How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland

I. INTRODUCTION 1824
II. BACKGROUND: SWITZERLAND, UBS, AND A LOOK TO THE FUTURE 1827
  A. *Switzerland and Its Role in Offshore Tax Evasion* 1827
  B. *Recent Controversies Surrounding Union Bank of Switzerland* 1828
  C. *Persisting Problems Despite the Recent Success in Fighting Tax Evasion via Swiss Banks* 1830
III. THE CURRENT STATE OF THE LAW AND WHAT IT LEAVES TO BE DESIRED 1832
  A. *Remedies Under Current Treaties with Switzerland* 1832
    1. The 1996 Convention 1832
    2. The 2003 Agreement 1834
  B. *The Gaps in the Current Legal Structure* 1836
IV. THE INADEQUACIES OF CURRENT PROPOSALS 1839
  A. *Chasing the Dream of Comprehensive Multilateral Treaties* 1839
  B. *Treaty Amendments: The 2009 Protocol* 1841
  C. *Congressional Action: A Unilateral Approach to a Bilateral Problem* 1844
    1. Stop Tax Haven Abuse Act 1845
    2. Foreign Account Tax Compliance Act 1849
  D. *Project Rubik: The Swiss Bankers Association Proposal* 1852
V. ADOPTING A BILATERAL WITHHOLDING SYSTEM 1854
  A. *Project Rubik: Respecting Swiss Privacy Laws and Collecting American Taxes Abroad* 1854
  B. *Making Project Rubik Work: Enforcing the Agreement and Recognizing Its Inherent Limitations* 1856

VI. CONCLUSION.. 1857

I. INTRODUCTION

It began with headlines of nearly $20 billion in hidden assets, 52,000 secret bank accounts, confidential informants, court proceedings, and a $780 million fine.[1] The Union Bank of Switzerland ("UBS") controversy, with all its dramatic appeal, attracted international attention and brought taxation issues to the forefront of public debate. As the scope of tax evasion activities involving UBS began to unfold, U.S. authorities on numerous fronts mobilized against international tax haven abuse—a problem much broader in scope than the scandal at hand.

In order to attract foreign capital to their respective markets, many countries have enacted favorable tax laws with regard to foreign investors.[2] All too happy to receive lower tax rates, or organically higher returns, taxpayers increasingly turn to markets outside their home countries.[3] At the same time, home countries often lack the tools and resources to keep up with their residents' offshore activities, thereby opening the door to tax evasion.[4] In the end, international competition for foreign investments, coupled with capital mobility, enables convenient tax-free investment[5] and leaves home countries in the dark and unable to collect their taxes.[6]

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1. *See infra* Part II.B; *see also* Bradley J. Bondi, *Don't Tread On Me: Has the United States Government's Quest for Customer Records from UBS Sounded the Death Knell for Swiss Bank Secrecy Laws?*, 30 NW. J. INT'L L. & BUS. 1, 2–3 (2010) (chronicling the UBS controversy).

2. Suzanne Walsh, Note, *Taxation of Cross-Border Interest Flows: The Promises and Failures of the European Union Approach*, 37 GEO. WASH. INT'L L. REV. 251, 256–57 (2005).

3. *Id.* at 256–57 (citing Howell H. Zee, *Taxation of Financial Capital in a Globalized Environment: The Role of Withholding Taxes*, 51 NAT'L TAX J. 587, 589 tbl.1 (1998)). While some argue that the flow of ever more mobile capital has commenced a "race to the bottom"—international competition for the most favorable taxation of foreign investment income—a normative discussion of tax policy is beyond the scope of this Note. *Id.* at 255–56 (quoting Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1581–82 (2000)). But few will contest that nations compete for foreign capital. This Note assumes that tax evasion that accompanies the international flow of money is a problem and should be remedied.

4. *Id.* at 256–57.

5. *See* Cynthia Blum, *Sharing Bank Deposit Information With Other Countries: Should Tax Compliance or Privacy Claims Prevail?*, 6 FLA. TAX REV. 579, 591 (2004) (noting that taxpayers' offshore activities have " 'thwart[ed] the collection of massive amounts of tax revenues.' " (quoting PERMANENT SUBCOMM. ON INVESTIGATIONS, S. COMM. ON U.S. GOV'T AFFAIRS, CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES (1985))).

6. Walsh, *supra* note 2, at 256.

Not surprisingly, wealthy Americans have exploited loopholes to take advantage of this phenomenon. While U.S. authorities struggle to enforce domestic tax laws beyond their borders,[7] U.S. taxpayers stand to benefit, albeit illegally: they invest offshore, omit the income produced from their tax returns, and employ a web of differing national legal regimes to avoid detection.[8] An estimated $100 billion of tax revenue evade the reach of U.S. authorities every year through the use of offshore tax havens.[9] In response, the Obama Administration has pledged to address the foreign tax shelter problem, which continues to burn holes in the U.S. Treasury.[10] In order to plug these holes, U.S. officials must focus their energies on creating a bilateral tax withholding system—the only feasible solution that promises relief in the near future.

This Note addresses the issues of, and solutions to, offshore tax evasion with a focus on Switzerland. As Part II.A illustrates, Switzerland is uniquely positioned among tax haven countries, making it an ideal paradigm for discussion. Swiss laws and tradition regarding banking secrecy make it an appealing tool for U.S. tax evaders. Part II.B outlines recent conflicts between U.S. authorities and one of Switzerland's largest banks that have brought offshore tax evasion to front pages of newspapers and the floor of Congress.[11] Upon exposure of a massive evasion scheme, U.S. authorities brought charges against Swiss and U.S. bankers and attorneys, as well as a

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7. *Id.*

8. Marla Carew & Eric Nemeth, *The Trouble with Foreign Financial Accounts*, MICH. BUS. J., Dec. 2009, at 34, 34 (" 'Some United States taxpayers are evading billions of dollars per year in United States taxes through the use of offshore accounts' " (quoting Press Release, John DiCicco, Acting Attorney Gen., U.S. Dep't of Justice Tax Div., Dep't of Justice Asks Court to Serve Summons for Offshore Records (Apr. 15, 2009), *available at* http://www.justice.gov/opa/pr/2009/April/09-tax-349.html)).

9. Bryan S. Arce, Note, *Taken to the Cleaners: Panama's Financial Secrecy Laws Facilitate the Laundering of Evaded U.S. Taxes*, 34 BROOK. J. INT'L L. 465, 467 (2009) (citing Mike Godfrey, *Senate 'Offshore' Hearing Called 'One-Sided'*, TAX-NEWS.COM (Aug. 3, 2006), http://www.tax-news.com/archive/story/Senate_Offshore_Hearing_Called_OneSided_xxxx24430.html; *UBS to Hand Over Small Amount of Data*, REUTERS (Nov. 14, 2009), http://www.reuters.com/article/idUSLE16175120091114 [hereinafter *UBS to Hand Over*]. Empirically, it is impossible to measure the true extent of offshore tax evasion and its effect on the U.S. Treasury, and consequently, tax gap numbers should be used with care. Nevertheless, the range of current estimates, as well as the amount of assets hidden from the IRS, illustrates the magnitude of the problem at hand.

10. Wayne Tompkins, *Reaction to UBS Debacle: Tough New Tax Laws*, DAILY BUS. REV., Nov. 5, 2009, *available at* http://www.law.com/jsp/article.jsp?id=1202435186330. Admittedly, competition for foreign investment through favorable taxation can be defended on national sovereignty or free market principles. But losses to the U.S. treasury are undeniably detrimental from a domestic perspective and therefore must be remedied.

11. Thus, a focus on Switzerland not only makes this discussion more relevant, but hopefully more interesting as well.

Swiss bank. Out of these indictments grew several settlements and a tax amnesty program unprecedented in scale. But while much progress has been made, the problem of offshore tax evasion persists. As discussed in Part II.C, a more systemic approach is needed to effectively enforce U.S. tax laws abroad.

Part III analyzes the current legal structure governing tax issues between Switzerland and the United States. Part III.A examines two tax treaties between the countries, the 1996 Convention and the 2003 Agreement, and discusses the tools they provide to U.S. tax authorities. Part III.B points out what is implicit in Part II—that current treaties are inadequate to protect the Treasury against Americans hiding money in Swiss bank accounts. It exposes the remaining holes in the current treaty structure through which tax dollars are drained from the Treasury.

Part IV explores the merits of various responses to the offshore evasion problem. Part IV.A explains why comprehensive multilateral tax treaties, the nirvana for tax authorities, are unrealistic, unattainable, and a waste of time and resources. Part IV.B examines a 2009 Treaty Protocol, not yet ratified as of this Note's publication, that may bring more uncertainty than relief to the offshore tax evasion dilemma. Next, Part IV.C outlines two legislative solutions[12] that seek to regulate U.S. offshore investments by imposing new disclosure requirements on foreign institutions subject to U.S. jurisdiction. Lastly, Part IV.D examines Project Rubik, a preliminary proposal by the Swiss Bankers Association, designed to alleviate international disagreements without sacrificing Swiss banking secrecy.

Finally, Part V shows that a bilateral withholding system, which consists of collecting U.S. tax dollars while retaining Swiss banking privacy, is the ideal solution. For the reasons discussed below, a withholding system based on Project Rubik that also borrows ideas from recently enacted legislation offers distinct advantages and avoids the major pitfalls of the alternative proposals. Only a mutually acceptable solution that respects U.S. tax enforcement concerns and Swiss privacy regimes can mitigate the multi-billion-dollar revenue loss caused by tax haven abuse.

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12. As further discussed below, one of these proposals has since been enacted, even if its scope will remain uncertain until the IRS issues interpretive guidance. *See infra* Part IV.C (discussing past Congressional action with respect to the prevention of international tax evasion).

II. Background: Switzerland, UBS, and a Look to the Future

A. Switzerland and Its Role in Offshore Tax Evasion

American tax evaders have used a number of tax havens spread across several continents. But one country in particular, a Mecca of banking secrecy, has attracted an undue share of attention: Switzerland. Thanks to its long tradition of banking secrecy, codified around the time of World War II,[13] and recently discovered missteps by one of its largest banks, UBS, Switzerland has been at the center of the international tax evasion debate.[14] Serving not only as a capital but as a synonym for banking secrecy, Switzerland plays a role of unique importance in the offshore tax evasion debate. Dealing with Switzerland may serve as a precedent for other jurisdictions. But to understand Switzerland's position in the bank secrecy debate, one must appreciate the history of Swiss privacy protection.

The Swiss view their tradition of secrecy as a protection of the individual, "a defining characteristic of Swiss culture and a pillar of the Swiss economy."[15] After many Europeans began depositing their money abroad to protect themselves against post-World War I hyperinflation, the Nazis in Germany tried to stop the outflow of capital.[16] As part of their efforts, the Nazis made it a capital offense to keep undisclosed assets abroad.[17] Once Germany began executing citizens for violating that law, the Swiss enacted legislation that criminalized disclosure of bank information.[18] Rather than a conspiracy against tax regimes around the globe, Swiss banking secrecy must therefore be understood as a protection against political persecution and infringements against privacy.

Describing Swiss banking practices as a crutch for crooks is thus not only inaccurate but also unfair, especially since banking secrets have their limits. Switzerland has laws in place to prevent the

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13. Carolyn B. Lovejoy, *UBS Strikes a Deal: The Recent Impact of Weakened Bank Secrecy on Swiss Banking*, 14 N.C. BANKING INST. 435, 442–43 (2010); Erich I. Peter, *Reasonable Limits of Transparency in Global Taxation: Lessons from the Swiss Experience*, 28 TAX NOTES INT'L 591, 615 (2002); Greg Brabec, Note, *The Fight for Transparency: International Pressure to Make Swiss Banking Procedures Less Restrictive*, 21 TEMP. INT'L & COMP. L.J. 231, 233 (2007).

14. *Swiss Bank Settles U.S. Tax Charges, Mounting U.S. Pressure on Swiss Bank Secrecy*, 103 AM. J. INT'L L. 338, 338–40 (2009) [hereinafter *Swiss Bank Settles*].

15. Bondi, *supra* note 1, at 1; *see also* Peter, *supra* note 13, at 615 ("Although the law speaks of bank secrecy, the term 'bank customer secrecy' is more accurate since it concerns a right of bank customers.").

16. Brabec, *supra* note 13, at 233.

17. *Id.*

18. *Id.* at 233–34.

abuse of its banks by terrorists and money launderers and furthermore applies a principle of proportionality to judge whether the banking secret should be lifted to expose potential wrongdoing.[19] In essence, a terrorist cannot hope for the privacy protections of a potential tax evader, as his crime creates a more compelling case for penetrating bank secrecy laws.[20] In sum, the Swiss are not opposed to lifting the veil of bank secrecy, but they do regard it as a precious privilege and will refuse to disturb it absent a compelling reason to the contrary.[21]

B. Recent Controversies Surrounding Union Bank of Switzerland

U.S. authorities have brought proceedings against and have convicted numerous Swiss and American individuals for their involvement in various evasion schemes.[22] Most notably, in June 2008 UBS banker Bradley Birkenfeld pleaded guilty to, and has since been sentenced for, conspiring to defraud the United States.[23] Mr. Birkenfeld also unveiled an evasion scheme that led to the well-publicized UBS settlements the following year.[24] According to court documents, UBS circumvented reporting requirements imposed under an earlier IRS settlement by helping Americans open accounts under the cover of nominees and sham entities.[25] The account holders, no longer indentified as beneficiaries, then filed false tax returns with the IRS, omitting information related to their UBS accounts.[26] Following the subsequent criminal investigation, UBS admitted its missteps in helping 19,000 Americans conceal approximately $20 billion in secret

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19. *See* Peter, *supra* note 13, at 607 (explaining the principle of proportionality and its strong support among the Swiss population). *See generally id.* at 596–604 (discussing the limits of Swiss banking secrecy, covering money laundering, organized crime, terrorism and terrorism financing, corruption, and certain fiscal offenses).

20. *Id.* at 607. Viewed in this light, the seemingly fundamental disagreements over banking secrecy between the Swiss and Americans can even be recast as a matter of how broad a right to privacy should be.

21. In that regard, Swiss banking secrecy is not unlike the professional confidentiality Americans know from their interactions with doctors and attorneys.

22. Lynnley Browning, *New Jersey Businessman, a UBS Client, Pleads Guilty to Tax Evasion*, N. Y. TIMES, Sept. 26, 2009, at B3, *available at* http://www.nytimes.com/2009/09/26/business/26ubs.html?_r=1&dbk; Press Release, Dep't of Justice, UBS Client Pleads Guilty to Failing to Report $6.1 Million in Swiss Bank Accounts (Sept. 25, 2009), *available at* http://www.justice.gov/tax/txdv091027.htm.

23. Lovejoy, *supra* note 13, at 440; Lynnley Browning, *Ex-UBS Banker Seeks Billions for Blowing Whistle*, N.Y. TIMES, Nov. 27, 2009, at B1, *available at* http://www.nytimes.com/2009/11/27/business/27whistle.html; Press Release, Dep't of Justice, *supra* note 22.

24. Lovejoy, *supra* note 13, at 440; Press Release, Dep't of Justice, *supra* note 22.

25. Press Release, Dep't of Justice, *supra* note 22.

26. *Id.*

accounts and agreed to a $780 million fine.[27] In response to further charges filed by U.S. authorities, the bank later agreed to disclose information on 4,450 secret accounts.[28]

The UBS settlements and, more specifically, the disclosure provisions have been heralded by some as a severe blow to Switzerland's prized banking privacy.[29] Others are less enthusiastic about the progress the disclosures represent.[30] But regardless of how successful recent efforts might prove in eroding tax evasion, UBS seems to have had enough. The bank reportedly directed many U.S. clients to move their business elsewhere and has even threatened to freeze accounts.[31] Likewise, many other foreign banks, not just in Switzerland, are no longer accepting U.S. clients, even if the clients can prove compliance.[32] At least in the short-term, the UBS debacle appears to have had a strong deterrent effect.

The UBS settlements also led to other, possibly more meaningful, inroads against U.S. tax evaders. Part of the agreement was a U.S. amnesty program allowing tax evaders to voluntarily step forward, report undeclared assets, and pay lower fines and avoid

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27. *Swiss Bank Settles*, *supra* note 14, at 338; Press Release, Dep't of Justice, *supra* note 22.

28. Carrick Mollenkamp et al., *UBS to Give 4,450 Names to U.S.: Tax-Evasion Pact May Disclose 10,000 Clients; Swiss Government Selling Stake*, WALL ST. J., Aug. 20, 2009, at C1; John Pacenti, *UBS Drops American Account Holders as Tax Amnesty Deadline Approaches*, DAILY BUS. REV., Oct. 13, 2009, *available at* http://www.law.com/jsp/law/international/LawArticleIntl.jsp?id=1202434482373; Martha Neil, *U.S. Tax Probe 'May Spread Like Wildfire' After UBS Settlement*, ABA JOURNAL.COM (Sept. 18, 2009), http://www.abajournal.com/news/article/us_tax_probe_may_spread_like_wildfire_after_ubs_settlement/; *UBS to Hand Over*, *supra* note 9. The U.S.-Swiss agreement can be found at Agreement Between the United States of America and the Swiss Confederation, U.S.-Switz., Aug. 19, 2009, http://www.usdoj.gov/opa/documents/us-swiss-agreement.pdf [English], http://www.admin.ch/ch/d/as/2009/5669.pdf [German], *amended by* Protokoll zur Änderung des Abkommens zwischen der Schweizerischen Eidgenossenschaft und den Vereinigten Staaten von Amerika über ein Amtshilfegesuch des Internal Revenue Service der Vereinigten Staaten von Amerika betreffend UBS AG, einer nach schweizerischem Recht errichteten Aktiengesellschaft unterzeichnet in Washington am 19. August 2009 [Protocol for the Amendment of the Agreement Between the Swiss Confederation and the United States of America], Mar. 31, 2010, http://www.admin.ch/ch/d/ff/2010/3027.pdf.

29. Curt Anderson, *IRS Settles With 14,700 Over Foreign Accounts*, DAILY HERALD, Nov. 17, 2009, at 2 (quoting IRS Commissioner Douglas Shulman); Carrick Mollenkamp, *More Banks in Europe Identified in Tax Probe*, WALL ST. J., Aug. 19, 2009, at C1; Mollenkamp et al., *supra* note 28.

30. Anderson, *supra* note 29 (quoting Sen. Carl Levin, who called the criteria for choosing on which accounts UBS must disclose disappointing: "[The agreement] complicates and muddies what should have been a straightforward agreement, by UBS and the Swiss government to disclose Swiss accounts hidden from the United States by U.S. account holders"); Mollenkamp et al., *supra* note 28 (quoting Sen. Carl Levin: "The UBS settlement is at most a modest advance in the effort to end bank secrecy abuses, tax haven bank misconduct, and the tax haven drain on the U.S. treasury.").

31. Pacenti, *supra* note 28.

32. Tompkins, *supra* note 10.

criminal prosecution.[33] By the deadline of the program, over 14,700 U.S. taxpayers had reported billions of dollars in assets in offshore accounts, not only with UBS or other Swiss banks, but in banks around the world.[34]

C. Persisting Problems Despite the Recent Success in Fighting Tax Evasion via Swiss Banks

Given the unprecedented success of the UBS settlements and the amnesty program, why should Americans still be worried about international tax evasion?

First, the now-reported assets are but a small piece of the pie. If Senator Carl Levin's estimates are realistic, then the United States loses around $100 billion in tax revenue through international tax evasion every year.[35] The reported $20 billion in assets with UBS only accounts for a fraction of that tax gap.[36] Likewise, the 4,450 accounts subject to disclosure represent but a share of the 52,000 UBS accounts for which the IRS initially sought information.[37] In light of these numbers, the 14,700 voluntary disclosures under the amnesty program represent a mere partial success.

Another reason for continued worry stems from the IRS's limited resources, which only allow for the prosecution of approximately 1,000 criminal tax cases per year, which is well short of the number of cases that can be expected to arise from the recent enforcement effort.[38] Complicating the problem is the fact that international evasion cases are particularly resource-intensive.[39] Even where the IRS knows the identity and methods of a particular tax

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33. *UBS to Hand Over*, *supra* note 9.

34. Anderson, *supra* note 29.

35. *UBS to Hand Over*, *supra* note 9.

36. *See* Lauren Gardner & Daniel Pruzin, *Geithner Signs Protocol to U.S.-Swiss Treaty To Provide Greater Tax Information Exchange*, Int'l Tax Monitor (BNA) (Sept. 24, 2009) (noting that UBS clients were accused of concealing approximately $20 billion in assets with UBS); *see also* Bondi, *supra* note 1, at 11 ("The deal required UBS to produce the names of . . . United States citizens whose accounts are believed to hold as much as $18 billion in assets."). Even if Senator Levin's popularly quoted tax gap figure is an overstatement, a Senate report has suggested that $40–70 billion escape the Treasury through offshore evasion practices. Compared to those numbers, taxes collected on $20 billion of assets will still only account for a relatively small share of missing tax revenues. Arce, *supra* note 9.

37. *Swiss Bank Settles*, *supra* note 14, at 339; Pacenti, *supra* note 28; Laura Saunders, *Tax-Cheat Showdown: Fess Up or Stay Quiet?*, WALL ST. J., Aug. 14, 2009, at C1.

38. Saunders, *supra* note 3.

39 *See* TAX DIV., DEP'T OF JUSTICE, FY 2008 PERFORMANCE BUDGET 48 ("As these offshore evasion schemes become common forms of tax cheating, the work of both IRS criminal investigators and federal prosecutors will become far more demanding and resource intensive."), *available at* http://www.justice.gov/jmd/2008justification/office/13_01_justification.doc.

evader, obtaining the evidence necessary to secure a conviction may prove difficult, especially where foreign bank secrecy laws are involved. Furthermore, the amount of information likely to be collected from the nearly 15,000 volunteers may easily become overwhelming. Processing that information to expose undisclosed evasion schemes will consume additional resources, as will the information-gathering process necessary to actually go after tax evaders still in hiding.

Consequently, U.S. taxpayers with hidden offshore assets may continue their hide-and-seek game with the IRS, relying on the resource limitations of the tax authority.[40] Even if detected, these evaders may not ultimately be convicted, given the complexities of international tax cases. Especially where the chance of prosecution is low, and the cost of defending a possible charge lower than the expenses related to coming clean, U.S. tax evaders may decide that hiding is the better option. One factor in that gamble might be the Obama Administration's plea for funding for 800 additional IRS agents and more offshore offices.[41] Nevertheless, it remains to be seen how effective the additional resources, if granted, would be in producing results.

Lastly, a temporary success does not necessarily lead to long-term improvement, as the offshore tax evasion problem is capable of repetition. Doubtlessly, the IRS has successfully stirred up the tax evasion community, but how long the success will last depends upon how the IRS proceeds from this point forward. To maximize the deterrent effect of criminal sanctions, the IRS can be expected to pursue the most high-profile cases, but will be forced to forgo many others.[42] As history shows, amnesty programs may attract only a small share of tax evaders,[43] suggesting that many others may still be in hiding.

Considering the large, yet unaccounted for tax gap, the resource limitations of the IRS, and the possibility that the offshore evasion problem may repeat itself, a systemic solution is needed. Part III analyzes what tools U.S. authorities possess to increase tax compliance under current legal structures.

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40. *Id.*

41. Laura Saunders, *IRS Touts Its Amnesty, Trains Sights on Evaders*, WALL ST. J., Oct. 15, 2009, at C7.

42. Saunders, *supra* note 37.

43. Blum, *supra* note 5, at 592; *see also* Saunders, *supra* note 41 (noting that only a few years ago a similar amnesty program attracted a mere 1,300 taxpayers).

III. The Current State of the Law and What It Leaves to Be Desired

A. Remedies Under Current Treaties with Switzerland

Tax treaties between Switzerland and the United States are pivotal to enforcing U.S. tax laws against U.S. clients of Swiss banks. Currently, two treaties govern the taxation landscape between the two countries: the 1996 Convention Between the United States and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income ("1996 Convention") and the 2003 Information Exchange Agreement ("2003 Agreement"). This Subpart analyzes each in turn, discussing the tools they provide for the IRS to enforce U.S. tax laws in Switzerland.

1. The 1996 Convention

The 1996 Convention replaced the earlier 1951 Convention and aimed to "provide[] for maximum rates of tax to be applied to various types of income, protection from double taxation of income, *exchange of information*, and rules to limit the benefits of the Convention . . . ."[44] Relevant to this discussion is Article 26 of the 1996 Convention ("Old 26") on Exchange of Information. President Clinton praised Old 26 as expanding the scope of information exchange by giving U.S. authorities access to Swiss bank information in cases of tax fraud, a purportedly broad category.[45]

But closer examination of the treaty itself reveals a fair degree of puffery in the former President's statements. So what tools does the treaty give U.S. authorities? Old 26 requires the "exchange [of] such information . . . as is necessary . . . for the prevention of tax fraud or the like . . . ."[46] However, one will look in vain for a definition of "tax fraud or the like" in the treaty itself. Instead, the Protocol to the Convention sets out that "the term 'tax fraud' means fraudulent conduct that causes or is intended to cause an illegal and substantial reduction in the amount of the tax paid to a Contracting State."[47] While that definition is not itself clear (for instance, what is "illegal" or "substantial"?), the protocol specifies that tax fraud includes "acts

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44. 1996 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, U.S.-Switz., May 29, 1997, S. TREATY DOC. No. 105-8 (emphasis added) [hereinafter 1996 Convention].

45. *Id.*

46. *Id.* art. 26, para. 1.

47. *Id.* Protocol, para. 10.

that . . . constitute fraudulent conduct with respect to which the requested Contracting State may obtain information under *its* laws or practices."[48] The problem with this definition is that tax fraud in Switzerland is defined very narrowly. It involves using falsified documents other than the tax return in order to deceive or, absent such documents, willful deceit to evade taxes.[49] Under Swiss law, without such conduct, bank secrecy will not be lifted and a banker who reveals client information may even face jail time.[50]

By comparison, tax evasion is not considered a criminal offense in Switzerland and, therefore, cannot trigger reporting obligations under the 1996 Convention.[51] Paragraph 1 of Old 26 clarifies that "[n]o information shall be exchanged which would disclose any trade, business, industrial or professional secret or any trade process."[52] Banking privacy is considered a professional secret in Switzerland and is therefore exempt from disclosure absent tax fraud.[53]

But the protocol also orders exchange of information in certain instances of fraudulent conduct that does not amount to tax fraud under Swiss law.[54] Under the Convention's protocol, "fraudulent conduct" is assumed where the taxpayer uses, or intends to use, false documents or a "scheme of lies ("Lügengebäude") to deceive the tax authority."[55] Commentators have argued that, in the aggregate, these definitions provide two separate classes of tax fraud—one tied to the laws of the requested state, the other independent of domestic laws.[56] However, as the above discussion illustrates, even the grounds for disclosure that are not tied to domestic laws closely mirror the Swiss definition of tax fraud.

Therefore, a closer reading of the 1996 Convention's information exchange provisions reveals their inadequacies and their limited utility in the effort to stop evasion of U.S. taxes. The agreement provides for information exchange in a narrow category of tax fraud cases, which must involve more than the mere filing of a false or incomplete tax return.

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48. *Id.* (emphasis added).

49. Peter, *supra* note 13, at 628.

50. *Id.* at 615.

51. *Id.* at 602, 629; Bondi, *supra* note 1, at 5–6.

52. 1996 Convention, *supra* note 44, art. 26, para. 1.

53. *Id.* Memorandum of Understanding, para. 8(d); Peter, *supra* note 13, at 627.

54. 1996 Convention, *supra* note 44, Protocol, para. 10.

55. *Id.*

56. Beckett G. Cantley, *The New Tax Information Exchange Agreement: A Potent Weapon Against U.S. Tax Fraud?*, 4 HOUS. BUS. & TAX L.J. 231, 237 (quoting W. Warren Crowdus, *U.S. Switzerland Sign Income Tax Treaty*, 13 TAX NOTES INT'L 1983, 1991–92 (1996)).

2. The 2003 Agreement

Having recognized the limitations of the 1996 Convention, U.S. authorities soon approached Switzerland to negotiate further.[57] Subsequent discussions eventually led to the much shorter 2003 Agreement, which was intended to expand upon Old 26.[58] Initially, the 2003 Agreement provides that Article 26 of the 1996 Convention and paragraph 10 of the accompanying protocol should be interpreted so as to further administration and enforcement of U.S. and Swiss tax laws "to the greatest extent possible."[59] However, the meat of the 2003 Agreement is in its more thorough definition of "tax fraud or the like."

Understanding 4(b) expands that definition to include the destruction of, non-production of, or failure to keep records that are legally required and establish figures that must go on a person's tax return.[60] Understanding 4(b) applies in cases where those figures were not properly reported on the return.[61] In essence, this means that taxpayers have to create, keep, and produce evidence of their own tax evasion, where they have a legal duty to have such records. Further, Understanding 4(c) includes within the ambit of "tax fraud or the like" the failure to file a tax return when coupled with "an affirmative act that has the effect of deceiving the tax authorities making it difficult to uncover or pursue the failure to file."[62] Such affirmative acts include concealing assets, covering up sources of income, and avoiding the creation of records.[63] Like Understanding 4(b), subsection (c) aims mainly at the creation and preservation of tax evasion evidence.

Understanding 4 is not exhaustive, but merely illustrates what the parties to the Agreement had in mind.[64] But, by extension, it limits the definition of tax fraud. The cited sections evince a concern for the existence of tax evasion evidence. They do not sweep tax

57. Peter, *supra* note 13, at 628–29.

58. *See* Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Income Tax Convention of October 2, 1996, U.S.-Switz., Jan. 23, 2003, https://www.treas.gov/press/releases/mutual.htm [hereinafter 2003 Agreement] (contrasting Article 26 of the 1996 Convention with the provisions of the 2003 Agreement); *see also* Cantley, *supra* note 56, at 241 ("In order to effectuate the 2003 Agreement's purpose of expanding information sharing between the two countries there are six (6) understandings agreed upon between the two countries.").

59. 2003 Agreement, *supra* note 58, para. 1.

60. *Id.* para. 4(b).

61. *Id.*

62. *Id.* para. 4(c).

63. *Id.*

64. *Id.* para. 4.

evasion itself into the fraud category, nor do they address the non-payment or underpayment of taxes directly.[65]

With regard to individual cases, Understanding 5 of the 2003 Agreement orders the exchange of information where one of the treaty parties has made a request based on a "reasonable suspicion" of tax fraud or the like.[66] Among other things, such a suspicion can be based on a variety of documents, taxpayer testimonial information, credible information from an informant, or circumstantial evidence.[67] Read in its entirety, Understanding 5 obligates a party to satisfy information requests by the other if the request is based on particular evidence of specific fraudulent conduct.

To further clarify what constitutes "tax fraud or the like" under Old 26 and when information must be exchanged, the 2003 Agreement includes fourteen "illustrative" hypotheticals.[68] These examples further underscore the treaty's focus on securing evidence of tax evasion which has come to the requesting state's attention. The hypotheticals involve false documents or records;[69] failure to file a tax return;[70] failure to produce records upon request;[71] a tax shelter scheme;[72] or a scheme of lies such as creation of a sham corporation to disguise the tax payer's identity.[73] Compared to the 1996 definition of tax fraud, these fourteen scenarios provide an illustration, but hardly a meaningful expansion, of that definition. The 1996 Convention already applied to conduct involving false records or a "scheme of lies."[74] What is new under the 2003 Agreement is that failure to file a

65. *See id.* ("It is understood that the following conduct constitutes 'tax fraud or the like'. . . . It is understood that these examples are by way of illustration, and not by way of limitation.").

66. *Id.* para. 5.

67. *Id.*

68. *Id.* para. 6, app.

69. *See id.* app., Hypotheticals 1–3, 6, 8. (illustrating five instances when keeping false records compelled a requested country to disclose banking information). Hypothetical 7 does not relate to use of falsified records, but arguably to a failure to keep complete records as legally required.

70. *See id.* app., Hypotheticals 11–14 (illustrating four examples of failure to file a tax return resulting in required disclosure of banking information).

71. *See id.* app., Hypothetical 4 (illustrating an instance where a requesting state does not receive records from an individual subject to its income tax and the requested state must disclose banking information).

72. *See id.* app., Hypotheticals 9–10 (illustrating two situations where individuals subject to a requesting state's income tax promote tax shelters in the form of façade corporations and the requested state must disclose banking information).

73. *See id.* app., Hypotheticals 5, 13, 14 (illustrating situations where an individual subject to a requesting state's income tax uses a business name instead of his real name or the individual creates a façade corporation to accept his income).

74. 1996 Convention, *supra* note 44, Protocol, para. 10.

return or produce documents upon request now constitutes tax fraud.[75]

The fourteen hypotheticals also clarify on what evidentiary basis information may be requested. In each example, authorities of one state have identified a suspected tax evader and already possess some evidence about the evasion scheme.[76] As the examples show, the type of evidence that can support a reasonable suspicion of tax fraud can take many forms—including written records and information from informants.[77] Once authorities possess that evidence, the 2003 Agreement entitles them to bank account information from the requesting state to bolster their investigation.[78] This express information exchange provision has led commentators to herald the 2003 Agreement as "an easing of Swiss banking secrecy laws with respect to fraud committed by U.S. persons" and "likely [to] have a significant impact on how business is conducted within its borders with respect to U.S. taxpayers."[79]

But, as the UBS debacle shows, that prediction may have been a little optimistic. So what are the remaining loopholes in the treaty structure? What obstacles remain to effective enforcement of U.S. tax laws against tax cheats using Swiss banks to evade taxes? Subpart B will address these issues by examining the shortcomings of the 1996 Convention and the 2003 Agreement and laying out the framework for an effective solution to this tax evasion problem in the process.

B. The Gaps in the Current Legal Structure

As the above discussion suggests, the U.S.-Swiss taxation treaties are limited in two significant respects—the scope of tax fraud and the basis for triggering information exchange obligations.

Even under the 2003 Agreement, tax fraud still excludes simple tax evasion. Without more, tax evasion does not amount to the kind of conduct that may trigger information exchange obligations.[80] A U.S. taxpayer who underreports his income and hides his undeclared funds in a Swiss bank account does not have to fear disclosure to U.S.

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75. 2003 Agreement, *supra* note 58, para. 4; *see also id.* app., Hypotheticals 4, 11, 13–14 (illustrating situations where failure to file a return or produce documents on request trigger the requirements for situations constituting "tax fraud or the like").

76. *Id.* app.

77. *Id.*

78. *Id.* para. 5.

79. *E.g.*, Cantley, *supra* note 56, at 253.

80. *See* 2003 Agreement, *supra* note 58, para. 4 (where all three examples involve conduct beyond mere tax evasion).

authorities. He will not come within the ambit of the 2003 Agreement until he fabricates documents, fails to maintain legally required records, hides behind a scheme of sham corporations, or fails to file a tax return altogether.[81]

For the individual taxpayer, these provisions are no more difficult to circumvent than the tax laws in general. If the taxpayer does not defraud a third party, Understanding 4(a) does not apply.[82] To escape Understanding 4(b), the individual must refrain from covering up the paper trail ancillary to his evasion activity.[83] But unless he has a legal obligation to create, keep, or produce records of his financial activity, the taxpayer may not even need to hide his tracks, his foreign bank records being the only evidence of tax evasion. Therefore, undeclared income, depending on its source, could be diverted into a Swiss account and not reported on the taxpayer's return. In that scenario, the individual would not commit tax fraud as defined by Understanding 4(b). Lastly, Understanding 4(c) can easily be circumvented by filing a tax return, a necessary omission to committing tax fraud under that subsection.[84]

Yet more detrimental to effective enforcement is the passive nature of the Agreements. Neither the 1996 Convention nor the 2003 Agreement entitle U.S. authorities to routinely obtain bank account information or to conduct audits.[85] Instead, U.S. officials must find the tax evader independently and obtain enough evidence to support a "reasonable suspicion" of tax fraud.[86] Although the directive to "exchange such information [as is] necessary . . . for the prevention of tax fraud or the like"[87] sounds like an affirmative, preemptive duty to report suspicious behavior to the treaty partner, such an interpretation would be misguided. First, the explicit protection of professional secrets[88] would be meaningless if information could be shared without evidence of a specific instance of tax fraud. Second, a treaty partner need not "supply particulars which are not procurable under its own legislation."[89] Since Swiss banking secrecy is protected by the Swiss Civil Code, the Swiss Code of Obligations, the Swiss

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81. *Id.*

82. *Id.* para. 4(a).

83. *Id.* para. 4(b).

84. *Id.* para. 4(c).

85. 2003 Agreement, *supra* note 56, 1996 Convention, *supra* note 44.

86. 2003 Agreement, *supra* note 58, para. 5.

87. 1996 Convention, *supra* note 44, art. 26, § 1.

88. *Id.* Bank account information is considered a professional secret in Switzerland. *See supra* note 53 and accompanying text.

89. 1996 Convention, *supra* note 44, art. 26, § 3.

Criminal Code, and the Swiss Banking Law and is only lifted for instances of fraud, routine information exchange is not permitted by Swiss domestic law.[90] Like paragraph 2 of Article 26, the provision giving deference to domestic legislation would be meaningless if information could be shared without evidence of a particular incidence of tax fraud.

When viewed in the broader context, the fact that information exchange is limited to particular occurrences of tax fraud becomes even clearer. The Swiss have consistently and adamantly opposed the routine exchange of bank information to combat tax evasion.[91] In fact, Swiss banking secrecy is widely supported by the Swiss population, who would not tolerate its elimination.[92] Given the popular support for banking secrecy, it is doubtful that Swiss negotiators would enter a treaty that would run counter to the country's popular will in addition to its legal rules.[93]

Paragraph 5 of the 2003 Agreement further clarifies that information will only be exchanged upon request, provided that certain conditions are met: an instance of tax fraud and a reasonable suspicion with an evidentiary basis.[94] Given this limitation on disclosure of requested information, it is clear that Article 26 cannot be interpreted to require proactive information exchange generally.

Lastly, in all fourteen hypotheticals, the requesting state's authorities already possess specific information about the tax evader and his misconduct upon which they based their information request.[95] In fact, all fourteen examples unambiguously state that the requesting state is entitled to bank account information "in response to a specific request . . . under Article 26 of the Convention."[96]

Viewed together, these details show that U.S. authorities have no authority to preemptively collect Swiss bank information. Instead, they must rely on other sources—such as informants, an ex-spouse or ex-employee of the tax evader, or a domestic audit—to reveal noncompliance with domestic tax laws.[97] Therefore, a U.S. taxpayer can hide income in Swiss bank accounts relatively safely, as long as no third party with knowledge of his activity exposes him to U.S. authorities. The numerous recent enforcement cases all arose as a

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90. Peter, *supra* note 13, at 619.

91. *Id.* at 603, 607–08, 614.

92. *Id.* at 607–08.

93. *Id.*

94. 2003 Agreement, *supra* note 58, para. 5.

95. *Id.* app.

96. *Id.*

97. *Id.*

result of information disclosed by insiders.[98] Thus, the IRS has not been able to effectively detect offshore tax evasion by itself and does not have the tools under the tax treaties to do so. Therefore, if the U.S. wishes to close the tax gap by eradicating offshore evasion, changes to the current legal structures are needed.

IV. THE INADEQUACIES OF CURRENT PROPOSALS

In response to the recent UBS controversy, a number of parties have proposed solutions to the offshore tax evasion problem. Commentators, White House Officials, American legislators, and the Swiss Bankers Association have come up with differing proposals to solve the same problem. This Part will address the merits of each suggested approach: comprehensive multilateral tax treaties, treaty amendments, domestic legislation, and a Swiss withholding tax system. As will become apparent from the discussion below, the optimal solution consists of a bilateral withholding system, drawing on proposals by the Swiss Bankers Association and Congress.

A. Chasing the Dream of Comprehensive Multilateral Treaties

Several recent academic articles argue that multilateral information sharing agreements are an ideal solution to offshore tax evasion.[99] This approach essentially requires negotiations among all countries with capital markets and financial services sectors.[100] Participation of tax haven countries—nations with strict bank secrecy laws and low or no taxation of foreigners—is particularly important for the multilateral approach to succeed, as these are the countries whose banking systems are being used to evade taxes.[101]

A multilateral tax treaty approach can take one of two forms: it can institute a withholding tax system or provide for the exchange of information among member-states. The withholding tax approach presents several problems. First, imposing a uniform withholding tax system upon countries with drastically different tax systems and philosophies may be perceived as an infringement upon their sovereignty.[102] Every country should be free to impose and collect its taxes in the way it deems proper. Similarly, a country or its financial

98. Browning, *supra* note 23; Press Release, Dep't of Justice, *supra* note 22.

99. Walsh, *supra* note 2, at 268–69; Brabec, *supra* note 13, at 232.

100. Walsh, *supra* note 2, at 269.

101. *Id.* at 268–69.

102. *See id.* (noting the Bush administration's opposition to a withholding tax system, due to concerns about national sovereignty).

entities should not have to aid other nations in enforcement and administration of their respective tax laws. Finally, an individual's country of residence should ultimately be entitled to tax the individual.[103] Even if withholding taxes are turned over to the residence country, source countries will likely want to keep part of the withholdings to finance their administrative burden.

A related problem deals with differing attitudes regarding the proper rate of taxation. To put an end to tax competition, withholding rates for foreign capital would have to be uniform among all treaty partners. Otherwise, the collective action problem would persist, and member states would retain the incentive to underbid each others' tax rates on foreign investment.[104] Achieving consensus among a large group of nations, some of which may rely heavily on foreign capital, seems difficult, if not impossible.

The alternative, then, would provide for information exchange among member-states regarding the investment activities of foreigners in their markets. This system would have the advantage of equipping the treaty partners with the requisite information for enforcement of their respective tax laws against their own residents. No tax rates would need to be harmonized, source countries would incur no significant administrative burdens, and taxes would end up in the hands of residence countries.

Most importantly, however, a multilateral information exchange agreement would avoid some of the pitfalls of the current system. In a world of bilateral treaties, tax evaders can move their assets to countries that do not have tax treaties with the evaders' residence countries. Alternatively, evaders could funnel unreported assets through a country which has no information exchange agreement.[105] That way, even if the residence country and the source country have an information exchange agreement, the intermediate step renders the agreement ineffective because the non-party nation would not need to provide the information.[106] Likewise, a U.S. tax evader could create a corporation in a secrecy jurisdiction, which in turn deposits the funds in the source country. The source country would then be unable to identify the individual behind the corporation.

But even a multilateral approach suffers from insurmountable obstacles. Granted, a multilateral information exchange agreement, if

103. *Id.*

104. *Id.* at 255–57.

105. *Id.* at 271–72.

106. *Id.*

it included all countries with financial markets, would cure the problems of bilateral treaties.[107] Regardless of where individuals invest their money, their residence countries would receive information about the activity and could impose taxes accordingly. But such an agreement is a mirage. First, a number of countries, especially those relying on unreported foreign investments, may have no incentive to reach an agreement. Second, given the number of necessary parties involved, it would be easy for a handful of nations to effectively shut down the entire negotiation process with any number of technicalities. For instance, it took Switzerland and the United States around sixteen years to come up with the 1996 Convention.[108] The added layer of complexity that would result from the inclusion of dozens of nations makes failure all but certain.

Third, attitudes regarding taxation, privacy, and information exchange differ drastically across nations. The Swiss, for instance, would not give up their deeply-rooted banking privacy, to which they make few exceptions.[109] It is highly improbable that countries like Switzerland would gather otherwise private information for use by another country, turning that information over beyond the control of their governments.

B. Treaty Amendments: The 2009 Protocol

In contrast to the theoretical multilateral treaties, amending existing treaties became reality as U.S. officials responded to the well-publicized UBS debacle by negotiating further with the Swiss. These negotiations ultimately produced an amendment to the 1996 Convention ("2009 Protocol"). Specifically, the 2009 Protocol includes a provision ("New 26") that was intended to replace Old 26.[110] Paragraph 1 of New 26 calls for the exchange of information that "may be relevant . . . to the administration or enforcement of the domestic

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107. *Id.* at 269 ("[W]here effective information reporting exists among all countries with capital markets and financial services sectors, investors wishing to evade taxation cannot simply move their capital to a low tax, secretive jurisdiction, thereby avoiding reporting the income to their home jurisdiction.").

108. Peter, *supra* note 13, at 629.

109. *Id.*; *see also infra* notes 124-25 and accompanying text (noting that Switzerland will not agree to exchange of information on an automatic or spontaneous basis).

110. As part of the UBS settlement agreement signed on August 19, 2009, Switzerland and the United States agreed to amend Old 26. Pursuant to their agreement, the countries signed the 2009 Protocol on September 23, 2009. *See infra* note 111 (detailing the 2009 Protocol).

laws concerning taxes covered by the Convention . . . ."[111] At first sight, it seems that the scope of information exchange has been broadened significantly, from the restrictive "tax fraud or the like" provision[112] to the "relevant to tax enforcement" directive.

Paragraph 3 of New 26 ("New Paragraph 3") essentially tracks Paragraphs 2 and 3 of its predecessor, with minor revisions. Like the old paragraphs, it does not obligate a contracting state to "carry out administrative measures at variance with [its] laws or administrative practice . . . ."[113] Therefore, the Swiss assume no new responsibility to enforce or administer U.S. tax laws. Similarly, New Paragraph 3 does not require a contracting state "to supply information which is not obtainable under the laws or in the normal course of the administration . . . ."[114] This provision closely tracks Paragraph 3 of Old 26, which does not "impose upon [a] Contracting State the obligation . . . to supply particulars which are not procurable under its own legislation . . . ."[115] Finally, New Paragraph 3(c) mimics Paragraph 1 of Old 26, by exempting from the exchange obligations information pertaining to trade, business, industrial, or professional secrets, or any trade process (dropping protection of commercial secrets).[116] It also gives deference to a contracting state's public policy preferences,[117] as did Paragraph 3 of Old 26.[118] Consequently, from the IRS's perspective, New Paragraph 3 can hardly be said to represent an improvement over Old 26's deference to domestic laws and limitations on information exchange.

However, New Paragraph 3's limitations might be overcome by Article 3, Paragraph 5 of the 2009 Protocol, which states that the requested state cannot "decline to supply information *solely* because the information is held by a bank [or the like]."[119] As becomes apparent from the text, Paragraph 5 is limited in two significant ways. First, it does not allow a requested state to deny an information

111. 2009 Protocol to the 1996 Convention, and Notes, U.S.-Switz., art. 3, *signed on* Sept. 23, 2009, [hereinafter 2009 Protocol], *available at* http://www.ustreas.gov/press/releases/docs/US-SwissProtocol.pdf.

112. *See supra* Part III (outlining the "tax fraud or the like" provision).

113. 2009 Protocol, *supra* note 111, art. 3, § 3(a); 1996 Convention, *supra* note 44, art. 26, § 3 (exempting a treaty partner from "the obligation to carry out administrative measures at variance with [its] *regulations and practice* . . . or which would be *contrary to its sovereignty*") (emphasis added).

114. 2009 Protocol, *supra* note 111, art. 3, § 3(b).

115. 1996 Convention, *supra* note 44, art. 26, § 3.

116. 2009 Protocol, *supra* note 111, art. 3, § 3(c); 1996 Convention, *supra* note 44, art. 26, § 1.

117. 2009 Protocol, *supra* note 111, art. 3, § 3(c).

118. 1996 Convention, *supra* note 44, art. 26, § 3.

119. 2009 Protocol, *supra* note 111, art. 3, § 5 (emphasis added).

request solely because the information is held by a bank or similar entity.[120] Thus, as long as the Swiss can find another basis on which to object to an information request, such as general privacy laws or criminal code provisions, Paragraph 5 can presumably be circumvented.[121] Second, it only purports to give a requested state the power to disregard New Section 3 and domestic laws; it does not require it.

In addition to replacing Article 26, the 2009 Protocol changed the Protocol to the Convention by replacing Paragraph 10. In pertinent part, the new Paragraph 10 envisions as extensive an information exchange as possible, while explicitly disallowing "fishing expeditions."[122] What constitutes a "fishing expedition" is open to interpretation and bound to be read differently by each treaty partner.[123] What is clear is that U.S. authorities are not entitled to automatic information exchange,[124] nor are taxpayers deprived of their procedural protections under the requesting state's law.[125] In practice, this means that the Amendment does nothing to enable U.S. authorities to detect tax evasion involving Swiss banks.[126]

To make matters worse, one can only guess as to how the 2009 Protocol will affect the 2003 Agreement—essentially a clarification of the now-to-be-replaced Old 26. With repeal of the "tax fraud or the like" provision, Article 4 of the 2003 Agreement (along with its fourteen hypotheticals) is undoubtedly off the books. But what happens to the other paragraphs? Does Paragraph 5 still lay out the

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120. *Id.*

121. Given that Swiss legal norms require interpretations of domestic law in a way that avoids conflicts with a valid treaty, and the ability of treaties to trump domestic law, such circumventions seem difficult. Nevertheless, where a treaty gives deference to domestic law it subordinates itself. Markus Reich, *Das Amtshilfeabkommen in Sachen UBS oder die Grenzen der Staatsvertragskompetenz des Bundesrats: Die Rechtslage nach dem BVGer-Urteil vom 21.1.2010*, [The Information Exchange Agreement in Regard to UBS or the Limitations of the Bundesrat's Power to Enter into Binding Treaties: The Legal Status After the BVG-Decision on 1.21.2010], IFF FORUM FÜR STEUERRECHT (2010), *available at* http://www.rwi.uzh.ch/lehreforschung/alphabetisch/reich/unterlagen/mitax/FStR2009-111-Reich-AmtshilfeabkommenUBS.pdf. The extent to which treaty obligations can be enforced to supersede Swiss domestic law, however, is a question beyond the scope of this discussion.

122. 2009 Protocol, *supra* note 111, art. 4(b).

123. Michael J. McIntyre, *How to End the Charade of Information Exchange*, WORLDWIDE TAX TREATIES, at 3–4 (2009). McIntyre suggests that the Swiss view the search for tax evaders as fishing expeditions, an interpretation that would render the 2009 Protocol entirely unresponsive to the problem at hand.

124. 2009 Protocol, *supra* note 111, art. 4(d).

125. *Id.* art. 4(e).

126. McIntyre, *supra* note 123, at 3 ("[T]he [2009 Protocol] offers no help in . . . detecting the hundreds of thousands of tax evaders who are using Swiss banking secrecy to cover their tracks.").

necessary basis for requesting information? The likely but far from certain answer seems to be no, as Article 5 explains the basis for a reasonable suspicion of tax fraud.[127]

Adding to the mystery of the 2009 Protocol is the fact that its final status is not yet clear. The 2009 Protocol has been signed but not yet ratified as of publication of this Note.[128] While the Senate can be expected to ratify the treaty, the Swiss Parliament might be more critical. More importantly, the treaty might be subjected to a Swiss popular referendum, which, given the strong public support for banking privacy, may just mark the 2009 Protocol's end.[129]

Lastly, the 2009 Protocol contains a number of equally authoritative provisions that stand in tension with one another.[130] Regardless of how those tensions may be resolved, the 2009 Protocol will fail to address the main obstacles to effective enforcement of U.S. tax laws. U.S. officials must continue to rely on external sources to catch and identify evaders, before wrestling with Swiss secrecy laws and traditions that enjoy broad popular support.[131] Furthermore, the new agreement submerges a much less ambiguous, albeit narrow, regime in a cloud of uncertainty. Therefore, it seems doubtful that the 2009 Protocol can meaningfully improve the landscape of U.S.-Swiss taxation issues, even if it is ratified by both sides.

C. Congressional Action: A Unilateral Approach to a Bilateral Problem

With the calls for action growing louder after the UBS incidents, U.S. legislators have taken up the issue of offshore tax

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127. 2003 Agreement, *supra* note 58, art. 5.

128. *See* 2009 Protocol, *supra* note 111 (confirming that the status of the protocol is still pending).

129. Following a January 21, 2010 Swiss court decision, it had become illegal for Switzerland to disclose information on 4,450 accounts pursuant to the UBS settlement. Reich, *supra* note 121. Only in a last minute decision did the Swiss parliament pave the way for compliance, by legislatively ratifying the UBS agreement without conducting a popular referendum. Abkommen zwischen der Schweizerischen Eidgenossenschaft und den Vereinigten Staaten von America über ein Amtshilfegesuch des Internal Revenue Service der Vereinigten Staaten von Amerika betreffend UBS AG [Treaty Between the Swiss Confederation and the United States of America About an Information Request by the IRS Regarding UBS], U.S.-Switz., Aug. 19, 2009, http://www.admin.ch/ch/d/as/2009/5669.pdf. But given that a different decision could have reopened U.S. proceedings against UBS and thus ruined a battered Swiss economy, it remains to be seen whether the 2009 Protocol will face more opposition as the stakes will be lower.

130. *See* McIntyre, *supra* note 123, at 3 ("What the agreement seems to say in the revised article 26 is countermanded by an explanatory document appended to the main body of the treaty. That explanatory document is part of the treaty just as much as article 26 itself.").

131. Peter, *supra* note 13, at 608 (citing a 2002 survey that "evidenced that the Swiss population would never accept the elimination of Swiss bank customer secrecy").

evasion as well. As one might expect, unilateral legislative solutions cannot solve the offshore tax evasion problem. Yet new legislation and proposed enactments present useful supplements to other solutions, as will be discussed in Part V.

1. Stop Tax Haven Abuse Act

On March 3, 2009, U.S. Representative Lloyd Doggett and Senator Levin introduced the Stop Tax Haven Abuse Act.[132] The proposed bill seeks to remedy offshore evasion by establishing a comprehensive disclosure regime for a number of parties subject to U.S. jurisdiction. Initially, it blacklists suspected tax haven countries and creates unfavorable evidentiary presumptions for taxpayers using those countries. Sections 6045C and 6045D of the bill further impose reporting obligations on payment agents and financial entities in the United States. Lastly, amendments to section 5318A seek to restrict access to U.S. markets for suspected tax evasion service providers.

Most notably, the bill creates an initial blacklist of so-called "offshore secrecy jurisdictions," including Switzerland, that is to be maintained and updated by the Secretary of the Treasury.[133] A country makes it onto the list "if the Secretary determines that such jurisdiction has corporate, business, bank, or tax secrecy rules and practices which, in the judgment of the Secretary, unreasonably restrict the ability of the United States to obtain information relevant to the enforcement of [the Internal Revenue Code]."[134] Secrecy rules and practices are broadly defined to include "both formal laws and regulations and informal government or business practices having the effect of inhibiting access of law enforcement and tax administration authorities to beneficial ownership and other financial information."[135] Consequently, the bill initially sweeps all countries that protect the privacy of account holders within the "offshore secrecy jurisdiction" category.

The only way to escape the blacklist is to implement "effective information exchange practices."[136] To qualify a country for that exception, the Secretary must annually determine that the jurisdiction has an information exchange agreement with the United States providing for "prompt, obligatory, and automatic exchange" of relevant

132. Stop Tax Haven Abuse Act, H.R. 1265, 111th Cong. (2009); Stop Tax Haven Abuse Act, S. 506, 111th Cong. (2009).

133. H.R. 1265, § 101(b).

134. *Id.*

135. *Id.*

136. *Id.*

information.[137] The Secretary must further establish that during the preceding twelve months, the information exchange agreement adequately prevented tax evasion and avoidance by U.S. persons, while also enabling effective enforcement of the Internal Revenue Code.[138] Lastly, the United States and any intergovernmental organization of which it is a member must not have deemed such country "uncooperative with international tax enforcement or information exchange" within the previous twelve months.[139] As illustrated by Part III, Switzerland does not have an automatic information exchange agreement in place and is unlikely to adopt one.[140] If the bill is adopted as proposed, Switzerland seems destined to remain blacklisted until the bill is changed.

But what exactly does it mean to become an "offshore secrecy jurisdiction"? Initially, not much. Blacklist status triggers a number of rebuttable presumptions that do not affect the listed countries directly, but rather apply to individuals in U.S civil litigation and administrative proceedings.[141] For proceedings relating to taxation or Title 21 of the United States Code, U.S. persons who have an interest in or are involved in transactions with[142] an entity[143] formed, domiciled, or operating in an offshore secrecy jurisdiction are presumed to have exercised control over such entity.[144] The Act further provides that anything of value received from an account or entity in an offshore secrecy jurisdiction constitutes previously unreported taxable income to the U.S. person receiving it.[145]

The blacklist provisions, however, do not help U.S. authorities detect, uncover, and prevent tax fraud. Because offshore secrecy jurisdictions have essentially no stake in the matter, they will be unlikely to abandon their banking secrecy or implement information sharing agreements with the United States. In particular, nations like Switzerland, with a strong tradition of banking secrecy backed by

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137. *Id.*

138. *Id.*

139. *Id.*

140. *See supra* Part III (explaining those inadequacies that are present in the 2003 Agreement).

141. H.R. 1265, § 101(b).

142. The exact language reads, "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." *Id.*

143. *See id.* (defining an entity as "including a trust, corporation, limited liability company, partnership, or foundation (other than an entity with shares regularly traded on an established securities market)").

144. *Id.*

145. *Id.*

strong popular support,[146] will see no reason to remove themselves from the Secretary's list.

U.S. tax evaders, likewise, are unlikely to change their ways in response to the proposed bill. It is true that they will face a higher evidentiary burden in litigation once caught. But affected evaders are determined to avoid detection and have already made the decision to violate U.S. civil and criminal tax laws, the latter of which remain unaffected by the blacklist presumptions.[147] It seems unrealistic that tax evaders hiding from their tax authorities would abandon secrecy jurisdictions only to avoid a higher evidentiary burden in civil litigation, should they get caught.

In fact, the biggest effects of blacklist status might be retaliatory action and a decline of goodwill towards the United States. Thus, the bill will induce reluctance rather than incentive to cooperate with U.S. authorities, as foreign nations can be expected to react negatively once the Secretary labels them "offshore secrecy jurisdictions."

Another provision of the bill imposes reporting requirements on withholding agents and financial institutions. Proposed section 6045C instructs withholding agents to file a return whenever they obtain gross income of a foreign entity from sources within the United States and suspect that a U.S person has a beneficial interest in either the entity or an account in the entity's name.[148] The withholding agent's return must include the name, address, and taxpayer identification number of the U.S person, information about his relationship to the foreign entity, the amount of U.S.-source income, and other information to be prescribed by regulation.[149] Lastly, in the spirit of good sportsmanship, the proposal instructs a withholding agent to alert the U.S. person that a return has been made.[150]

But like the proposed statutory presumptions, section 6045C will be of little to no help for U.S. tax authorities. The section only applies to gross income derived from U.S. sources.[151] By definition, it does not extend to unreported income earned abroad. To the extent that U.S. evaders wish to invest in U.S. markets, the proposal may disincentivize tax evasion—or at least make it more difficult. More likely, however, the proposal will deter U.S. evaders from U.S.

146. Peter, *supra* note 13, at 607–08.

147. H.R. 1265, § 101(b).

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

markets and channel their capital into other countries. In the end, section 6045C will achieve little more than diverting funds from the United States to other nations, thereby contributing to economic growth in foreign countries.

Proposed section 6045D instructs financial entities to file a return whenever they open an account[152] or form or acquire an entity[153] in an offshore secrecy jurisdiction at the direction of, on behalf of, or for the benefit of a U.S. person.[154] The return must contain the taxpayer's name, address, and taxpayer identification number; the name and address of the financial institution as well as information about the account; the name, address, and type of the entity and the name of the formation agent; and other information prescribed by regulation.[155] As under section 6045C, under 6045D U.S. taxpayers are to receive notice once a return regarding their offshore activity is filed.[156]

While a step in the right direction, section 6045D leaves the core problem of catching undiscovered tax evaders unaddressed. At best, the provision creates legal conflicts for banks operating in the United States as well as in countries like Switzerland that prohibit disclosure of client information. Given the failure of specific tax treaties to remedy the disclosure dilemma, it seems doubtful that unilateral domestic legislation will accomplish what bilateral, international agreements have not achieved.

Possibly the most promising provision contained in the proposal is an amendment to 31 U.S.C. § 5318A. That section essentially allows the Secretary of the Treasury to prohibit or condition the opening or use of various accounts within the United States by or for a jurisdiction, financial institution, or transaction that the Secretary deems to be impeding U.S. tax enforcement.[157] This proposal gives the Secretary the power to effectively exclude tax evasion service providers from conducting business within the United States. However, the Secretary's authority is limited, as he must first consult with the Secretary of State, the Attorney General of the United States, and the Chairman of the Board of Governors of the

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152. More specifically, a bank, brokerage, or other financial account. *Id.*

153. *See id.* (defining an entity as "including a trust, corporation, limited liability company, partnership, or foundation (other than an entity with shares regularly traded on an established securities market)").

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.* § 102.

Federal Reserve System.[158] Each official will have her own agenda, possibly weighing against strict tax enforcement measures. The Secretary of State, for instance, may value diplomatic relationships over additional tax revenue. The Chairman of the Federal Reserve might be worried about the ramifications of limiting foreign banks' access to U.S. markets. And both may well be correct in that the benefits to be gained are outweighed by the costs of making use of the new section 5318A.

Lastly, the Stop Tax Haven Abuse Act contains additional provisions and amendments that aim to combat tax evasion but only tangentially address the issue of detecting and preventing offshore tax evasion. Among those provisions is an extension of money laundering laws to include tax evasion,[159] revisions of the John Doe Summons procedure,[160] changes to penalty provisions,[161] and a revision of the economic substance doctrine.[162]

2. Foreign Account Tax Compliance Act

On March 18, 2010, Congress enacted the Foreign Account Tax Compliance Act of 2009 ("FATCA")[163] essentially to combine a withholding tax with an information disclosure option. Newly-enacted section 1471 establishes a thirty percent withholding tax, directing a withholding agent to retain thirty percent of any interest, dividend, or other income, including any proceeds from the sale of property that produces dividends or interest, paid from U.S. sources to a foreign financial institution.[164] A withholding agent is anyone who has possession of, or control over, such a payment before it is handed over to a foreign financial institution.[165] Foreign financial institutions include any non-U.S. entity engaged in banking, investing, or holding of assets.[166] Together, these provisions impose a thirty percent tax on

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158. *Id.*

159. *Id.* § 102.

160. *Id.* § 204(a).

161. *Id.* §§ 105(b), 105(d), 301–02, 402.

162. *Id.* § 401.

163. FATCA was enacted as Title V of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, §§ 501-62, 124 Stat. 71 (codified as amended in scattered sections of 26 U.S.C.).

164. 26 U.S.C. §§ 1471(a), 1473(1) (2010).

165. *Id.* § 1473(4).

166. *Id.* § 1471(d)(4)–(5). The definition is therefore much broader than the name itself suggests and presumably extends not only to banks, but also to hedge funds, foreign pension funds, etc. Who will ultimately be a foreign financial institution will depend on what the FATCA regulations will say.

every U.S.-source payment to such a foreign entity. Thus, a U.S. client of UBS would be taxed even on his unreported investment income from the bank whenever that income derives from U.S. sources.

The alternative to the withholding option is for the foreign financial institution to become FATCA-compliant by entering into an agreement with the Secretary of the Treasury.[167] Under such an agreement, a foreign financial institution must identify any U.S. clients, establish reliable procedures for making such identifications, annually report to the United States about its U.S. clients, withhold tax from payments to non-compliant entities, comply with specific information requests, and obtain privacy waivers from the clients.[168] So, unless a foreign financial institution wants to be taxed thirty percent on all investments earned in the United States, regardless of the client's nationality, it must provide U.S. authorities with detailed information about its U.S. account holders, allowing the IRS to enforce U.S. law.[169]

Because the choice to withhold rather than report is an institution-wide one, foreign banks with clients from different countries have an incentive to comply with FATCA, especially if some of their non-U.S. clients would be taxed at less than thirty percent on their investment income or are evading their home country's taxes completely. By choosing not to disclose under FATCA, a foreign financial institution in essence subjects all of its customers to a thirty percent tax on U.S. income. Since such a uniform tax may scare away clients, foreign banks have a strong incentive to comply. Although U.S. clients will lose their privacy protection, the institution's other clients will remain unaffected by the institution's compliance—they can continue to enjoy favorable tax treatment by the United States, while possibly avoiding their home countries' taxes.

Of particular importance with regard to institutions like UBS is section 1471(b)(1)(F). That section requires a foreign financial institution to obtain a privacy waiver from its U.S. clients or close their accounts in order to be to be FATCA-compliant, thereby circumventing Swiss privacy laws without creating a conflict of laws.[170] Because Swiss bankers cannot disclose banking information

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167. *Id.* § 1471(b)(1).

168. *Id.*

169. *Id.* § 1471(a), (c).

170. *Id.* § 1471(b)(1)(F). If the institution cannot obtain a waiver from the client, or if domestic laws do not permit such privacy waivers, the institution must close the affected accounts. Essentially, a FATCA-compliant bank could not service accounts where foreign privacy laws would interfere with disclosure.

without the client's consent,[171] their options are to get the client's approval or to stop servicing U.S. accounts. FATCA further closes several otherwise obvious loopholes, as it also covers payments made to affiliates of foreign financial institutions[172] as well as to non-financial foreign entities.[173]

Nevertheless, FATCA is problematic in several ways. It might, for instance, scare U.S. taxpayers away from large foreign banks and towards smaller institutions without a presence in the U.S. market. These banks would likely fly under the radar of U.S. authorities, making enforcement of tax laws all the more difficult. Exacerbating the problem is the fact that, if U.S. tax evaders disperse and seek refuge with multiple small banks scattered across the globe, big catches like those resulting from the recent UBS investigations will become unlikely. U.S. officials would need to invest the same, if not more, resources for substantially lower payoffs when going after U.S. clients of small banks. More fundamentally, if a bank has no U.S. presence, it evades U.S. jurisdiction altogether and therefore has little to fear from the U.S. government. The counterargument contends that banking clients would not trust less established banks and would choose to report rather than risk losing their deposits to untrustworthy banks.[174]

In addition, FATCA might also have an adverse effect on foreign investment in the United States. The U.S. economy has come to rely on foreign capital and holds over $2 trillion of foreign assets.[175] Exposing income from invested foreign capital to the looming threat of a thirty percent withholding tax may deter investors and lead to significant capital flight. Because the Secretary can terminate a disclosure agreement and thereby reinstate the thirty percent withholding tax, this threat is in fact very real.[176] The effects of such a capital outflow might well prove more detrimental to the U.S.

171. Peter, *supra* at note 13, at 615 ("Swiss bank customer secrecy prohibits anyone who functions as an officer, employee, or mandatory of a Swiss bank from disclosing any information that a bank customer entrusts to them in this capacity. . . . Bank customer secrecy is regulated in Switzerland under several areas of law.").

172. 26 U.S.C. § 1471(e).

173. *Id.* § 1472 (obligating all non-financial foreign entities to disclose information about their ten-percent U.S. owners or to certify that they have no such owners, in order to be FATCA-compliant).

174. *See infra* Part V (arguing that a bilateral withholding system is an ideal solution).

175. U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 2010 at tbl.1255 (2009), *available at* http://www.census.gov/compendia/statab/2010/tables/10s1255.pdf.

176. 26 U.S.C. § 1471(b)(1) ("Any agreement entered into under this subsection may be terminated by the Secretary upon a determination by the Secretary that the foreign financial institution is out of compliance with such agreement.").

economy, and therefore the Treasury, than would be warranted by the additional tax revenues. Particularly in light of today's troubled economy and still-frozen capital markets, any action that might lead to capital flight should be treated with skepticism.[177]

Finally, there is the threat of retaliatory measures by other nations. For instance, unhappy about U.S. interference with its banking privacy regime, Swiss officials might bar bankers from disclosing information about their clients, instead placing the burden to provide information on the tax-evading clients themselves. Under the current law, this would lead to the closure of U.S. accounts.[178] But even absent affirmative retaliatory measures, the Swiss are unlikely to respond favorably to a circumvention of their banking privacy laws. They might, for instance, be less cooperative under new treaty provisions that require Swiss goodwill to become successful. Thus, this unilateral approach may lead to more reluctance than cooperation by Swiss banks and government officials.

D. Project Rubik: The Swiss Bankers Association Proposal

Meanwhile, Swiss banks have offered their own solution to the tax evasion dilemma. In December 2009, the Swiss Bankers Association ("SBA") introduced Project Rubik, a proposal seeking to ensure that Swiss banking clients comply with their home country's tax laws, while also preserving bank clients' privacy.[179] Essentially, the model adopts a withholding tax system, the alternative to information exchange. Citing parallels to the EU Savings Tax Agreement, the SBA suggests that payment agents withhold taxes from foreigners' incomes and turn the withholdings over to the respective governments in full satisfaction of the foreigners' tax liability.[180] In exchange for essentially collecting other nations' taxes, Project Rubik envisions free access to those countries' markets and an end to the criminalization of Swiss banks and their clients.[181] Logically then, to avail themselves of the benefits of Project Rubik,

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177. The IRS has yet to provide guidance on FATCA. Given the considerations outlined above, it is possible that interpreting regulations will limit the scope of the law substantially. In any case, the precise impact of FATCA is still uncertain.

178. 26 U.S.C. § 1471(b)(1)(F). Unless the institution can obtain a privacy waiver from the client under subsection (F)(i), it must close that client's account under subsection (F)(ii).

179. SWISS BANKERS ASS'N, PROJECT – FLAT RATE TAX: FLAT RATE TAX ON ASSETS HELD WITH BANKS ON A CROSS-BORDER BASIS 3 (2009), *available at* http://www.swissbanking.org/en/20091210-4730-dok-rubik_businesscase_sbvg-uka-final.pdf.

180. *Id.*

181. *Id.* at 9.

other nations would have to enter into bilateral agreements with the Swiss government.[182]

The payoffs of such a deal, however, may well be worth waiving domestic remedies against Swiss banks. Specifically, Project Rubik would impose a flat tax on five different types of income, referred to as Modules.[183] Module 1 envisions a tax on interest income at a rate equal to the treaty state's domestic rate.[184] Module 2 builds upon the U.S. Qualified Intermediary Agreement and would tax dividends.[185] Module 3 breaks the taxation of collective investments into two categories—distributions and gains. The former are taxed when made, while the latter are taxed upon realization, or sale of the asset, allowing taxpayers to offset gains and losses.[186] To the extent that the two categories cannot be distinguished, no offsetting would be allowed.[187] Module 4 imposes a capital gains tax upon the sale of an instrument.[188] It allows account holders to offset capital gains and losses, and permits capital losses to be carried forward for a number of years.[189] As a practical condition, the SBA insists upon a uniform method for calculating gains and losses among all treaty countries.[190] Finally, Module 5 would impose a wealth tax directly on the assets of an account holder whose home country has a wealth tax.[191]

After taxes are withheld, the taxpayer may request a certificate from his paying agent listing the amounts withheld.[192] This provision should provide comfort to U.S. taxpayers who might be worried about the IRS double-dipping, by collecting the withholding tax while also challenging the taxpayer's return for underreporting by omitting his foreign income. Alternatively, account holders may choose a voluntary reporting option, pursuant to which the Swiss bank will gather information and relay it to U.S. authorities through the Swiss Federal Tax Administration.[193]

The main challenge involves proper client identification. Swiss banks would have to implement reliable measures for determining

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182. *Id.* at 3.
183. *Id.* at 5–6.
184. *Id.* at 6.
185. *Id.* at 7.
186. *Id.*
187. *Id.*
188. *Id.* at 8.
189. *Id.*
190. *Id.*
191. *Id.* at 9.
192. *Id.* at 5.
193. *Id.* at 9.

their clients' domiciles. Doubtlessly, this can be done, and is to some extent already required by Swiss know-your-customer laws.[194] Equally difficult is creating the appearance of legitimacy. Even if Swiss banks can reliably determine the domiciles of account holders and beneficial owners, treaty partners must have confidence in these determinations. If Switzerland is to retain its banking secrecy, U.S. officials must be able to trust the Swiss in identifying U.S. taxpayers and in remitting the proper tax payments to the U.S. government. To take things one step further, the U.S. populace, to whom U.S. politicians are accountable at least in theory, must likewise feel that Project Rubik adequately addresses tax evasion involving Swiss financial institutions.

Like with the customer identification procedures, many of the details regarding legitimacy still need to be worked out between the treaty countries. But the current proposal nevertheless offers a good indication of what Swiss banks are willing to concede. If Project Rubik is palatable to the United States, the negotiations should be relatively painless, given the Swiss's willingness to compromise[195] and their incentive to get U.S. authorities off their backs.

V. ADOPTING A BILATERAL WITHHOLDING SYSTEM

A. Project Rubik: Respecting Swiss Privacy Laws and Collecting American Taxes Abroad

Among all these proposals, the ideal solution will get tax dollars flowing without threatening Swiss banking privacy. This can be done because information exchange, the key source of conflict, is a mere means to an end for U.S. authorities and should therefore be dispensable. The logical solution must thus take the form of a withholding tax system. In order to make quick progress, such a model should be based on Project Rubik—implementing a withholding tax on various kinds of investment income at domestic U.S. tax rates.

An approach based on Project Rubik would offer a number of distinct advantages. First, it should be fairly quick and easy to implement. Opposition from Switzerland seems unlikely, as the proposal was drafted by Swiss banks themselves. Legal and cultural conflicts regarding bank secrecy would be avoided, virtually

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194. Peter, *supra* note 13, at 596–97 (discussing Switzerland's anti-money-laundering regime under which Swiss banks are obligated to identify and verify customers and beneficial owners).

195 After all, Project Rubik is a Swiss creation and it seems unlikely that the Swiss population will vehemently oppose a reform drafted by its own bankers association. *See infra* Part V.A.

eliminating the chance of interference by the Swiss government. To the contrary, all parties involved have a stake in quickly reaching an accord. U.S. authorities, under pressure from the press and the public at home, could win approval by producing quick results. Furthermore, recent criminal convictions of offshore tax evasion service providers, settlements with UBS, and a tremendously successful amnesty program have built strong momentum. By using Project Rubik as a baseline for an expeditious agreement, U.S. officials could ride that momentum to the shore and reach a final solution to the offshore evasion dilemma. Likewise, Swiss banks have an incentive to resolve the issue quickly. In light of the UBS scandal, Switzerland now has the opportunity to draw a line, repair its image, and enter a new era, effectively ending international pressure to abandon banking privacy in the process. By coming to terms with nations like the United States, Switzerland can send a signal that it will no longer serve as a haven for tax evaders,[196] that its banks will adhere to the laws of treaty partners, and that its banking clients will be safe from foreign governments' inquiries. A quick agreement, marking a period of reconciliation, further presents an opportunity to improve diplomatic relationships between Switzerland and the United States.

Another distinct advantage of implementing a Project Rubik-based withholding system would be that account holders could no longer escape taxation as long as their home country has a treaty with Switzerland. To make the agreement meaningful, Swiss banks would have to guarantee that they can reliably establish the identities and nationalities of their clients. They could do so by availing themselves of existing anti-money laundering laws and ideas entailed by FATCA. The former already impose know-your-customer requirements on Swiss banks.[197] The latter envision development of reliable procedures for identifying U.S. account holders.[198]

196. Markus Städeli, *Wir müsen uns auf Steuerehrlichkeit fokussieren* [We Must Focus on Tax Honesty], NZZ ONLINE (Nov. 15, 2009), http://www.nzz.ch/nachrichten/wirtschaft/aktuell/wir_muessen_uns_auf_steuerehrlichkeit_fokussieren_1.4016937.html (interviewing Patrick Odier, Chairman of the Swiss Bankers Association, on his commitment to eradicating tax evasion services from Swiss banking).

197. Peter, *supra* note 13, at 633 ("Switzerland has strong know-your-customer rules."); *see also id.* at 616 ("The identity of the account holder is known for both resident and nonresident clients [of Swiss banks] . . . .").

198. 26 U.S.C. § 1471(b)(1)(A)–(B) (2010).

B. Making Project Rubik Work: Enforcing the Agreement and Recognizing Its Inherent Limitations

Switzerland and the United States might even agree that Swiss banks must reject clients who are less than forthright about their identities or nationalities. Having rejected U.S. clients in the aftermath of the UBS settlements, Swiss banks have proven their willingness to close accounts,[199] while U.S. legislators have displayed a desire to use such measures as reinforcement against uncooperative bank clients.[200] An account-closing provision would lend further credibility to the solution, reassuring not only U.S. officials, but their constituents as well.

Another way to increase Americans' comfort level with the proposed solution would be to give U.S. authorities "disciplinary" powers. As inherent in FATCA, the Secretary might be granted authority to determine Swiss violations of the agreement, which would trigger a withholding tax on all U.S.-source income flowing to affected institutions.[201] Giving the Secretary this authority would essentially employ the same coercive mechanism by which FATCA seeks to induce the reporting of U.S. account information. Only this time, the Secretary would not force Swiss banks to enter into an agreement but to honor an existing one.

However, a Project Rubik-based withholding system would pose several challenges. First and foremost, a bilateral treaty solution would allow evaders to avoid detection by moving to secrecy jurisdictions that have not entered treaties with the United States.[202] The only sure remedy against this problem would be a multilateral treaty approach involving all countries with a financial sector. But that such an IRS-nirvana is unattainable has been discussed in Part IV.A and does not need to be restated here. Furthermore, eliminating Switzerland as a haven for tax evaders has the potential to increase voluntary compliance. Few taxpayers would fear for the security of their investments held by Swiss banks. The country's banking system has been among the most trusted and robust banking systems in the

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199. Pacenti, *supra* note 28 ("[UBS] sent letters to many American customers [in 2009] . . . telling them their business was no longer wanted and to move their assets or their accounts would be frozen . . . ."); Tompkins, *supra* note 10 ("Some foreign banks have already [asked their American clients] . . . to move their money elsewhere, and have stopped accepting new accounts from the U.S."). As these measures show, Swiss banks are in fact able to identify American clients.

200. 26 U.S.C. § 1471(b)(1)(F)(ii) (ordering foreign financial institutions to close U.S. accounts for which no privacy waiver can be obtained).

201. *Id.* § 1471(b)(1)(D).

202. *See supra* Part III.A (discussing the flaws in the current tax treaty system).

world. Tax evaders who are forced to shift to tax havens like Panama, Bermuda, or Singapore may not have the same level of comfort in those jurisdictions.[203] Consequently, as more big banks and trusted jurisdictions are eliminated as possible tax havens, evaders will have to turn their assets over to smaller, less reputable banks. Because the (perceived) risk of losing one's assets deposited with those banks is higher, many evaders may in fact prefer to pay taxes and enjoy the security of Swiss or U.S. banks.

Lastly, Part IV.A cited sovereignty concerns relating to international withholding tax systems. These issues are unlikely to arise as to Switzerland, as Project Rubik is a Swiss proposal. Furthermore, an agreement with the Swiss could serve as a paradigm for dealing with other tax haven jurisdictions. Given Switzerland's role in the banking secrecy world, a Swiss precedent along the lines of Project Rubik might have a strong persuasive effect on other nations. Admittedly, each country is unique, and negotiations must account for different cultural, economic, and legal environments. But such factors will play a role in every solution that goes beyond the scope of unilateral legislation.

VI. CONCLUSION

Rapid globalization and the integration of capital markets have enabled taxpayers to exploit loopholes in offshore tax enforcement. Competition for foreign investments has led to increasing foreign investments by taxpayers, whose home countries often cannot keep up with the offshore activities of their citizens. To this, the United States is no exception. Around $100 billion are believed to escape the U.S. Treasury every year due to offshore tax evasion. As a trusted banking capital with a strong tradition of banking secrecy, Switzerland has attracted U.S. clients seeking to avoid taxation at home. Servicing that demand, UBS engaged in a number of illegitimate practices until being exposed to U.S. authorities. After two settlements with the bank, the prosecution of numerous perpetrators, and a successful amnesty program, U.S. authorities must come up with a systemic solution, one that will prevent repetition.

As the scale of the UBS debacle suggests, current treaties are incapable of addressing the underlying problems that prevent the IRS from enforcing its tax laws abroad. Neither the 1996 Convention nor the 2003 Agreement provides the IRS with tools to discover evasion

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203. *See* Brabec, *supra* note 13, at 231 ("The Swiss have developed, and now take pride in, a highly-secure banking system that is trusted worldwide.").

schemes, identify tax cheats, or prevent evasion effectively. Until U.S. authorities have identified an evader they cannot request evidence from the Swiss. To solve the problem, the U.S. government must be able to either collect taxes abroad or gather the information necessary to trace offshore investment activities by U.S. taxpayers.

Given Switzerland's strong opposition to intrusions into banking privacy, collecting offshore is clearly the more feasible alternative. If information exchange seemed ineffective before, the UBS controversy has certainly put the nail in the coffin. A withholding tax system, on the other hand, could be implemented quickly, avoid legal and cultural conflicts, and eliminate Switzerland as a haven for U.S. tax evaders. Project Rubik, a recent SBA proposal, offers a good starting point for bilateral treaty negotiations between Switzerland and the United States.

Alternative solutions are either not feasible or fatally ineffective. Multilateral tax treaties are an unattainable goal; agreement among the requisite number of countries unrealistic. The 2009 Protocol tries to broaden information exchange obligations, but will not provide the IRS any additional tools to independently detect tax evasion. The same shortcomings haunt the Stop Tax Haven Abuse Act, which is currently pending before Congress. A second legislative solution, the Foreign Account Tax Compliance Act, may cleverly circumvent Swiss secrecy laws, but it is likely to provoke intense resistance from Switzerland. Unlike these proposals, Project Rubik offers an attainable solution. If supplemented by several ideas from the Foreign Account Tax Compliance Act, the proposal could effectively end tax evasion involving Swiss banks.

And although there are a number of secrecy jurisdictions, all of which will remain unaffected by a bilateral agreement between Switzerland and the United States, shutting down a Mecca of banking secrecy would be a great accomplishment. While sending a strong signal to tax cheats, a U.S.-Swiss solution could serve as a precedent for dealing with other tax haven jurisdictions. Finally, not all tax havens enjoy the same degree of trust as Switzerland, possibly leading taxpayers to consider the risk of losing their deposits completely.

Thus, dealing with Switzerland as a paradigm for offshore tax evasion will not only appease the media's and citizenry's demand for a symbolic sacrifice. The blood drawn will also affect tax evaders and other tax havens, none of whom will want to be brought to the altar next.

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