Affairs, Professor Reuven Avi-Yonah specifically noted the need to renegotiate the agreements to obtain more extensive and elaborate exchange of information than what is available today.[131]

The first problem with these agreements is the narrow scope of the information exchange. The bilateral agreements are mostly restricted to criminal matters, which represent only a small part of the revenues involved and often pose difficult evidentiary issues.[132] Also, these agreements usually impose a "dual criminality" requirement, meaning that the activity related to the information sought must constitute crimes in both countries and, as a result of the lenient tax laws in tax havens, tax-related offenses rarely pass this substantial hurdle.[133] Essentially, the result of this provision is that an individual must be suspected of a crime other than tax evasion before authorities can request information about the individual.[134]

A second concern with the agreements is the lack of automatic exchange of information. Bilateral agreements usually only require information exchange upon specific requests relating to particular individuals, requiring the IRS to identify the potential tax evaders in

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unable to exercise significant control over its member countries. *See* J. C. SHARMAN, HAVENS IN A STORM: THE STRUGGLE FOR GLOBAL TAX REGULATION 128 (2006) (giving a brief overview of some of his criticisms of OECD efforts); *see also* Anthony C. Infant, *Havens in a Storm: The Struggle for Global Tax Regulation*, 42 LAW & SOC'Y REV. 690 (2008) (book review) (describing Sharman's efforts to identify the shortcomings of OECD's work).

129. SHARMAN, *supra* note 128, at 75.

130. *See* Steven A. Dean, *Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation*, 58 HASTINGS L.J. 911, 961 (2007) ("Faced with an indefinite promise/threat of transnational collateral consequences . . . tax havens made a show of cooperation by entering into the OECD's cooperation commitments but have not developed the information infrastructure the OECD sought.").

131. *See Tax Haven Hearing*, *supra* note 39, at 34 (testimony of Professor Avi-Yonah) ("I would encourage renegotiating . . . the exchange of information agreements to make them broader and more automatic . . . .").

132. Guttentag & Avi-Yonah, *supra* note 6, at 105.

133. *Id.*

134. *See id.* (noting that, as opposed to the current agreements, the revised model agreement would not have a dual criminality requirement, and would thus not require "suspicion of a crime other than tax evasion").

advance.[135] The TIEAs include strict conditions about the information required before a successful request can be made.[136] Basically, this would force the IRS to know exactly what it is looking for before it can request it. The ostensible purpose behind the request requirement is to prevent "fishing expeditions" from foreign authorities.[137] However, the effect is to leave the IRS with a type of "catch-22" because bank secrecy provisions usually prevent the IRS from identifying the individual in the first instance.[138] If the authorities do not have automatic access to the necessary financial records to determine if its citizens are using the tax haven to conceal income, governments must first find a way to discover which citizens actually maintain accounts in a particular tax haven. Moreover, some states impose further restrictions on the procedures for obtaining or supplying information. For example, some tax havens require that before any information is provided, the person concerned must be notified of the request and be given an opportunity to object.[139] Incidentally, this also gives tax evaders an opportunity to remove assets from that jurisdiction. However, in a recent modification in the exchange of information provisions, the OECD altered the terms of the model agreement so that exchange of information is automatic, rather than by request.[140] The revised provision applies both to civil and criminal tax liabilities, whereas the previous provision arguably required the suspicion of a crime other than tax evasion to override

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135. *Tax Information Exchange Arrangements*, *supra* note 120, at 4.

136. *See, e.g.*, *id.* at 3 ("[A] detailed case must be made, with the criteria set out in a lengthy legal document. In effect, this means that the authorities requesting the information must already have a strong case even before they request the information."). For example, the tax information exchange agreement between Norway and St. Kitts and Nevis, requires the requesting party to include the identity of the person under investigation, a statement of the information sought, the tax purpose, grounds for believing that the information is in possession of the requested party, a statement that all domestic means have been exhausted in trying to obtain the information, as well as other items, in its request for information. Agreement Concerning the Exchange of Information Relating to Tax Matters art.5(5), Nor.–St. Kitts & Nevis, Mar. 24, 2010, *available at* www.regjeringen.no/en/dep/fin/Selected-topics/taxes-and-duties/skatteavtaler/agreement-norway---saint-christopher-sai.html?id=635957.

137. *Tax Information Exchange Arrangements*, *supra* note 120, at 4.

138. *See* Guttentag & Avi-Yonah, *supra* note 6, at 105 ("[T]hey typically require the United States to make a specific request relating to particular individuals, and they also typically do not override bank secrecy provisions in tax haven laws.").

139. *Tax Information Exchange Arrangements*, *supra* note 120, at 3.

140. *See* OECD, *Recommendation of the Council on the Use of the OECD Model: Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes*, C(2001)28 (Mar. 22, 2001) (recommending adoption of the automatic exchange of information provisions); OECD, Memorandum of Understanding Between the Competent Authorities of (State X) and (State Y) on Automatic Exchange of Information for Tax Purposes art. 2 (2001) (containing the Draft Articles that provide for automatic exchange of certain information).

bank secrecy provisions.[141] Nevertheless, the United States has not yet modified its existing agreements to reflect the changes in the OECD model agreement, and therefore, the agreements are still of limited value.[142]

Another concern with the bilateral agreements is their lack of multinational nature.[143] Even if such agreements successfully facilitated the exchange of information, tax evaders could simply shift assets to a tax haven that has yet to enter into such an agreement.[144] This disincentivizes tax havens from entering TIEAs and shifts business to non-cooperating tax havens.[145] Moreover, the stronger bargaining power of non-tax havens could potentially discourage tax havens from engaging in negotiations. Bilateral agreements may unfairly favor developed countries with large economies to the detriment of developing countries because it is unlikely that developing countries possess sufficient leverage to negotiate a good deal.[146] Most likely, strong economies like Switzerland and Monaco will be in a better negotiating position than Tonga or Guyana, and such countries may therefore be reluctant to fully participate in the process.[147] Some also criticize the agreements for only requiring compliance from non-OECD members, which may seem unfair from the tax havens' perspective.[148]

Additionally, the agreements fail to account for the loss in GDP that tax havens would experience with reduced demand for their

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141. *Compare* Model Tax Convention, *supra* note 67, art. 26 ("In no case shall the [information exchange requirements] be construed so as to impose on a Contracting State the obligation: . . . to supply information which is not obtainable under the laws or in the normal course of the administration . . . ."), *with* Agreement on Exchange of Information on Tax Matters, *supra* note 123, art. 5, para. 1 ("Such information shall be exchanged *without regard* to whether the conduct being investigated would constitute a crime under the laws of the requested Party . . . ." (emphasis added)).

142. *See* Guttentag & Avi-Yonah, *supra* note 6, at 105 (recommending the adoption of the new model agreement); *see also Tax Haven Hearing*, *supra* note 39, at 33 (testimony of Professor Avi-Yonah) (opining that the United States would benefit from renegotiating these agreements to better reflect the updated model tax treaty).

143. Because bilateral agreements are, by definition, entered into by two countries, the agreements will not provide a comprehensive system of regulation similar to multilateral treaties. The use of bilateral treaties will also allow a country to differentiate, or even favor, certain countries it deals with through these agreements.

144. Guttentag & Avi-Yonah, *supra* note 6, at 107.

145. *Id.*; *see also Whiter than White: Tax Havens Under Pressure*, ECONOMIST, June 20, 2009, at 37 (using the flight of several companies from Bermuda in wake of its increased commitment to transparency as an example).

146. *See Tax Information Exchange Arrangements*, *supra* note 120, at 3 (discussing the relatively lower bargaining power of developing countries).

147. *Id.*

148. SHARMAN, *supra* note 128, at 75.

financial services industry.[149] Essentially, the financial industries in these tax havens sell secrecy, and without that secrecy, investors would have little incentive to invest their money in tax havens.[150] In an effort to protect the financial services industry, many tax havens have declared that any agreement entered into would not require them to surrender any financial records unless certain conditions were satisfied.[151]

Finally, the agreements do not provide any additional tools to help the IRS with the procedural task of collecting taxes. The agreements were primarily enacted to trade *information* between the IRS and the tax havens party to the agreements.[152] Even where the IRS is able to secure information about a U.S. taxpayer, the agreements do not provide for assistance with the *collection* of U.S. taxes from foreign-based assets.[153] Consequently, the assets that are located in tax havens mostly remain out of reach of U.S. enforcement, and the IRS must instead obtain judicial assistance to enforce against U.S.-based assets.[154] Similarly, the success of the agreements entirely depends on the availability of the relevant information because under the agreements tax havens are usually not required to produce information that the tax havens do not already have.[155] Because tax havens tend to have very few public registries that contain the information the IRS

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149. *See Whiter than White*, *supra* note 145, at 37 (stating that tax havens will undoubtedly lose business in the absence of sufficient secrecy for investors).

150. *Cf., e.g.*, Addison, *supra* note 75, at 711 ("A state becomes a tax haven for one undeniable reason: to attract capital to help promote growth in its financial industry.").

151. *See* Model Tax Convention, *supra* note 67, art. 26 (listing certain situations, including violating local law or disclosing trade or business secrets, that would eliminate a state's obligation to provide information); *Tax Information Exchange Arrangements*, *supra* note 120, at 3 (noting that countries often impose certain conditions as a precondition to releasing information under a TIEA).

152. *Cf.* Agreement on Exchange of Information on Tax Matters, *supra* note 123 (containing no procedural provisions to assist with enforcement).

153. *See Tax Haven Hearing*, *supra* note 39, at 18 (testimony of Comm'r Everson) (noting that nothing in the agreements "would help [the IRS] get the money").

154. One possible method for collecting the assets abroad is a suit for repatriation, whereby a U.S. resident is ordered by the court to repatriate assets or be subject to contempt proceedings. *E.g.*, *id.* at 105 (written testimony of Comm'r Everson); *see also* I.R.S. Treas. Order, IRM 5.21.3.6 (Feb. 17, 2009) (explaining the purpose of a suit for repatriation and the requirements necessary to successfully file one).

155. *See* Agreement on Exchange of Information on Tax Matters, *supra* note 123, art. 5, para. 2 (requiring a requested government to use "all relevant information gathering measures" to provide information that it does not currently have in its possession; however, this requirement has not yet been interpreted to require the requested party to compile new records).

requires, tax enforcers may be out of luck even if they successfully submit a request for information.[156]

2. The Stop Tax Haven Abuse Act

In February 2007, then-Senator Barack Obama, along with fellow Senators Carl Levin and Norman Coleman, introduced the Stop Tax Haven Abuse Act, a comprehensive piece of legislation aimed at preventing tax haven abuses.[157] Because the bill did not pass prior to expiration of the congressional session, the bill was cleared from the books.[158] The bill was reintroduced in 2009, but like its predecessor, failed to pass and was subsequently removed.[159] Representative Lloyd Doggett simultaneously introduced a companion bill in the House of Representatives, but this was also cleared from the books when the congressional session ended.[160] The bill has since been reintroduced in both the Senate and the House of Representatives.[161]

The primary goal of the Act is "[t]o restrict the use of offshore tax havens and abusive tax shelters"[162] and to target "offshore tax abuses that rob the U.S. Treasury of an estimated $100 billion each year, reward tax dodgers using offshore secrecy laws to hide money from Uncle Sam, and offload the tax burden onto the backs of middle income families who play by the rules."[163] The Act speaks in terms of "offshore secrecy jurisdictions," but rather than providing a specific definition for determining what qualifies, it provides a list of thirty-four jurisdictions and grants the Treasury Secretary discretion to add or subtract from

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156. *See* GRAVELLE, *supra* note 30, at 21 (using the British Virgin Islands as an example and noting that the country does not have any laws that require registration of shareholders, directors, or financial records).

157. Press Release, Senate Comm. on Homeland Sec. & Governmental Affairs, *supra* note 14.

158. *See S. 681: Stop Tax Haven Abuse Act*, GOVTRACK.US, http://www.govtrack.us/congress/bill.xpd?bill=s110-681 (last visited Dec. 26, 2011) (showing the progress and current status of the bill).

159. *See* Press Release, Senator Carl Levin, Statement of Senator Carl Levin on Introducing the Stop Tax Haven Abuse Act, Part I (Mar. 2, 2009), *available at* http://levin.senate.gov/newsroom/press/release/?id=680c7457-9c8d-4be7-b4ca-2e918f9935b9. The bill has been pending before the committee for a long period of time, and many believe that the power of large U.S. commercial banks have provided political opposition to the bill. *See infra* notes 200–04 and accompanying text.

160. Stop Tax Haven Abuse Act, H.R. 1265, 111th Cong. (2009); FRESHFIELDS BRUCKHAUS DERINGER US LLP, SENATOR LEVIN AND REPRESENTATIVE DOGGETT INTRODUCE STOP TAX HAVEN ABUSE ACT 1 (2009), *available at* http://www.freshfields.com/publications/pdfs/2009/mar09/25385.pdf.

161. Stop Tax Haven Abuse Act, S. 1346, 112th Cong. (2011) (introduced by Senator Levin and seven co-sponsors); Stop Tax Haven Abuse Act, H.R. 2669, 112th Cong. (2011) (introduced by Representative Doggett and fifty-six co-sponsors).

162. Stop Tax Haven Abuse Act, S. 506, 111th Cong. pmbl. (2009).

163. Press Release, Senator Carl Levin, *supra* note 159.

the list.[164] An important qualification for being excluded from this list is the effective and automatic exchange of information with U.S. tax authorities.[165] This may be accomplished through the existence of a TIEA if the agreement provides for "prompt, obligatory, and automatic exchange of such information as is foreseeably relevant for carrying out the provisions of the treaty . . . ."[166]

a. The Use of Presumptions to Circumvent the "Veil of Secrecy"

One of the strongest tools of the Stop Tax Haven Abuse Act is the use of a presumption strategy for determining certain information. The Act essentially begins with the premise that anyone who has a connection to an "offshore secrecy jurisdiction" has a tax avoidance motive by creating a presumption that any "United States person . . . who directly or indirectly formed, transferred assets to, was a beneficiary of, had a beneficial interest in, or received money or property . . . from an offshore secrecy jurisdiction entity" is presumed to be in control of that entity.[167] Similarly, for the purpose of enforcing tax laws, a U.S. person who "formed, transferred assets to, was a beneficiary of, had a beneficiary interest in, or received money or property from . . . an offshore secrecy jurisdiction entity" is presumed to be the beneficial owner of that entity.[168] It further supposes that any distributions from, or other property received from such an entity is taxable income and that funds or other property transferred to such an entity have not yet been taxed in the United States or in any other country and thus constitutes taxable income in the year of receipt.[169]

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164. An "offshore secrecy jurisdiction" is a jurisdiction determined to have "corporate, business, bank, or tax secrecy rules and practices which . . . unreasonably restrict the ability of the United States to obtain information relevant to the enforcement of this title, unless . . . such country has *effective information exchange practices*." S. 506 § 101(b) (emphasis added). It is worth emphasizing that the Act relies on essentially one criterion to classify a country as a tax haven—the absence of informational transparency. Although the Act refers to tax havens as offshore secrecy jurisdictions, for purposes of consistency, this Note will continue to use the term tax haven.

165. *Id.*

166. *See id.* (noting that a jurisdiction is deemed to have *ineffective* information exchange practices unless such jurisdiction has in effect a treaty that satisfies these requirements).

167. *Id.* § 101(a) (footnote added). Publicly traded U.S. entities and transactions with publicly traded offshore secrecy jurisdiction entities are generally exempted from the provisions of the Act. *See id.* § 101(c) (exempting "entit[ies] with shares regularly traded on an established securities market" from several sections).

168. *Id.* § 101(c).

169. *Id.* § 101(a) ("[T]here shall be a rebuttable presumption that any amount or thing of value received by a United States person . . . directly or indirectly from an account or entity in an offshore secrecy jurisdiction, *constitutes income* of such person taxable *in the year of receipt* . . . and any amount of value paid or transferred by or on

Finally, the legislation presumes that a financial account controlled by a U.S. taxpayer in a foreign country contains enough money to trigger a statutory reporting threshold of $10,000, thus allowing the IRS to assert the minimum penalty for a taxpayer's nondisclosure of the account.[170] These sections essentially shift the burden of proof from the IRS onto the taxpayer and eliminate a lot of the necessity for information exchange. The Act would require a taxpayer dealing in an offshore secrecy jurisdiction to produce evidence that offshore funds or other property are not taxable income. The presumptions are limited to civil proceedings and may be rebutted only by "clear and convincing evidence, including detailed documentary, testimonial and transactional evidence" to the contrary.[171] To successfully rebut the presumption, the taxpayer must prove that (1) the taxpayer did not exercise any "control, directly or indirectly, over such entity at the time in question" and (2) that the transfers "did not represent income related to such United States person."[172]

The burdens imposed by the legislation would primarily fall on non-U.S. financial institutions, essentially enlisting their assistance in the collection of U.S. tax liabilities. Agents who receive income from an offshore secrecy jurisdiction entity on behalf of U.S. persons would be required to report to the IRS the client's personal details and the nature of the individual's relationship with the entity.[173] For domestic financial institutions, the Act would trigger an obligation when a U.S. person opens an account in the name of an entity in an offshore secrecy jurisdiction and that U.S. person is a direct or indirect beneficial owner of that offshore entity.[174] Furthermore, the Act tries to remedy the issue of shell corporations by requiring any publicly traded corporation, or one with assets of $50 million or more and whose management and control occurs primarily in the United States, to be treated as a U.S. company.[175] This provision would not operate to reframe the origin of foreign subsidiaries of U.S. corporations simply because some decisions are made at the parent level; rather, it would have to be clear that no

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behalf of a United States person . . . to an account or entity in any such jurisdiction represents *previously unreported* income of such person taxable in the year of the transfer." (emphasis added)).

170. *See id.* § 101(d) (providing a rebuttable presumption where an account in a tax haven contains the minimum amount provided in the Act).

171. *Id.* § 101(a).

172. *Id.*

173. *See id.* § 105 (providing triggers for reporting obligations and listing the information required to be reported to the IRS).

174. *Id.* (imposing requirements on a withholding agent with control over offshore entities if it is determined that a U.S. person has any beneficial interest in such entity).

175. *Id.* § 103.

productive activity is conducted in the subsidiary.[176] Similarly, the Act would address potential trust abuses by providing that any powers held by a trust protector be attributed to the trust grantor.[177] This would essentially eliminate the trust grantor's ability to exercise control through the trust protector. It also provides that any U.S. person benefiting from a trust be treated as a beneficiary even if not named in the trust instrument, that future or contingent beneficiaries be treated as current ones, and that loans of assets and property as well as cash or security be treated as trust distributions.[178]

b. Codification of the Economic Substance Doctrine

Additionally, the Act makes an effort to codify the economic substance doctrine and would impose severe penalties for those engaging in non-substantive transactions.[179] The economic substance doctrine requires both a subjective (profit intended) and an objective (profit achieved) test.[180] Under the provisions of the Act, a transaction would have economic substance only if the transaction changes the taxpayer's economic position in a meaningful way—the taxpayer has a purpose, other than a tax purpose, for entering into such transaction and the transaction is a reasonable way to accomplish that goal.[181] Consequently, a transaction would not be treated as having economic substance solely by reason of potential profit unless the present value of the reasonably expected pre-tax profit from the transaction is substantial in relation to the present value of the expected net federal tax benefits that would be allowed if the transaction were respected.[182]

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176. *See* GRAVELLE, *supra* note 30, at 44–45 (noting that the purpose is to prevent the operation of shell subsidiaries, including hedge funds and investment management businesses).

177. S. 506 § 106(a) ("[A] grantor shall be treated as holding any power or interest held by any trust protector or trust enforcer or similar person appointed to advise, influence, oversee, or veto the actions of the trustee.").

178. *Id.* § 106(b) ("Any United States person receiving from a foreign trust cash or other property, or receiving the use thereof, shall be treated as a beneficiary of such trust regardless of *whether such person is a named beneficiary* . . . ." (emphasis added)); *id.* § 106(c) (amending 26 U.S.C. § 643(i)(1) (2006)) ("[I]f a foreign trust makes a loan of cash or other property . . . directly or indirectly to (A) any grantor or beneficiary of such trust who is a United States person . . . the amount of such loan shall be *treated as a distribution* by such trust to such grantor or beneficiary . . . ." (emphasis added)); *id.* § 106(d) (amending 26 U.S.C. § 679(a)(1) (2006)) ("A United States person who directly or indirectly transfers property to a foreign trust . . . shall be treated as the owner . . . of such trust attributable to such property if for such year *or for any subsequent year* there is a United States beneficiary (*including a contingent beneficiary*) of any portion of such trust." (emphasis added)).

179. *Id.* § 401.

180. GRAVELLE, *supra* note 30, at 36.

181. S. 506 § 401.

182. *Id.*

In determining the profit, fees, other transaction costs, and foreign taxes would have to be taken into account.[183]

c. Expanding the IRS's Toolbox

The Stop Tax Haven Abuse Act would also expand the IRS's authority to take the same measures against foreign jurisdictions as the U.S. Treasury currently can take in money laundering cases.[184] These measures would include prohibiting U.S. financial institutions from opening accounts for a foreign banking institution if the Treasury Secretary suspects such institution is involved in money laundering.[185] The Act would also extend the statute of limitations to complete an audit involving any funds held in an offshore secrecy jurisdiction from three to six years.[186] Additionally, the legislation provides for stricter penalties for failures to make appropriate securities disclosures and would allow monetary penalties up to $1 million for knowing breaches of the duty to disclose offshore stock holdings and transactions in violation of U.S. securities laws.[187] The Act also attempts to remedy the problems of detailed requirements in many bilateral agreements by allowing the IRS to issue a John Doe summons when the IRS does not know the names of taxpayers, whereas the IRS must currently request court permission to serve such summons.[188] Under the Act, a court should relieve the IRS of the obligation to identify the taxpayer's name when there is a *reasonable basis* for believing that a person or group has failed to comply with tax laws and the information sought to be obtained is not readily available from other sources.[189] The Act would also eliminate the barrier that has existed between enforcement agencies by authorizing the Secretary of the Treasury to disclose to the SEC, federal banking agencies, and the Public Company Accounting

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183. *Id.* Congress has codified the economic substance doctrine elsewhere. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409, 124 Stat. 1029 (codified as amended at 26 U.S.C. §§ 6662–6662A, 6664, 6646, 7701(o) (2006)).

184. *See also* S. 506 § 102 (authorizing sanctions if the Secretary of the Treasury finds that the entity or transaction "imped[es] United States tax enforcement"). Currently, the U.S. Treasury has authority under the Patriot Act to impose financial sanctions on foreign jurisdictions, financial institutions, or transactions found to be of "primary money laundering concern." USA PATRIOT Act, 31 U.S.C. § 5318A (2006).

185. S. 506 § 102.

186. *Id.* § 104(a).

187. *Id.* § 201.

188. *Id.* § 204; I. R. S. Treas. Order, IRM 25.5.7.3 (Nov. 22, 2011) (providing that the IRS must submit a statement of fact to a court in order to obtain approval to serve the summons).

189. S. 506 § 204. Note, however, that the John Doe summons is only relevant when the records sought are U.S. bank records. *Id.*

Oversight Board information about abusive tax practices evident in tax returns.[190]

d. Criticisms of the Stop Tax Haven Abuse Act

Although the Stop Tax Haven Abuse Act has yet to be passed into law, certain issues are apparent even prior to its implementation. Similar to the bilateral agreements that have been discussed earlier, the Stop Tax Haven Abuse Act is a unilateral initiative.[191] Tax havens are a global concern and without a widely implemented regulation, any legislation is likely to just be a part solution to the problem.

Professor Avi-Yonah points out two important aspects that legislation must address in order to successfully reduce the harmful effects of tax havens.[192] The first is to discover who actually controls the various foreign entities suspected of tax evasion.[193] The Act answers this question by creating a rebuttable presumption that if a U.S. person sets up an entity in a tax haven jurisdiction, then he or she controls that entity, as opposed to the current legislation under which the IRS bears the burden of proving control by an entity.[194] The second aspect Professor Avi-Yonah emphasizes is the secrecy issue. Here, it is unclear whether the Act's requirements would really be effective.[195] The Act attempts to deal with the secrecy issue in two ways. First, by imposing a presumption of control, the Act may cause secrecy laws to be far less effective.[196] This presumption and the high penalty provisions could potentially incentivize people to voluntarily disclose more information related to their foreign assets. Second, as explained previously, the Act would impose certain reporting requirements.[197] However, the reporting requirements are based on the same

190. *Id.* § 306 (allowing information sharing between these authorities provided that they comply with certain requirements).

191. *See supra* Part III.A.1.

192. *Tax Haven Hearing*, *supra* note 39, at 34 (testimony of Professor Avi-Yonah).

193. *Id.*

194. *Id.*; *see also* S. 506 § 101(a) ("[T]here shall be a rebuttable presumption that a United States person . . . who directly or indirectly formed, transferred assets to, was a beneficiary of, or received money or property or the use thereof from an entity . . . formed, domiciled, or operating in an offshore secrecy jurisdiction, exercised control over such entity.").

195. *See Tax Haven Hearing*, *supra* note 39, at 34 (testimony of Professor Avi-Yonah) (encouraging Congress to give the IRS more resources in this area).

196. *See supra* note 194 (quoting the relevant section which provides for presumption of control).

197. *See* S. 506 § 101 (providing a presumption that foreign accounts held in offshore secrecy jurisdictions contain sufficient funds to trigger reporting obligations); *id.* § 105(a)–(b) (requiring U.S. entities to report the establishment of accounts and creation of offshore entities).

underlying sanctions principles as OECD regulations that have failed to achieve any success so far.[198] Moreover, the reporting obligations would fall on the financial institutions in the respective offshore jurisdictions,[199] and it is questionable whether financial institutions would voluntarily enforce these obligations or retain the status quo to avoid loss of revenue.

The Act could also adversely impact the competitiveness of U.S. companies. John Castellani, the president of the Business Roundtable, an organization dedicated to promoting corporate interests in the formation of public policy, described the Act as "the wrong idea at the wrong time for the wrong reasons."[200] Specifically, some are concerned about giving preferential treatment to foreign companies at the expense of domestic companies.[201] The Stop Tax Haven Abuse Act has created somewhat of a dilemma for politicians. On the one hand, they do not want to disadvantage companies, but on the other hand, they do not want to condone tax evasion.[202] Undoubtedly, a stricter tax policy would limit the profitability of U.S. companies, and therein, their ability to compete. Legislators must therefore consider what the optimal balance is between strictly enforcing the U.S. Tax Code to maximize tax revenue, and implicitly subsidizing companies through lax enforcement, to avoid impeding their ability to compete. This comes down to a judgment call of whether to prioritize a level playing field for U.S. companies or to allow U.S. companies operating overseas to pay the same tax rates as their local competitors. In this respect, it is worth emphasizing that companies do not tend to make decisions purely on a

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198. *Compare* Model Tax Convention, *supra* note 67, art. 26 (limiting the required information to that "foreseeably relevant" but further restricing the scope by imposing a dual criminality requirement), *with* S. 506 (requiring disclosure of information for a particular transaction *only* if it exceeds a statutory threshold).

199. *See, e.g.*, S. 506 § 104 (requiring banks and other financial institutions to disclose any foreign-held assets); *id.* § 105 (imposing reporting obligations on intermediate withholding agents).

200. Christopher Beam, *The Fairness Doctrine: The Best Argument Against Obama's Tax-Haven Plan*, SLATE (May 5, 2009), http://www.slate.com/id/2217717. *See generally About Us*, BUS. ROUNDTABLE, http://businessroundtable.org/about-us (last visited Dec. 26, 2011) (noting that the organization is based on the idea that businesses should "play an active and effective role in the formation of public policy").

201. Senate Minority Leader Mitch McConnell described the plan as "giv[ing] preferential treatment to foreign companies at the expense of U.S.-based companies." Beam, *supra* note 200. Similarly, Representative Joseph Crowley, demonstrated his loyalty to his financial constituency, noting that he did not want any tax changes to "hurt" Citigroup, New York's largest private-sector employer. *Id.*

202. A common argument holds that the United States should avoid imposing strict tax obligations on U.S. companies operating abroad because it impedes on their ability to compete. *See, e.g.*, NAT'L FOREIGN TRADE COUNCIL, THE NFTC FOREIGN INCOME PROJECT: INTERNATIONAL TAX POLICY FOR THE 21ST CENTURY 11, 41 (1999) ("[L]oss in world market-share . . . can occur where it is difficult for U.S. multinationals to offset the higher tax burdens imposed.").

tax basis, but primarily look for business justifications.[203] Companies are only taxed on profits, and will therefore seek to maximize profits before addressing tax concerns.[204]

B. *International Regulation*[205]

1. OECD

The OECD has been at the leading edge of persuading tax havens to cooperate to facilitate the exchange of information, and is an organization in which the United States has historically had a leading role.[206] However, when it comes to tax haven policies the United States has had a "patchy history of cooperation" with the OECD in their efforts to reduce the number of tax havens.[207] Some argue that it was not until after September 11, and the realization that tax havens aided the channeling of terrorist funding, that the United States started cooperating with international organizations on these matters.[208]

The first initiative of the OECD to begin regulating tax havens was the order of the Ministerial Communiqué of May 1996 to "develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases."[209] In endorsing the request, the G-7 countries specifically noted that tax schemes aimed at attracting capital can "create harmful tax competition between States," with the risk of eroding national tax bases.[210] The countries simultaneously encouraged the OECD to pursue a "multilateral approach under which countries could operate individually and collectively to limit the extent of these practices."[211] The work of the OECD is

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203. *See* Beam, *supra* note 200 ("I tend to think people are driven to make business decisions based on business reasons. Then they deal with tax reasons.").

204. *See, e.g., id.* ("You're taxed on what you earn . . . [a]nd that is calculated after the profit of a company is figured out.").

205. The Norwegian Government Commission on Capital Flight's report provides a useful overview of the international organizations and their work. *See* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 91–100.

206. *See, e.g.,* Press Release, OECD, Business Engages Top International Tax Officials at OECD Conference in Washington (June 5, 2007), *available at* http://www.oecd.org/document/10/0,3343,en_2649_34897_38730826_1_1_1_1,00.html.

207. *Tax Haven Hearing, supra* note 39, at 33 (testimony of Professor Avi-Yonah).

208. *Id.*

209. OECD, *supra* note 16, para. 1.

210. G-7, *Economic Communiqué: Making a Success of Globalization for the Benefit of All,* ¶ 16, DOC/96/5 (June 28, 1996), *available at* http://www.g7.utoronto.ca/summit/1996lyon/communique.html. The G-7 countries are France, Germany, Italy, Japan, the United States, Canada, and the United Kingdom.

211. *Id.*

summarized in its report: *Harmful Tax Competition: An Emerging Global Issue.* [212] The report is intended to develop a better understanding of how tax havens harm the economy, and what constitutes "harmful tax competition."[213] Today, the organization's work is mainly focused on mapping the current extent of the problem by identifying tax havens.[214] However, as mentioned previously, the OECD also plays a significant role in establishing TIEAs with the various tax havens.[215] The OECD has developed a model TIEA, which most of the current agreements are modeled after.[216]

In the beginning, the OECD focused its work against tax havens on informational aspects by shedding light on the harmful practices in tax havens and, in its 1998 report, the organization publicized the first comprehensive list of tax havens featuring the names of states that did not comply with the OECD's proposed standards.[217] Initially, the list included thirty-five countries, but the OECD noted that a future report would include all states it considered to be uncooperative tax havens.[218] Similarly, the OECD promised to remove from the list any country that pledged to commit to the proposed standards and to remove any practices the OECD deemed harmful. [219] The OECD recommendations included sanctions against non-complying jurisdictions such as disallowing deductions and requiring comprehensive reporting on transactions with tax havens. [220] The OECD currently distinguishes the various complying tax havens by putting them on different lists.[221] The OECD operates with three lists: a "white list" of countries implementing the proposed standard, a "gray" list of countries that have committed to implementing the

212. *See* OECD, *supra* note 16.

213. *Id.* at 8–9 (noting the need to address the harmful consequences set forth by the G-7 countries and the proposal to establish guidelines to classify preferential tax regimes).

214. *See* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 96 (describing the organization's work to develop a list of tax haven jurisdictions).

215. *See id.* (noting the organization's important role in developing tax treaties).

216. *Tax Information Exchange Arrangements*, *supra* note 120, at 1.

217. *See* OECD COMM. ON FISCAL AFFAIRS, *supra* note 30, at 5–7 (updating OECD member countries on the results of the work).

218. *Id.* at 16–17 (commenting that the countries that had made a "public political commitment at the highest level . . . to eliminate their harmful tax practices" were not included in the list even if they met the tax haven criteria).

219. *See id.* at 12 n.5, 20 (noting the "dynamic nature" of the work, as well as the importance of not limiting focus to existing tax havens, and continuously anticipating that new jurisdictions may develop into tax havens).

220. OECD, *supra* note 16, at 56, 58. *See generally id.* at 52–59 (providing an exhaustive list of sanctions).

221. GRAVELLE, *supra* note 30, at 5.

standard, and a "black" list of countries that have not yet committed.[222] Many countries listed on the OECD's original "black" list protested because of the negative publicity and many now have signed agreements to negotiate TIEAs.[223] In 2009, the last four countries on the "black" list, none of which were included on the original OECD list—Costa Rica, Malaysia, the Philippines, and Uruguay—were moved to the "gray" list.[224] Furthermore, even if tax havens commit to or enter into TIEAs, this does not necessarily mean that they will choose to comply with these agreements, so removing the name from the list of non-complying tax havens does not necessarily mean that the problem has disappeared.[225] In fact, some argue that the lack of obligations for pledging tax havens is one of the primary shortcomings of the TIEAs.[226]

2. The European Union

The European Union has participated in several measures that impact the operation of tax havens; however, none directly seek to regulate these jurisdictions.[227] The European Union's overall goal to make competition fair by securing equal conditions for all competitors in a market implicitly allows the European Union to address the economic disparities caused by tax havens.[228] This includes the Savings Tax Directive, which orders all members of the European Economic Community (EEC) to exchange information regarding individual taxpayers' income from interest payments.[229] This includes

222. *Id.* To be placed on the "white" list, the OECD requires that the tax haven has signed twelve TIEAs. *Whiter than White*, *supra* note 145, at 37.

223. *See, e.g.*, David Crawford, *Tax Havens Pledge to Ease Secrecy Laws*, WALL ST. J., Mar. 13, 2009, at A1; Anthony Faiola & Mary Jordan, *Tax-Haven Blacklist Stirs Nations: After G-20 Issues Mandate, Many Rush to Get Off Roll*, WASH. POST, Apr. 4, 2009, at A7.

224. GRAVELLE, *supra* note 30, at 5.

225. *See* Evan Landre & Jonas Tjersland, *Må Fremlegge Bevis*, E24.NO (Jan. 28, 2011), http://e24.no/makro-og-politikk/maa-fremlegge-bevis/4006907?view=print (Nor.) (quoting Professor Guttorm Schelderup on why he believes the OECD should require more proof of cooperation than merely entering into the TIEA itself).

226. *Id.*

227. *See* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 98–99 (describing various efforts by the European Union to counter the effects of tax havens).

228. *See Policy Areas: Competition*, EUROPA: GATEWAY TO EUR. UNION, http://europa.eu/pol/comp/index_en.htm (last visited Dec. 26, 2011) ("The [EU] has wide powers to make sure businesses and governments stick to EU rules on fair competition."); GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 98–99 (describing how the directive contributes to reducing differences in competitive terms between institutions that offer savings products).

229. Council Directive 2003/48, art. 9(2), 2003 O.J. (L 157) 38, 43 (EC) ("The communication of information shall be automatic and shall take place at least once a

information about interest earned on deposits and income from other investment vehicles.[230] Income earned by trusts, as well as income from mutual funds, is excluded from the reporting requirements of the directive.[231] Importantly, the directive envisions a type of automatic exchange of information. Under the directive, the format of the information and its collection are automated, and thus tax havens do not retain any discretion regarding how to interpret these treaties.[232]

The most significant flaw of the Savings Tax Directive has been the many ways in which it can be circumvented. The rules are easy to avoid partly because "beneficial owner" in the legislation is defined as an individual.[233] Hence, the provisions of the directive may be avoided by placing the funds on deposit in the name of a company or by using a trust or a shell corporation.[234] These arrangements usually require the funds to be held by professional nominees or trust officers on behalf of the beneficial owners, but several strategies are available to allow the beneficiary to retain almost full control.[235]

Although the primary goal for the Savings Tax Directive is to avoid tax evasion, it also contributes to reducing economic disparities between institutions that offer different types of investments, subject to different tax treatment based on the jurisdiction those investments are located in.[236] However, some countries have objected to the directive and excluded themselves from the obligation to furnish the

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year, within six months following the end of the tax year of the Member State of the paying agent, for all interest payments made during that year.").

230. *Id.* art. 6, at 41–42 ("For the purposes of this Directive, 'interest payment' means: (a) interest paid or credited to an account, relating to debt claims of every kind . . . .").

231. *Id.* art. 4(1), at 40, art. 6(1), at 41 (defining interest payments as "interest paid or credited to an account, relating to debt claims of every kind" and paying agent as "any economic operator who pays interest to or secures the payment of interest for the immediate benefit of the beneficial owner").

232. *Tax Information Exchange Arrangements*, *supra* note 120, at 5.

233. Council Directive 2003/48, *supra* note 229, art. 2, at 40 ("'[B]eneficial owner' means any individual who receives an interest payment or any individual for whom an interest payment is secured, unless he provides evidence that it was not received or secured for his own benefit . . . .").

234. MARKUS MEINZER, TAX JUSTICE NETWORK, POLICY PAPER ON AUTOMATIC TAX INFORMATION EXCHANGE BETWEEN NORTHERN AND SOUTHERN COUNTRIES 5, 25 (2010), *available at* http://www.taxjustice.net/cms/upload/pdf/AIE_100926_TJN-Briefing-2.pdf.

235. *Europe and the Anti-States*, TAX JUST. NETWORK (Sept. 13, 2008, 11:52 PM), http://taxjustice.blogspot.com/2008/09/europe-and-anti-states.html.

236. *See* Council Directive 2003/48, *supra* note 229, art. 1(1), at 39 ("The ultimate aim of the Directive is to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident for tax purposes in another Member State to be made subject to effective taxation in accordance with the laws of the latter Member State.").

required information.[237] In these jurisdictions, foreign recipients of interest income may either choose to pay a small "withholding tax" or allow data regarding their financial status and interest income to be delivered to the tax authorities in their country of domicile.[238]

The European Union has also entered into multilateral agreements with a number of countries outside the European Economic Area (EEA) with the purpose of engaging in similar exchanges of information.[239] However, due to its inherent shortcomings, the European Commission concluded that the directive had not significantly changed the pattern of investment or savings.[240] To make it more efficient, the Commission proposed, as a first step, an extension of the directive that would also apply to other forms of investments, including trusts, thereby closing one important loophole.[241] As a second tool, the European Union has developed a "code of conduct" for tax systems.[242] When adopting this code of conduct, the European Union simultaneously analyzed the EU countries' current tax systems to identify violations of the norms.[243] The countries deemed to have violations were given until 2006 to correct these deviations.[244]

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237. The EU countries include Belgium, Luxembourg, Austria, and outside the EU, Guernsey, Jersey and the Isle of Man. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 98.

238. *Id.*

239. These countries include Andorra, Switzerland, Liechtenstein, as well as several Caribbean countries. *Id.*

240. *Commission Proposal for Amending Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments*, at 11, COM (2008) 727 final (Nov. 13, 2008).

241. *Id.* Annex 1 at 5.

242. *See Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the Work of the EU Joint Transfer Pricing Forum in the Field of Business Taxation from October 2002 to December 2003 and on a Proposal for a Code of Conduct for the Effective Implementation of the Arbitration Convention (90/436/EEC of 23 July 1990)*, at 9–17, COM(2004) 297 final (Apr. 23, 2004) (revising the Code of Conduct for business taxation); *Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Towards Tax Co-ordination in the European Union*, at 11–14, COM(97) 495 final (Oct. 1, 1997) (containing a draft Code of Conduct for business taxation); *see also* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 99 (giving a general overview of the work of the European Union).

243. COM(97) 495 final, *supra* note 242, at 5–6.

244. COM(2004) 297 final, *supra* note 242, at 5.

3. G-20 Countries

The G-20 is an economic forum comprised of the largest economies in the world.[245] The representatives at the forum are the member countries' finance ministers and central banks governors, representatives of the European Union, the International Monetary Fund (IMF), and the World Bank.[246] During the 2009 meeting in London, the forum addressed issues related to tax havens and Offshore Financial Centers.[247] The report from the meeting noted that these tax haven jurisdictions create significant problems for maintaining economic stability.[248] Although the meeting produced no specific regulation, it focused on the OECD list comprising the countries that qualify as tax havens and those who have refused to enter into agreements to exchange information for tax purposes.[249] The 2009 G-20 meeting suggested that sanctions may be brought against countries that fail to comply with "international standards" on transparency in tax issues.[250] By "international standards," the report arguably referred to the OECD's recommended TIEAs.[251] The report also noted that information exchange is not merely for the benefit for developed countries, but that underdeveloped countries could also reap the benefits of increased information exchange.[252] During this meeting, members appointed the Financial Stability Board to promote the

245. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 99; *see also About G-20: What Is the G-20?*, G-20, http://www.g20.org/en/g20/what-is-g20 (last visited Dec. 26, 2011) (explaining the mandate, origins, membership, and achievements of the G-20).

246. *About G-20: What Is the G-20?*, *supra* note 245.

247. *See generally* G-20, GLOBAL PLAN ANNEX: DECLARATION ON STRENGTHENING THE FINANCIAL SYSTEM 4–5 (2009), *available at* http://www.g20.utoronto.ca/2009/2009ifi.html (explaining the G-20's commitment to taking action against those jurisdictions that do not comply with tax transparency standards and outlining tools it plans to develop to address these issues).

248. *Id.* at 4.

249. *See* G-20, PROGRESS REPORT ON THE ACTIONS OF THE WASHINGTON ACTION PLAN 13–15 (2009), *available at* http://g20mexico.org/images/stories/canalfinan/docs/uk/10actionplan.pdf (summarizing some of the conclusions from the Conference).

250. G-20, *supra* note 247, at 4.

251. *See id.* at 1–4 (referring to several different organizations, including the World Bank and IMF, that endorse the OECD agreements); *see also* GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 99 (noting that it is likely that "international standards" refers to the recommended UN and OECD agreements on exchange of tax information).

252. *See* G-20, *supra* note 247, at 5 (noting the G-20's commitment to developing proposals to secure the benefits of the new tax environment).

development of a uniform policy on transparency for tax issues aimed at promoting economic stability.[253]

4. The Financial Stability Forum and the Financial Action Task Force

The Financial Stability Forum (FSF) was established by the G-7 countries to promote financial stability by focusing on international cooperation regarding the exchange of information and overview of financial markets.[254] The finance ministries, central banks, and regulatory authorities in the different member nations meet in the FSF.[255] The organization specifically targets poor information exchange and weak regulatory authorities in tax havens.[256] The work of FSF is largely based on the previous work of organizations such as OECD, IMF, and International Organization of Securities Commissions.[257] During its meeting in November 2008, the FSF specifically discussed the role of tax havens in bringing about, or intensifying the scope of, the recent financial crisis.[258] Additionally, the G-7 countries created the Financial Action Task Force (FATF) in 1989 to advise in the efforts to eliminate money laundering.[259] It is working based on a limited mandate that expires in 2012 and has issued several reports documenting the practices of money laundering.[260]

IV. CREATING A COMPREHENSIVE SOLUTION TO EFFECTIVELY REMEDY THE LACK OF INFORMATION EXCHANGE

Despite increasing global awareness of tax havens' detrimental effects, tax information exchange agreements have produced only marginal results and have failed to close the growing tax gap in the

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253. *See id.* at 1 (giving the Financial Stability Board instructions to develop guidelines to ensure cooperation and coordination between different jurisdictions relating to efforts to increase transparency).

254. In addition to the G-7 countries—United States, Germany, France, Canada, Italy, Japan and the United Kingdom—Switzerland, the Netherlands, Singapore, Australia, and Hong Kong are also members. GOV'T COMM'N ON CAPITAL FLIGHT FROM POOR COUNTRIES, *supra* note 15, at 93.

255. *Id.*

256. *Id.*

257. *Id.*

258. *Id.*

259. *Id.*

260. The organization has issued a report listing their main recommendations for combating money laundering. FATF, FATF 40 RECOMMENDATIONS (2003), *available at* http://www.fatf-gafi.org/dataoecd/7/40/34849567.pdf.

United States.[261] The lack of success in the fight against tax havens does not result from a lack of effort, but rather from policies that have failed to address the underlying reasons why tax havens exist. Governments have prioritized the use of tax information exchange and other international agreements without taking into account the effect these agreements would have on the tax havens themselves. What remains clear is that the current regulatory framework lacks international consensus. No one has reconciled work of the various international organizations that currently have projects to reduce the number of tax havens. Moreover, although the proposed Stop Tax Haven Abuse Act proposes some new techniques to reduce tax evasion, it also has inherent shortcomings, one of which is its lack of emphasis on finding a multinational solution. To summarize, an effective solution should contain both a multinational and a national strategy component. To effectively combat the tax haven problem, governments must also adopt policies that address why tax havens exist in the first place. These policies should focus on domestic development and should strengthen already existing laws, which, at present, are weak and underutilized. Additionally, the United States should take part in a multinational effort to solve the collective action problem by reducing the costs of regulation. Similarly, rather than trying to remedy the problem from outside, the United States should seek to include tax havens in the solution through incentives and penalties to ensure that the strategy comprehensively covers potential tax havens.

A. *Multinational Approach*

One of the inherent challenges in regulating a truly international problem is the issue of collective action. Although unilateral action plays an important role in the fight against tax havens, the collective action problem will not disappear until the world implements a unified international solution. Negotiating treaties requires both resources and time, and by organizing a joint effort these costs could be distributed across the participating countries. Therefore, the United States should continue to support the OECD's efforts to develop and perfect the model agreement and other initiatives. This approach would also minimize the detrimental effects caused by disparate bargaining positions because each TIEA would begin with the same premises.

A principal problem of dealing with tax havens is that if even a few of them do not cooperate with information exchange, tax evaders will likely shift their funds to the non-compliant countries, essentially rewarding the non-cooperating countries and deterring others from

261. *See supra* Part III.A.1.

cooperation.[262] One possible solution to address holdouts is to follow the strategy the European Union used in the Savings Tax Directive by imposing a withholding tax or allowing financial data to be delivered to the tax authorities in an individual's country of domicile for transactions with non-complying tax havens.[263] This could also be done on a smaller scale, for example, by refusing to allow deductions for payments to non-cooperating tax havens or restricting the ability of financial institutions to provide services with respect to tax haven operations.[264] Alternatively, the OECD could make the agreements contingent upon a fixed minimum number of tax havens entering into the agreement.[265] However, even though this would remedy the problem with holdouts, it would do little to incentivize tax havens to actually sign the agreement and could create a situation where the tax havens may be better off holding out uniformly. Additionally, non-tax havens could try to apply political pressure on non-complying tax havens.

The fundamental concern that much of the current regulatory framework fails to address is why tax havens exist in the first place. Since registration fees from foreign corporations are the main source of revenue for tax havens, the tax havens themselves have little incentive to combat harmful tax practices.[266] The primary product that these jurisdictions sell is privacy.[267] Therefore, cooperation is likely to have large repercussions for the tax havens because it would erode their primary product. This effect would be reinforced if tax evaders shift assets to non-cooperating tax havens. The inherent risk with attempting to remedy the problem from the outside is that once policymakers fix one loophole, tax evaders can simply find other ways to bypass the system. Therefore, a solution should incorporate financial

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262. *See supra* notes 143–44 and accompanying text.

263. *See European Union Savings Directive*, TAX JUST. BRIEFING (Tax Justice Network, Brussels, Belg.), Mar. 2008, at 1–2 (noting how a withholding tax has already been implemented in the Directive in lieu of an automatic exchange requirement for certain countries in which such a requirement is currently not feasible); *see also* Council Directive 2003/48/EC, *supra* note 229, pmbl. para. 16 (stipulating that Member States exchanging information pursuant to the directive may not rely on Article 8 of Directive 77/799/EEC, limiting the exchange of information).

264. *See* GRAVELLE, *supra* note 30, at 25 (mentioning a bill that would effectively disallow deductions until the income is repatriated).

265. *See* Addison, *supra* note 75, at 723 (suggesting that making the TIEAs contingent on a minimum number of signatories is the proper way to address holdouts).

266. *See, e.g.*, Ronen Palan, *Tax Havens and the Commercialization of State Sovereignty*, 56 INT'L ORG. 151, 163 (2002) ("[The tax havens'] 'core' business consists of charging 'rent' or license fees in return for granting firms a right to incorporate in their jurisdictions.").

267. *See* SENATE REPORT ON TAX HAVEN ABUSES, *supra* note 3, at 11 (explaining that offshore providers generally provide services and products that cannot be found onshore, including a "level of secrecy and tax avoidance").

incentives to induce tax havens to cooperate comprehensively with regard to information exchange and implementation of more stringent tax politics. The OECD could reward compliance by, for example, giving tax benefits that would make investments in the tax haven more attractive for U.S. investors. By providing financial incentives, the interests of tax haven and non-tax haven states can be better aligned to minimize the risk of non-compliance. Increased assistance to tax havens would enable these nations to shift their economies from reliance on offshore financial income to other sources of income. Because professionals such as lawyers and investment professionals in tax havens receive the bulk of offshore income, a subsidy approach could potentially increase the aggregate social welfare in tax havens.[268] If tax havens are not included in the process, the non-tax havens would essentially label the tax havens as the "bad guys."[269] Part of the challenge is that many tax havens have a lot of economic substance and real business activities taking place, but it is difficult for outsiders to distinguish between legitimate asset protection and efforts to limit taxation through lack of transparency.[270] On a similar note, it is important that non-tax havens do not attempt to dictate to any country what its tax rate should be or how its tax system should be structured. Rather, non-tax havens should encourage an environment of disclosure to ensure laws are applied on an open and consistent basis among similarly situated taxpayers, and that information needed by tax authorities to determine a taxpayer's situation is in place. This facilitates tax competition between countries, yet ensures that this competition takes place on equal terms with equal access to information.

Conversely, the OECD could use penalty provisions to induce compliance. For example, in the United States, the Tax Shelter and Tax Haven Reform Act envisions a "guilt" strategy by requiring public disclosure of jurisdictions identified as tax havens.[271] This provision would authorize the Treasury Secretary to issue a list of tax havens

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268. *See Tax Haven Hearing*, *supra* note 39, at 117 (statement of Professor Avi-Yonah) (noting that most of the financial benefits from tax haven operations flow to professional service providers).

269. *See* Democracy Now!, *Offshore Banking and Tax Havens Have Become Heart of Global Economy* (Apr. 15, 2011), http://www.democracynow.org/2011/4/15/offshore_banking_and_tax_havens_have (noting that several jurisdictions have resented being labeled with the term "tax haven," including Hong Kong, Barbados, and Vanuatu); Alan Markoff, *Caribbean Tax Havens Talk Back Against G20 'Finger Pointing,'* ISLAND J. (Sept. 26, 2009), http://www.islandjournal.net/reportc.htm?section=caribbeannewsnow&story=Caribbean-tax-havens-talk-back-against-G20-'finger-pointing'&id=19015&catid=30 (quoting statements by several Caribbean leaders as to the perceived unfairness of blaming tax havens for financial issues in other countries).

270. *Tax Haven Hearing*, *supra* note 39, at 19 (testimony of Comm'r Everson).

271. *Id.* at 12 (statement of Sen. Levin).

that fail to cooperate with U.S. tax enforcement and to exclude actors from receiving U.S. tax benefits for income in those jurisdictions.[272] The OECD could facilitate this by maintaining its "list" system but changing the criteria for removal from the list. Under its current state, a tax haven merely has to commit to entering into an agreement, without any sort of follow-up, to be removed from the black list.[273] Rather than accepting the commitment as sufficient evidence, the OECD should set a time limit that reduces the amount of time between a commitment to the date a tax haven first enters into an agreement. If the tax haven does not comply with this limit, it should receive an additional quarantine that excludes it from promotion to the gray list. In order to achieve "white" list status, the OECD should require more than just the signing of a single agreement. The OECD must ensure that the agreements are not rendered merely symbolic by forcing tax havens to include progress reports on their effective TIEAs and their intent to further negotiate and enter into TIEAs.

B. *Updating the Tax Information Exchange Agreements to Respond to Past Failures*

Even with a joint international initiative in place, the United States should nonetheless develop an independent strategy for dealing with tax havens. Thus, the United States should continue to enter into bilateral agreements with the various tax havens. Here, the OECD agreement should serve as a basis for the treaties but should be updated in order to maximize the efficiency of the exchange. This will enable tailoring of the information exchange to best fit the needs of the United States.

Most importantly, these agreements must be changed to reflect the updated model OECD agreement in order to maximize their efficiency. First, the agreements must address the issue of secrecy provisions. One option would be to only focus on the information exchange, however, this would require tax havens to create and maintain proper registries that contain the records sought. Second, the agreements must set the appropriate threshold for obtaining information. On the one hand, information could be automatically exchanged between the countries, similar to the approach taken in the EU Tax Savings Directive. This would most likely recover the highest

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272. *See* Tax Shelter and Tax Haven Reform Act of 2005, S. 1565, 109th Cong. § 401(a) (2005) (defining uncooperative tax havens and explaining the process in which the Secretary will issue a list of those jurisdictions).

273. OECD COMM. ON FISCAL AFFAIRS, *supra* note 30, at 16–17 (noting that a "public commitment" is sufficient to be removed from the list); *supra* Part III.B.1 (describing the list system applied by the OECD).

amount of revenue because it would require information reporting on all income paid to foreign entities.[274] Alternatively, the information could be triggered upon request, however, the requirements for submitting a successful request should be lower than that of today's bilateral agreements. This would extend the information exchange to cover civil, in addition to criminal, issues. Similarly, the agreements should avoid making a disclosure obligation contingent on violation of local law, and instead, the proper measure should be the laws of the requesting party. Another option would be a presumption strategy akin to the one applied in the Stop Tax Haven Abuse Act. By imposing a presumption of control, there would be added incentives for those already in compliance to disclose information.

Undoubtedly, the most effective type of exchange of information is automatic exchange of information, such that the country where an investment is made would automatically transmit the relevant information to the jurisdiction in which the investor resides, without having to submit a formal request. Such an automatic exchange provision, as opposed to information by request, would not require suspicion of a crime to override tax haven bank secrecy laws. Agreements requiring exchange of information only upon request are not as effective because such an exchange requires the requesting government to already have knowledge of the details of the records that it is requesting. The small number of requests for information made under the current system, and the even smaller likelihood of success for a given request make this clear.[275] Furthermore, an automatic exchange provision may increase voluntary compliance.[276] If taxpayers know that financial institutions have a legal duty to report income information to tax authorities, they are much more likely to file accurate returns.[277] Although automatic exchange provisions would impose larger costs on the dealing party due to the large amount of information that would need to be disclosed, creation of proper registries would eventually decrease both the burden and cost for the producing party. As a result, the United States should seek to include automatic exchange provisions in its bilateral agreements.

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274. This is also the approach that has been proposed by the Tax Justice Network. *Tax Information Exchange Arrangements*, *supra* note 120, at 5.

275. Letter from Bruno Gürtner, Chairman of the Int'l Bd., Tax Justice Network & Others, to Robin Moncrieff Oliver, Chair, Subcomm. on Exch. of Info., UN Comm. on Int'l Cooperation in Tax Matters 7 (Dec. 15, 2009), *available at* http://www.taxjustice.net/cms/upload/pdf/Info_Exchange_Letter_0912.pdf.

276. *See, e.g.*, OECD COMM. ON FISCAL AFFAIRS, IMPROVING ACCESS TO INFORMATION FOR TAX PURPOSES 30 (2000), *available at* http://www.oecd.org/dataoecd/3/7/2497487.pdf (noting that if taxpayers believe they are paying an unfair portion of the tax burden, non-compliance will likely increase).

277. *Id.*

C. *Creating a Comprehensive Approach for Regulating Tax Havens*

In addition to the steps set forth above, the United States should continue to draft legislation to assist with enforcement of the U.S. Tax Code and collection of taxes abroad. The IRS Commissioner, Mark Everson, specifically noted that even with effective agreements in place, the scope of the agreements rarely runs past the provision of information to actually facilitating collection by the IRS.[278] From a U.S. perspective, the Stop Tax Haven Abuse Act is a significant step towards expanding the IRS's toolbox. The Act allows the IRS to specifically target individuals and corporations that use tax havens to shelter income.[279] However, in order to successfully reduce the tax gap, it is also necessary to significantly increase the number and scope of audits and the resulting penalties for violations.[280] Currently, a very low number of tax returns are audited, in absence of high penalties for tax code violations; this will not be a significant deterrent for tax evaders.[281] Harsher penalties should be imposed upon individuals that participate in tax evasion to make up for the lower chance of getting caught.

Other benefits of the Stop Tax Haven Abuse Act are the various presumptions intended to reduce the IRS's burden in civil proceedings. Under the current agreement's conditions, the IRS essentially has to prove its case before it can obtain the information necessary to support its allegations, which renders it nearly impossible for the IRS to obtain any information from tax haven jurisdictions.[282] If the Act passes, the burden of proof would shift to the party transacting with entities located in the tax haven.[283] These presumptions would not only aid the

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278. *See supra* note 153.

279. *See* Stop Tax Haven Abuse Act, S. 506, 111th Cong. §§ 301–307 (2009) (focusing specifically on combating problems related to tax shelter promoters); *see also* S. 506 pmbl. ("To restrict the use of offshore tax havens and abusive *tax shelters* to inappropriately avoid Federal taxation, and for other purposes." (emphasis added)).

280. *See Tax Haven Hearing, supra* note 39, at 19 (testimony of Comm'r Everson) (testifying that one of his primary goals as Commissioner is to increase the number of audits on high-income individuals and corporations).

281. *See* INTERNAL REVENUE SERV., FISCAL YEAR 2007 IRS ENFORCEMENT AND SERVICE STATISTICS (2009), *available at* http://www.irs.gov/pub/newsroom/irs_enforcement_and_service_tables_fy_2007.pdf (showing that for the fiscal year 2007 only 2.87 percent of all tax returns filed by individuals with income exceeding $200,000 were subject to an audit by the IRS).

282. *See supra* Part III.A.1 (describing the challenges the IRS faces with the bilateral agreements, including dual criminality, lack of automatic exchange of information, and the detailed specificity that is required for any successful request).

283. This is a consequence of the presumption strategies described *supra* Part III.A.2.a. The burden shifts to the taxpayer to disprove that he had ownership or control over such entity, or that transfers did not represent taxable income. *See supra* Part III.A.2.a.

IRS in the proceedings themselves, but would also reduce the evidentiary burden during audits and other tax assessments. However, inherent risks exist in a presumption strategy. Most critically, this strategy may deter U.S. investment abroad because investors would fear invoking the provisions of the Act. This is especially problematic because a majority of investment vehicles contain some offshore component, effectively forcing a comprehensive restructurings of investments. Nevertheless, the difficulties of enforcing U.S. tax laws abroad in the past indicate that a presumption strategy, although harsh, may be an efficient solution.

Importantly, the Act would allow the United States to close some of the loopholes that currently exist. In particular, it would address the abuse of foreign trusts.[284] By increasing the pressure on trust administrators and protectors, the Act could potentially facilitate the collection of a substantial amount of information about U.S. taxpayers. If intermediaries in the transaction were required to inquire about and independently verify the ownership of foreign entities—information that they already must acquire to deal with money laundering—the IRS could obtain more information about these transactions, while also subjecting intermediaries to more scrutiny.[285] The Stop Tax Haven Abuse Act would impose further restrictions on foreign trusts by providing that any powers held by trust protectors would be attributed to the trust grantor, and by providing that any U.S. person who benefits from the trust would be treated as a formal beneficiary even if not named.[286] It also provides that any future or contingent beneficiary be treated as a current one, and would treat loans of assets and property as distributions.[287] Similarly, there is a problem with

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284. *See* S. 506 § 106 (explaining the proposed process to prevent "misuse of foreign trusts for tax evasion").

285. *See* GRAVELLE, *supra* note 30, at 30 (outlining the benefits of the Qualified Intermediary program).

286. *Id.* § 106(a) ("[A] grantor shall be treated as holding any power or interest held by any trust protector or trust enforcer or similar person appointed to advise, influence, oversee, or veto the actions of the trustee."); *id.* § 106(b) ("Any United States person receiving from a foreign trust cash or other property, or receiving the use thereof, shall be treated as a beneficiary of such trust regardless of *whether such person is a named beneficiary* . . . ." (emphasis added)).

287. *See id.* § 106(c) ("[I]f a foreign trust makes a loan of cash or other property . . . directly or indirectly to or by (A) any grantor or beneficiary of such trust who is a United States person . . . the amount of such loan . . . shall be *treated as a distribution* by such trust to such grantor or beneficiary . . . ." (emphasis added)); *id.* § 106(d) ("A United States person who directly or indirectly transfers property to a foreign trust . . . shall be treated as the owner . . . of such trust attributable to such property if for such year *or for any subsequent year* there is a United States beneficiary *including a contingent beneficiary* of any portion of such trust." (emphasis added)).

accepting shell companies as beneficial owners.[288] The Stop Tax Haven Abuse Act would deal with this through a provision that any publicly traded firm or form that has assets over $50 million is to be treated a U.S. corporation.[289] This strengthening of domestic policies will go a long way in closing the current loopholes for trusts and shell corporations.

Finally, the United States should try to incorporate country-by-country reporting whereby all multinational corporations report profits and taxes paid in all jurisdictions in their audited financial returns.[290] This would make it more difficult for multinational corporations to shift profits between jurisdictions because it would treat the company as a single entity, as opposed to the patchwork approach that is currently in place.[291]

V. CONCLUSION

Although the international community has expended much effort in an attempt to eliminate the number of tax havens, it is clear that much work still remains. This Note argues that countries should take both unilateral and multilateral action in addition to the regulations currently in place. Most importantly, these initiatives should attempt to address the underlying reasons why tax havens exist. By using a multinational organization such as the OECD, non-tax haven countries can apply pressure such that the immediate effect will not merely be a shift in assets from one tax haven to another, but a permanent solution characterized by openness and cooperation between governments and regulatory bodies. To increase the number of tax havens that

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288. *See, e.g.*, GRAVELLE, *supra* note 30, at 30 (citing a statement that this type of beneficial ownership is troublesome and a call for a revision of laws to close this loophole).

289. The relevant provision states:

> For purposes of any United States civil judicial or administrative proceeding to determine or collect tax, there shall be a *rebuttable presumption* that a United States person . . . who directly or indirectly formed, transferred assets to, was a beneficiary of, had a beneficial interest in, or received money or property or the use thereof from an entity, including a trust, corporation, limited liability company, partnership, or foundation . . . formed, domiciled, or operating in an offshore secrecy jurisdiction, exercised control over such entity.

Id. § 101(a)(1) (emphasis added).

290. *See Country-by-Country Reporting*, TASK FORCE ON FIN. INTEGRITY & ECON. DEV., http://www.financialtaskforce.org/issues/country-by-country-reporting (last visited Dec. 26, 2011) (outlining the details of country-by-country reporting and the benefits of the approach).

291. *See id.* (stating that the current approach requires each group within the corporation to report results separately, rather than as a unit).

voluntarily submit to regulation, any agreements or legislation should include both an incentive, such as some type of compensation for cooperating tax havens, and a penalty provision that sanctions non-cooperating tax havens. Furthermore, the United States should update its current Tax Information Exchange Agreements to broaden the scope and provide for automatic exchange of information. It is also worth noting that full compliance with tax laws is probably not desirable. The IRS needs to weigh the benefits of strict enforcement—reducing the tax gap and increasing tax revenue—against the costs of enforcement. Tax haven regulation should aim to strike an optimal economic balance between allowing tax competition and preventing the harmful effects that result from excessive secrecy.

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