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Tax Compliance and Norm Formation Under High-Penalty Regimes

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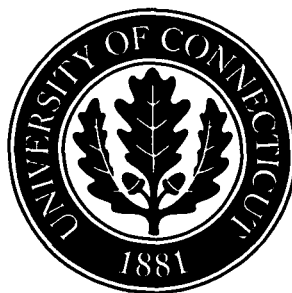
Skepticism about the potential of moral appeals relating to tax compliance—for example, as applied to large groups of individual taxpayers outside a wartime context—has resulted in the absence of a theory about how government communication can further tax compliance. This Article fills that gap. It provides a theory of tax compliance and norm formation under high-penalty regimes from the starting point of a noncompliance norm.

The theory explains the roles of, and mutually reinforcing relationships between, the compliance mechanisms of deterrence, separation, and reputation signaling. The success of these mechanisms depends on the presence of (i) taxpayer perception of penalty imposition, (ii) taxpayer perception of detection efficacy, and (iii) an absence of close substitutes. Either government enforcement or a reputation market can provide penalty imposition and detection efficacy. This Article offers the U.S. requirement of self-reporting of offshore bank account information as an example of a potentially effective high-penalty regime founded on aggressive and creative government enforcement efforts.

The theory also defines an appropriate role for expressive law in advancing tax compliance. This role has relevance, at least, when resources have been committed and government enforcement is not practical. The theory suggests that using law to define good-reputation indicators has particular promise when applied to reputation-sensitive taxpayers such as large intermediaries. This Article identifies four expressive law tax compliance tactics: reputation referencing, salience, management targeting, and incrementalism. It illustrates the expressive law portion of the theory with the example of FATCA, a law passed in 2010 that will require non-U.S. banks to identify U.S. account holders or face withholding on certain U.S. investment returns.

ARTICLE CONTENTS

I. INTRODUCTION.....	677
II. COMPLIANCE MECHANISMS OF HIGH-PENALTY REGIMES.....	679
A. ASSUMPTIONS	679
B. DETERRENCE, SEPARATION, AND SIGNALING	681
C. HOW DETERRENCE, SEPARATION, AND SIGNALING INTERACT	685
D. SET ASIDE CROWDING OUT	687
III. THREE SUPPORTS OF HIGH-PENALTY REGIMES	687
A. PENALTY CREDIBILITY	688
B. DETECTION AND INFORMATION STRATEGIES	689
C. NO CLOSE SUBSTITUTES	691
D. ALL THREE SUPPORTS NEEDED	692
IV. EXPRESSIVE LAW, REPUTATION, AND TAX COMPLIANCE	693
A. PLAN B: EXPRESSIVE LAW	693
B. REPUTATION-SENSITIVE TAX EVADERS	694
C. NORM ENTREPRENEURSHIP AND TAX COMPLIANCE.....	695
V. AN EXAMPLE: OFFSHORE ACCOUNT INFORMATION ASYMMETRY	700
A. THE PROBLEM	700
B. THE OECD’S EXPRESSIVE LAW HARMFUL TAX PROJECT	702
VI. THE FBAR AS AN ENFORCED HIGH-PENALTY REGIME.....	708
A. THE FBAR.....	708
B. APPLYING THE HIGH-PENALTY ANALYTICAL FRAMEWORK TO THE FBAR.....	710
C. FBAR REPORTING AS A SUCCESSFUL HIGH-PENALTY REGIME.....	722
VII. AN EXPRESSIVE LAW FATCA STRATEGY.....	722
A. WHAT FATCA IS.....	722
B. APPLYING THE HIGH-PENALTY ANALYTIC FRAMEWORK TO FATCA	724
C. ADMINISTERING FATCA WITH EXPRESSIVE LAW IN MIND.....	727
D. SEEKING MULTINATIONAL ENFORCEMENT.....	733
VIII. CONCLUSION	735



Tax Compliance and Norm Formation Under High-Penalty Regimes

SUSAN C. MORSE*

I. INTRODUCTION

Scholars disagree about how the government can influence compliance with the law, including tax compliance. Under a view that takes seriously the assumption that taxpayers are rational economic decision-makers, the government can influence compliance mainly by increasing or enforcing penalties. This view has its roots in the theory of deterrence. The government may also provide opportunities for compliant taxpayers to self-identify as such. This can separate compliant from noncompliant taxpayers, boosting government's ability to tailor enforcement solutions to each.

Under another view, the government's statements and actions have an expressive function and can provide content for compliance norms enforced by informal sanctions. This view connects to the idea of reputational signaling. In the tax context, the use of expressive law lacks broad support, and the connection between expressive law and deterrence has not yet been fully explored.

This Article provides a theory of tax compliance under high-penalty regimes. The theory accommodates both the strict rational economic actor view and the expressive law view; explains the roles of and mutually reinforcing relationships between deterrence, separation, and signaling; and defines an appropriate role for expressive law in advancing tax compliance. The example of offshore accounts is used to illustrate the theory.

Parts II and III of this Article set forth an analytic framework for analyzing high-penalty tax regimes where there is no strong pre-existing compliance norm. Part II outlines the compliance mechanisms of deterrence, separation, and signaling and describes their mutually

* Associate Professor, UC Hastings College of the Law. Many thanks for helpful comments to Leandra Lederman and participants at the June 2010 IRS Research Conference; to Darien Shanske and participants at the December 2010 Northern California Tax Roundtable; to Oliver Goodenough, Lynn Stout, and Bart Wilson, and participants at the May 2011 Gruter Institute Conference on Law, Institutions and Behavior; to David Duff and participants at the June 2011 Law and Society Association Annual Meeting; and to Leigh Osofsky. The UC Hastings Summer Research Stipend Program helped fund this project. Some portions of Parts II, III and VI of this Article draw from an earlier conference paper. See Susan C. Morse, *An Analysis of the FBAR High-Penalty Regime*, in I.R.S. RESEARCH BULLETIN: PROCEEDINGS OF THE 2010 IRS RESEARCH CONFERENCE 49 (2010).

reinforcing relationships. Part III argues that three supports are necessary for a high-penalty regime to implement successfully one or more of these compliance mechanisms. Taxpayers should (i) perceive that they actually face material penalties for noncompliance, (ii) believe that the government has an effective mechanism for detecting noncompliers who attempt to masquerade as compliers, and (iii) lack close-substitute choices not subject to penalties. Either government enforcement or a reputational market can provide perceived penalties and detection of masquerading noncompliers.

Part IV theorizes the problem presented where government enforcement cannot provide the supports of perceived penalties and masquerading noncomplier detection. It argues that an expressive law strategy may be capable of triggering a tax compliance norm that then can support a full set of the three compliance mechanisms of signaling, separation, and deterrence. This strategy has particular promise when applied to large tax intermediaries that are reputation-sensitive, participate in a robust reputation market, and have the opportunity to signal publicly their tax compliance behavior.

Parts V, VI, and VII use the problem of offshore account information asymmetry to illustrate the analytic framework developed in Parts II, III, and IV. Part V explains that some U.S. persons transfer funds to financial accounts outside the United States and fail to include related items in their reported taxable income. Part V also describes how the multinational Organization for Economic Cooperation and Development (“OECD”) used an expressive law strategy in this context to persuade countries to take certain steps toward information exchange and transparency and to remove themselves from the so-called tax haven “blacklist.”

Part VI applies the analytic framework developed in Parts II, III, and IV to the Report of Foreign Bank and Financial Accounts (“FBAR”) requirements that oblige U.S. taxpayers to disclose their offshore account information to the U.S. government. It argues that government enforcement can provide the three supports necessary for the FBAR system to function as an effective high-penalty regime. Key elements include the government’s creative and aggressive publicity of successful audits and its persuasive anchoring on willfulness-based penalties despite the uncertain applicability of such penalties under the *Cheek* standard.

Part VII applies the analytic framework to the Foreign Account Tax Compliance Act (“FATCA”), which will require foreign financial intermediaries, such as foreign banks, to report automatically U.S. account holders’ ownership of offshore accounts to the U.S. government. Noncompliance with FATCA requirements carries high potential penalties, but the United States, as a practical matter, will not directly enforce it. FATCA may, however, find success if policymakers use an expressive law norm development strategy. In particular, one immediate goal of the U.S. policymakers implementing FATCA should be to persuade non-U.S. banks

that compliance with FATCA signals good reputation. This expressive law strategy would also permit a parallel pursuit of other nations' cooperation in order to enable government enforcement.

II. COMPLIANCE MECHANISMS OF HIGH-PENALTY REGIMES

A. Assumptions

1. Pre-Existing Noncompliance Norm

This Article examines situations in which a high-penalty regime faces a pre-existing norm of noncompliance. In the case of tax compliance, it is often true in situations of interest that a noncompliance norm exists. U.S. taxpayers have a high rate of income tax compliance,¹ but it does not follow that U.S. taxpayers have strong voluntary compliance norms. Most U.S. taxpayers have no choice but to comply: their taxable income is automatically withheld upon or at least automatically reported to the government.² The difficult compliance questions relate to taxpayers who have the ability to evade tax. This category includes cash business owners and the group that is the focus of Parts V, VI, and VII of this Article—holders of offshore financial accounts. For these taxpayers, tax evasion is commonplace and the norm is, or at least historically has been, at a noncompliance equilibrium.³

In addition to having practical importance, pre-existing noncompliance norms provide an analytically attractive starting point. The pre-existing noncompliance norm features a low compliance baseline, and so the enactment, or increased enforcement, of a high-penalty regime might have a material positive effect on compliance. It would be more difficult to theorize about a high-penalty regime applied to, say, individual wages, because the tax compliance rate for such income already approaches one hundred percent.⁴

2. Legal Certainty

This Article also intends to analyze situations where the law is clear, as it largely is in the offshore account example used to illustrate the theory

¹ In 2001, the U.S. compliance rate was about eighty-four percent when measured as the ratio of the tax paid voluntarily and on time to the total tax due. See U.S. DEP'T OF THE TREASURY, A COMPREHENSIVE STRATEGY FOR REDUCING THE TAX GAP 5 (2006), available at http://www.irs.gov/pub/irs-news/comprehensive_strategy.pdf (showing gross tax gap and net tax gap figures).

² See, e.g., Susan Cleary Morse, Stewart Karlinsky & Joseph Bankman, *Cash Businesses and Tax Evasion*, 20 STAN. L. & POL'Y REV. 37, 39 (2009) ("Taxpayers report cash income less accurately than income subject to third party reporting and/or withholding.").

³ For example, Schedule C small-business taxpayers have a noncompliance rate of about fifty percent. *Id.*

⁴ See *id.* (reporting that the evasion rate on wage income is about one percent).

developed here.⁵ Introducing legal uncertainty complicates the analysis, for example by raising the possibility that actions taken by governments or others may affect taxpayers' understanding of the degree of certainty of a certain legal result. There is a lively debate about the impact of legal uncertainty on the design of tax penalties,⁶ but this Article does not mean to engage it.

3. High Penalties

This Article focuses on high-penalty regimes because such regimes are prominent relative to, for example, the interest and time-based penalty regimes generally applicable to underpayments of tax. High penalties are either criminal penalties or punitively high civil penalties that could exceed the amount of tax due several times over. Each of the compliance mechanisms described relies on perceptions of the regime and therefore it is important that the rules have qualities that make them noticeable and salient.⁷ Regimes that feature less severe penalties might also succeed in achieving the prominence necessary to trigger the described compliance mechanisms, but consideration of that possibility falls outside the scope of

⁵ It is true that some questions around the edges of the FBAR and FATCA rules include elements of uncertainty. It is not perfectly clear whether a court would uphold the legality of large civil willfulness-based FBAR penalties. *See infra* Section VI.B.1. Nor is it clear whether quiet disclosure in practice cures the failure to file an FBAR. *See infra* Section VI.B.3. The scope of the financial institutions subject to FATCA and the details of its due diligence rules also await finalized guidance. *See infra* Section VII.C.4. But definitional questions at the margins do not add substantial uncertainty because this Article focuses on the paradigm case where the FBAR or FATCA requirements plainly do apply. Moreover, in the case of FATCA, the rules must in practice be relatively clear, as intermediary banks must translate them into standard operating procedures and clear computer programs. *See, e.g.*, I.R.C. §§ 6045, 6049 (2006 & Supp. III 2010) (outlining the rules for gross proceeds and interest reporting).

⁶ *See, e.g.*, Michael Doran, *Tax Penalties and Tax Compliance*, 46 HARV. J. ON LEGIS. 111, 138 (2009) (arguing that due to the indeterminacy of many tax compliance questions, penalties define required taxpayer standards of care); Mark P. Gergen, *Uncertainty and Tax Enforcement: A Case for Modest Fault-Based Penalties*, 64 TAX L. REV. 453, 472 (2011) (suggesting that legal uncertainty can cause high penalties to over-deter tax noncompliance among risk-averse taxpayers, while not sufficiently deterring risk-neutral taxpayers); Sarah B. Lawsky, *Probably? Understanding Tax Law's Uncertainty*, 157 U. PA. L. REV. 1017, 1074 (2009) (summarizing conclusions drawn from the "subjectivist" view that legal uncertainty relates to taxpayers' beliefs about uncertainty); Kyle D. Logue, *Optimal Tax Compliance and Penalties When the Law is Uncertain*, 27 VA. TAX REV. 241, 293–96 (2007) (analyzing strict liability and fault-based tax penalty structures assuming legal uncertainty).

⁷ Salience, here, is used to mean salience of government or reputational market enforcement, which can affect compliance decisions. This differs from the broader understanding of salience in the tax context put forward in other work. *Compare* Deborah H. Schenk, *Exploiting the Salience Bias in Designing Taxes*, 28 YALE J. ON REG. 253, 264 (2011) (defining salience as "the degree to which a tax . . . is visible or prominent to the public"), *with* David Gamage & Darien Shanske, *Three Essays on Tax Salience: Market Salience and Political Salience*, 65 TAX L. REV. (forthcoming 2012) (manuscript at 2) ("Market salience refers to how tax presentation affects market decisions and economic activity. Political salience refers to how tax presentation affects voting behavior and political outcomes.").

this Article.

4. “Taxpayers” Includes Tax Intermediaries

Tax law imposes requirements not only on taxpayers, but also on tax intermediaries who must report items to the government and/or withhold tax. Requiring third parties to report or withhold is a variety of gatekeeper regulation.⁸ As Leandra Lederman has argued, a third-party strategy, including a tax reporting or withholding requirement, is particularly useful if the third party’s reputational, financial, or other interests are aligned with the government’s interest in enforcement.⁹

This Article considers the application of high-penalty regimes to tax intermediaries as well as to taxpayers themselves. In some cases, tax intermediaries’ compliance behavior is more visible than taxpayers’. Also, tax compliance may provide a stronger reputational signal in the case of tax intermediaries. Accordingly, the expressive law strategy described in Part IV and illustrated in Section V.B and Part VII has particular relevance when applied to intermediaries.

B. Deterrence, Separation, and Signaling

High penalties can increase compliance in several ways. One mechanism is deterrence. The hypothetical fully rational taxpayer decides whether to evade tax by comparing the amount of saved tax to the penalties for cheating weighted by the chance that the evasion will be detected.¹⁰ Risk aversion modifies this analysis, adding a compliance bias to the fully rational model.¹¹ Reputational concerns also modify the cost-benefit calculus.¹²

As Alex Raskolnikov has observed, high penalties can also prompt

⁸ Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 53–56 (1986) (introducing the gatekeeper regulation concept). This Article does not mean to consider generally issues and opportunities raised by other gatekeepers such as tax preparers.

⁹ Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733, 1739–41 (2010) [hereinafter Lederman, *Reducing Information Gaps*] (listing factors that support a successful information reporting strategy, including arm’s length parties with the capacity to perform the reporting tasks and the absence of “alternative arrangements”); Leandra Lederman, *Statutory Speed Bumps: The Role Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 734–41 (2007) (outlining reasons for tax authorities to suspect the quality of the check third parties may provide).

¹⁰ See Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 J. PUB. ECON. 323, 326 (1972) (observing initially the implication “that the taxpayer will declare less than his actual income if the expected tax payment on undeclared income is less than the regular rate”).

¹¹ See *id.* at 327–28 (considering the risk aversion function).

¹² See *id.* at 326–27 (adding reputation to mark “nonpecuniary” considerations in general); James Andreoni et al., *Tax Compliance*, 36 J. ECON. LIT. 818, 850–51 (1998) (noting the likely impact of guilt and shame on tax compliance decisions); James P. F. Gordon, *Individual Morality and Reputation Costs as Deterrents to Tax Evasion*, 33 EUR. ECON. REV. 797 (1989) (modeling tax behavior to include both an honesty trait and reputation cost).

self-identification by compliant taxpayers, permitting separation. Self-identification separates taxpayers into compliant and noncompliant groups that the government can observe, and to which it can apply different regimes. The idea is that compliant taxpayers may be more inclined to self-identify if they know that failing to do so subjects them to the possibility of high penalties,¹³ whether imposed by the government or the reputation market.

As Eric Posner has explained, tax compliance might also serve as a reputation signal. For example, a taxpayer's peers may interpret a compliance choice to connote a reputation-enhancing quality such as trustworthiness.¹⁴ Signaling connects to deterrence, as suggested above and explored more fully below, because a rational actor may choose to provide a compliance signal because of the superior reputational benefits that result, apart from any moral or altruistic reason for complying.¹⁵ This Article distinguishes between, on one hand, reputation; and, on the other hand, other possible "warm glow" effects such as patriotism or the satisfaction of contributing to worthy public goods.¹⁶ Confining the purpose of tax compliance signaling to reputation is consistent with Posner's understanding of signaling.¹⁷

But this Article does not conceive of a reputation signal as a mark of "good type" exceptionalism that strengthens if good types are harder to find.¹⁸ Rather, this Article follows others who have assumed,¹⁹ with some

¹³ See Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement*, 109 COLUM. L. REV. 689, 701–05 (2009) (describing the separation function of penalties).

¹⁴ Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1789 (2000).

¹⁵ See ERIC A. POSNER, *LAW AND SOCIAL NORMS* 18–27 (2000) (exploring the economics-grounded theory of signaling based in game theory and the problem of distinguishing between good types and bad types); see generally SOCIAL NORMS, NONLEGAL SANCTIONS, AND THE LAW (Eric A. Posner ed., 2007) (collecting articles relating to social norms and the law).

¹⁶ Compare Robert B. Cialdini, *Social Motivations to Comply: Norms, Values and Principles*, in 2 TAXPAYER COMPLIANCE: SOCIAL SCIENCE PERSPECTIVES 200, 209 (Jeffrey A. Roth & John T. Scholz eds., 1989) (suggesting a commitment and consistency link between overarching norms like patriotism or honesty and tax compliance), and Marjorie E. Kornhauser, *Tax Compliance and the Education of John (and Jane) Q. Taxpayer*, 121 TAX NOTES 737, 740–44 (Nov. 10, 2008) (recommending public education and media tactics to connect tax payment and public goods), with Susan Cleary Morse, *Using Salience and Influence to Narrow the Tax Gap*, 40 LOY. U. CHI. L.J. 483, 505–06 (2009) (arguing that small group norms among similar taxpayers have a clearer link to tax compliance than large-group or national norms).

¹⁷ See Posner, *supra* note 14, at 1788 (explaining the potential of tax compliance as a good-reputation signal).

¹⁸ POSNER, *supra* note 15, at 19. Posner's theory could be understood to mean that the rarer good types are, the harder they are to find and the more powerful the "good type" reputation signal. See *id.*

¹⁹ See Robert Cooter, *Expressive Law and Economics*, 27 J. LEGAL STUD. 585, 593 (1998) (describing an equilibrium shift from less compliance to more compliance as more people comply and cause others to comply by "punish[ing] wrongdo[ers] by informal means"); see also Alex Geisinger & Michael Ashley Stein, *A Theory of Expressive International Law*, 60 VAND. L. REV. 77, 118 (2007)

empirical support,²⁰ that signaling becomes more powerful with a decreasing proportion of evaders relative to compliers. In other words, signaling has a virtuous-circle quality: as more people signal compliance as a positive reputation signal, the positive reputation signal grows in strength.

Signaling also has a second potential virtuous-circle quality. It can strengthen the compliance behavior of the taxpayer who signals through the commitment consistency heuristic. Commitment consistency induces us to act consistently with past acts and statements,²¹ and avoid questions about “one’s reputation for consistency, a highly valued asset in our economic culture.”²² Nothing limits the operation of commitment consistency to drive behavior around negative instead of positive norms. Commitment consistency has the capacity to reinforce the compliance behavior of a taxpayer who self-identifies as compliant under a signaling mechanism.

The signaling model can help explain the development of law-breaking norms as well as compliant norms,²³ and, accordingly, noncompliance might also serve as a “good” reputational signal under some circumstances. The success of a tax compliance reputation signaling story thus requires a

(“As other States are guided by the norm, certainty that a particular behavior is norm-congruent increases, with a corresponding increase in the esteem a State would expect from acting in accordance with the norm.”); Gordon, *supra* note 12, at 801 (describing a reputation cost that rises with “the proportion of the population who are believed to consider evasion to be morally wrong”).

²⁰ See, e.g., James Alm & Michael McKee, *Tax Compliance as a Coordination Game*, 54 J. ECON. BEHAV. & ORG. 297, 310–11 (2004) (noting that taxpayer communication regarding planned noncompliance increases noncompliance and describing ways in which audit policy can discourage noncompliance cooperation); James Alm et al., *Changing the Social Norm of Tax Compliance by Voting*, 52 KYKLOS 141, 153, 161 (1999) (reporting increased compliance if experimental subjects were permitted to communicate about their compliance decisions); Michael Wenzel, *Motivation or Rationalisation? Causal Relations Between Ethics, Norms and Tax Compliance*, 26 J. ECON. PSYCHOL. 491, 504–05 (2005) (reporting longitudinal study results indicating that group norms affect personal ethics when a taxpayer identifies with the group).

²¹ See, e.g., ROBERT B. CIALDINI, *INFLUENCE: SCIENCE AND PRACTICE* 59–88 (5th ed. 2009) (detailing results of commitment consistency studies); Dan M. Kahan, *Social Influence, Social Meaning, and Deterrence*, 83 VA. L. REV. 349, 358–59 (1997) (noting that the desire to avoid cognitive dissonance motivates individuals to conform their behavior).

²² Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, in *BEHAVIORAL LAW AND ECONOMICS* 144, 151 (Cass R. Sunstein ed., 2000); see also Jon Hanson & David Yosifon, *The Situational Character: A Critical Realist Perspective on the Human Animal*, 93 GEO. L.J. 1, 72 & n.324 (2004) (arguing that individuals are not aware of the influence that commitment or other heuristics exert over their decision-making); Dan Simon, *A Third View of the Black Box: Cognitive Coherence in Legal Decision Making*, 71 U. CHI. L. REV. 511, 522 (2004) (“The central feature of constraint satisfaction mechanisms is that the mental model will reconfigure itself until the constraints settle at a point of maximal coherence.”).

²³ See Dan M. Kahan, *Signaling or Reciprocating? A Response to Eric Posner’s Law and Social Norms*, 36 U. RICH. L. REV. 367, 370–73 (2002) (using “body-piercing, law breaking, or drug use” as examples).

reputational market that connects signals of tax compliance to other valued qualities like honesty or responsibility. Another objection to signaling theory is the possible suitability of the theory to only “‘medium-sized’ communities in which a particular person does not have extensive personal experience with most potential cooperative partners, but in which it is plausible that there will be repeated interactions with a given signaler.”²⁴ There is also the concern that the signaler may change his or her mind.²⁵

Finally, signaling faces the problem that it may be impossible to observe signals. This is a particular problem for tax compliance, as taxpayers are not generally forced to show publicly whether or not they comply.²⁶ This distinguishes tax compliance from a law relating to, say, water conservation in residential landscaping, where signaling is usually inevitable and social pressures naturally encourage compliance.

However, some taxpayers are subject to public tax reporting requirements. Examples include third-party reporting by tax intermediaries such as banks, pass-through entity reporting by partnerships and S corporations, and disclosure of tax returns by politicians. Public tax reporting has greater potential to support a reputation signal if the reporting audience, perhaps composed of clients or owners, views compliance with the reporting requirements favorably.

This Article does not mean to claim that signaling always, or even usually, can work to generate a tax compliance norm. An important prerequisite for the argument, developed in Part VII, that signaling might be used to develop a tax compliance norm in the case of the administration of FATCA, is that the targets of FATCA—large global financial institutions—operate in a well-functioning reputational market. Large banks care about their reputation for honesty and responsibility. Their market constitutes a community where customers need reputation to choose a bank, with which they will then enter into a series of interactions and transactions.²⁷ Banks are less likely to change an established signaling behavior, as it must be woven into the organizational structure, computer systems, and other standard operating procedures of the bank. Finally, banks’ compliance behavior—such as the sending of annual tax reports to

²⁴ Paul G. Mahoney, *Norms and Signals: Some Skeptical Observations*, 36 U. RICH. L. REV. 387, 392 (2002).

²⁵ See Elmer J. Schaefer, *Predicting Defection*, 36 U. RICH. L. REV. 443, 447–51 (2002) (analyzing preference shift possibilities).

²⁶ Taxpayer confidentiality and the ability to settle claims with the government often conceal tax compliance and noncompliance signals. See, e.g., Doran, *supra* note 6, at 135–38 (noting that norm development theory generally fits poorly with tax compliance); Eric A. Posner, *The Signaling Model of Social Norms: Further Thoughts*, 36 U. RICH. L. REV. 465, 468 (2002) (noting the difficulty of demonstrating tax compliance).

²⁷ See, e.g., *infra* Section V.B.2 (describing the reputation concerns of tax haven banking industries).

clients and the government—is public within relevant reputation markets.

Effective signaling requires the existence of a compliance norm of some kind. Absent such a norm, a visible compliance choice cannot serve as a good-reputation proxy. This Article assumes that the pre-existing norm is a noncompliance norm. This means that some other mechanism, such as enforcement-based penalties and detection, or an expressive norm-building mechanism, must generate a compliance norm before signaling can effectively incent tax compliance.

C. How Deterrence, Separation, and Signaling Interact

Deterrence, separation, and signaling mechanisms interact and can reinforce each other. As described below, relationships exist between deterrence and separation, deterrence and signaling, and separation and signaling. In each case, causality runs in both directions.

1. Deterrence and Separation

Consider first the relationship between deterrence and separation. The idea of deterrence, which proceeds from the premise that penalties incent rational taxpayers to comply, is that it can transform noncompliant taxpayers into compliant taxpayers. The dependent variable or goal of deterrence is not an inherent or exogenous quality of a compliant nature or personality, but rather an exhibited taxpayer behavior. Under a deterrence theory, taxpayers' compliance behavior must be fluid, not exogenous. This view of deterrence follows Leandra Lederman in contending that sufficiently increased enforcement may produce a new and more compliant norm.²⁸

If deterrence persuades some noncompliers to act as compliers, deterrence should expand the group eligible to self-identify as compliant to obtain the benefits of a compliance-appropriate government regime under the separation mechanism. Separation can also reinforce deterrence because it can produce the disclosure of information that makes it easier for the government to carry out its enforcement program. For example, separation can make it easier to audit taxpayers who have self-declared as compliant to ensure that they are in fact complying.

2. Deterrence and Signaling

Deterrence can also strengthen reputation signaling. This is because effective signaling requires the existence of a compliance norm. Successful deterrence, by pushing taxpayers into the compliant group,

²⁸ Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1508 (2003) (“It may, therefore, be possible to change normative commitments by reducing the opportunity for noncompliance, such as through increased enforcement of the tax laws.”).

tends to make compliance a more dominant behavior, thus increasing the chance that it will be understood to connote good reputation.²⁹ In addition, because of the behavioral tendency toward commitment consistency, self-identifying as compliant for any reason—including a reason relating solely to concerns about government enforcement—should make a taxpayer more likely to in fact behave in a compliant way and associate compliance with good reputation.³⁰

In the other direction, signaling influences deterrence by changing the individual utility curve referenced by a taxpayer when making a decision as to whether to evade tax. If compliance brings reputational benefits, the tax evasion calculus, which compares the amount of saved tax to the risk-adjusted penalty for cheating, changes. In particular, the reputational benefit of advertising compliance adds to the list of factors that incents tax compliance. Good reputation—understood within the context of appropriate norms—has positive utility.³¹

3. *Separation and Signaling*

Separation, or compliant taxpayers' self-identification to the government, supports signaling in two different ways. The key to the first is commitment consistency. Taxpayers' self-identification in response to a separation program is at least a quasi-public declaration about their compliance values. After such a declaration, taxpayers will be more likely to internalize such compliance as consistent with their view of themselves and with their desire to demonstrate their good reputation. Separation also may strengthen signaling because the act of self-identification to the government as a compliant taxpayer can serve as a strong reputational signal. The more effective self-identification is as a utility-enhancing signaling mechanism, the more likely a taxpayer will be willing to self-identify as compliant for purposes of the separation mechanism.

In the other direction, signaling can change the separation dynamic by adding a reputation-market separation function. For example, reputation market participants could apply categorically different and more advantageous rules of interaction to a taxpayer who displays a positive reputation signal. This is apart from any government promise to treat compliers and noncompliers differently.³²

²⁹ See *id.* at 1509–10.

³⁰ See *supra* notes 21–22 and accompanying text (discussing commitment consistency).

³¹ Since signaling is consistent with a rational actor model, it may seem redundant to say that it also supports deterrence. This Article separates the two ideas to emphasize that even if a compliance norm has moral origins, it can immediately serve a deterrence purpose as well.

³² This Article distinguishes the concepts of signaling and the concept of reputation-market separation to emphasize that a reputation market may develop influential and separating rules of thumb (consider the tendency to divide markets into “tiers”) loosely based on, but existing separately from, reputational signals delivered in individual interactions.

D. *Set Aside Crowding Out*

High penalties may have the potential to crowd out compliant behavior as well as to serve the compliance-enhancing functions of deterrence, separation, and signaling.³³ Some argue that high penalties can commoditize, and thereby undermine, previous social norms of compliance.³⁴ Or high penalties may be interpreted by a compliant taxpayer as a defecting move in the previously reciprocal tit-for-tat compliance relationship the taxpayer had built with the government.³⁵

The penalties in the offshore account case, which are triggered by narrowly defined failures to report, may successfully resolve the risk that high penalties will crowd out compliant behavior, since they are arguably “‘appropriately tailored’ penalties ‘aimed specifically’ at taxpayers who ignore tax compliance.”³⁶ Also, it is not clear just how strong a phenomenon crowding out is.³⁷ In any case, this Article will focus on penalties only, not rewards, and it sets aside the possibility of crowding out in an effort to streamline the analysis.

III. THREE SUPPORTS OF HIGH-PENALTY REGIMES

A high-penalty regime can produce the mutually reinforcing mechanisms of deterrence, separation, and signaling described in Part II. But achieving these results requires the three supports of penalty credibility, the perception that the noncompliers who masquerade as

³³ See Doran, *supra* note 6, at 133 (describing the conundrum presented when crowding out suggests that high penalties may reduce voluntary compliance, but deterrence theory suggests that high penalties will increase compliance); Eric Fleisig-Greene, *Law's War with Conscience: The Psychological Limits of Enforcement*, 2007 BYU L. REV. 1203, 1233–35 (arguing that law can have an adverse impact on previously existing positive norms and citing one empirical study suggesting that taxpayers who received letters notifying them of a likely audit reported less income than other taxpayers).

³⁴ See, e.g., Marjorie Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*, in 2 NAT'L TAXPAYER ADVOCATE, 2007 ANNUAL REPORT TO CONGRESS 138, 151 (2007) (arguing that a commodified exchange view of taxation can “crowd[] out positive normative influences on [compliance] behavior” and prompt taxpayers to believe that the government is not fair); Kornhauser, *supra* note 16, at 739 & n.21 (noting the importance of procedural fairness and reciprocal trust for compliant taxpayers).

³⁵ See Dan M. Kahan, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71, 83–84 (2003) (noting the inconsistency of audit threats with a reciprocal compliance relationship).

³⁶ Doran, *supra* note 6, at 133 (quoting Kahan, *supra* note 35, at 79); see also Morse, *supra* note 16, at 510–12 (arguing that publicizing penalties and rewards commensurate with taxpayer behavior would minimize the crowding-out problem).

³⁷ Compare Lederman, *supra* note 28, at 1489–99 (arguing that available evidence supports the view that taxpayers generally interpret sanctions and enforcement as measures that properly target evading taxpayers, thus supporting a compliance norm), with Kahan, *supra* note 23, at 377 (citing studies that support crowding out).

compliers will be detected, and the absence of close substitutes. In the cases of penalty credibility and masquerading noncomplier detection, government enforcement and/or a robust reputation market can provide the supports.

A. *Penalty Credibility*

Penalty credibility based on government enforcement depends on more than the penalties as stated in the statute books. Various factors contribute to gaps between an on-the-books penalty and its enforcement in practice. These may include litigation risk management;³⁸ internal agency politics, such as a desire to stick to prior practice or avoid adversarial relationships with regulatees;³⁹ national politics, including the goal of avoiding backlash legislation that could curb the agency's power or resources in response to an excessively tough public image;⁴⁰ and international politics, including a reluctance to upset foreign governments by pushing U.S. policies that appear harsh and unilateral.⁴¹

A conceptually distinct—and more important⁴²—gap also often exists between a de jure penalty and taxpayers' perception of a de facto penalty policy. Taxpayers' internal perception of the likelihood of penalty imposition drives their compliance decisions; hence, this perception is the real key to this element of a successful high-penalty strategy.⁴³ Elements that influence this perception include how the agency actually imposes penalties; whether it says it will impose penalties; and how information

³⁸ See, e.g., IAN AYRES & JOHN BRAITHWAITE, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* 44–47 (1992) (arguing that an agency that threatens serious punishments may be “vulnerable to a litigious firm determined to shatter its myth of invincibility”).

³⁹ For example, although the IRS has broad statutory powers to summon documents, see I.R.C. § 7602 (2006), and the Supreme Court has vindicated its authority to use these powers to summon tax accrual workpapers prepared by accountants, *United States v. Arthur Young & Co.*, 465 U.S. 805, 816 (1984), the IRS has historically followed a “policy of restraint” under which it will only seek workpapers “to obtain collateral sources of data, not to fish for new issues,” Thomas J. Monks, *Your Papers, Please: Requests for FIN 48 Workpapers*, 125 TAX NOTES 901, at nn.72–75 (2009). This restraint may stem from habit as well as from a desire to dodge litigation risks, limit exposure to restrictive statutory changes, and/or avoid souring relationships with taxpayers. See generally Dennis J. Ventry Jr., *A Primer on Tax Work Product for Federal Courts*, 123 TAX NOTES 875 (2009) (arguing that tax accrual workpapers can never constitute protected work product).

⁴⁰ See, e.g., Bryan T. Camp, *Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998*, 56 FLA. L. REV. 1, 79–81 (2004) (describing the public perception of an overzealous IRS that led to the passage of a statute curtailing the agency's power).

⁴¹ Cf. JOSEPH S. NYE, JR., *SOFT POWER: THE MEANS TO SUCCESS IN WORLD POLITICS* 63–65 (2004) (connecting a “unilateral” approach to American foreign policy and the “decline of America's attractiveness abroad”).

⁴² See, e.g., AYRES & BRAITHWAITE, *supra* note 38, at 44–47 (identifying regulatees' perception of an agency's “invincibility” as a key factor).

⁴³ Cf. Lawsky, *supra* note 6, at 1041–42 (making a parallel point about the importance of taxpayers' beliefs about the law's certainty).

about penalty imposition and rhetoric is made public and, separately, publicized.

If affected taxpayers perceive that the reputation market is well-supplied with information and able to impose reputational sanctions, credible reputation penalties can also support compliance. One kind of reputational penalty consists of the stigma that may attach if a taxpayer is audited and charged with tax evasion.⁴⁴ However, in many cases, taxpayers' actual compliance behavior is confidential and not visible.⁴⁵ In these cases, the possibility of public litigation provides the main possible reputational feedback loop. Its power is limited because audit, let alone litigation, is unlikely.

But sometimes taxpayers' compliance behavior is visible. Tax intermediaries with third-party withholding and/or reporting obligations and pass-through entities, such as partnerships and S corporations, provide two examples. If a robust reputation market can observe tax compliance behavior, and if this market gives taxpayers reputation demerits for tax noncompliance, the reputation market can provide credible penalties that can support compliance for reputation-sensitive taxpayers.

B. Detection and Information Strategies

As Alex Raskolnikov has persuasively argued, a key task in tax administration is to identify noncompliers who masquerade as compliers.⁴⁶ This point is highly relevant to a high-penalty regime, whether the high penalty is intended to serve only the separation purpose that Raskolnikov identified in the context of menu-based regulatory penalty default structures or whether the high penalty also functions as a deterrent and/or signal. The deterrence function will also be frustrated if noncompliers can hide behind a mask of compliance. Signaling will falter if "[c]on artists . . . send false signals of being cooperative."⁴⁷ Moreover, masked noncompliance might become a known workaround that can serve as a competing signal.

The focus on the identification of noncompliers masquerading as compliers does not dismiss the more general goal of discovering and penalizing noncompliers. But that goal belongs with the analysis in Section III.A, above, which discusses whether taxpayers perceive penalties as credible possibilities. Assuming that they do, and that they self-identify as compliers, the necessity of detection and information strategies to

⁴⁴ See Posner, *supra* note 14, at 1789 (describing the bad-type tax audit signal).

⁴⁵ See *supra* note 26 and accompanying text (explaining the problem of communicating tax compliance).

⁴⁶ See Raskolnikov, *supra* note 13, at 724–28 (exploring several ways to increase the likelihood of detection in the compliance group).

⁴⁷ Schaefer, *supra* note 25, at 446–47.

determine whether they are telling the truth is a separate and important component of an effective high-penalty strategy.

Either the government or a reputation market may detect masked noncompliance. For the government, one way that information filing can improve detection is through its interaction with audit policy. In simplest form, regulatees who identify themselves as compliers may be subject to more frequent or more thorough audit.⁴⁸ Larger populations of regulatees require an audit selection strategy that identifies compliant filers who are more likely to be in fact noncompliant. Part of this can be based solely on the compliance information provided by regulatees, as they can be sorted based on statistical information about the likelihood of compliance by regulatees who meet certain descriptive characteristics. This works only if those characteristics are available in information provided to the regulating agency and it works best if the data are provided in a form that allows automatic information searching.

A different audit selection strategy may be available if there are alternative sources of information about regulatees. Third party reporting is most prevalent in tax administration, but “non-tax documentation” sources,⁴⁹ such as book-tax balance sheet differences, might also be used. Strategies here go beyond sorting based on a statistical model built from taxpayer-provided data. Instead, the regulator may analyze different sources of data to check whether they match and/or to feed a richer statistical model of the likelihood of compliance. Because of the importance of interactions between alternative sources of data and the taxpayer-provided information that signals compliance, careful design of the reporting required by compliant taxpayers will increase the chance of success for a high-penalty regime.

A reputational market might also police the possibility of masquerading noncompliers. For example, in the case of third-party intermediaries, or partnerships and S corporations, the clients or equity owners who receive reports have a non-tax financial interest in ensuring that the reports comprehensively list all income items. The omission of

⁴⁸ This may be a sufficient strategy for a small population of regulatees, if it is possible to craft the audit approach in a way that does not interfere with the goal of rewarding compliant taxpayers with better service. The IRS’s Compliance Assurance Program, or CAP, for large corporate taxpayers is an example of an attempt to craft this kind of service-oriented audit strategy. See I.R.S. Announcement 2005-87, 2005-50 I.R.B. (Dec. 12, 2005) (anticipating government-taxpayer cooperation in the CAP early issue resolution program); CLIFF JERNIGAN, CORPORATE TAX AUDIT SURVIVAL: A VIEW OF THE IRS THROUGH CORPORATE INSIDER EYES 76–77 (2005) (explaining that the IRS invited taxpayers with a “history of honest dealings” to participate in CAP). *But see* Leigh Osofsky, Getting Realistic About Responsive Tax Administration (Oct. 1, 2011) (unpublished manuscript) (on file with author) (arguing that an absence of data on CAP makes it impossible to evaluate the success of the program and the extent of problems of regulatory capture).

⁴⁹ Joshua D. Blank, *Overcoming Overdisclosure: Toward Tax Shelter Detection*, 56 UCLA L. REV. 1629, 1685–86 (2009).

some items might suggest that the value of the account or equity interest is not accurately stated in the records of the intermediary or entity. The inaccuracy of tax reports might also flag a broader mismanagement or agency cost problem.⁵⁰

C. *No Close Substitutes*

Like any other kind of rule, the operation of a high-penalty regime will also be affected by the ability of taxpayers to avoid the whole scheme by making choices that are sufficiently close substitutes for the penalized behavior. The success of a high penalty for a particular infraction requires the absence of sufficiently close substitutes for the penalized action. The penalty will be less effective if the taxpayer can make choices that achieve the goal of tax evasion without incurring a penalty.

David Weisbach has conceptualized the idea of minimizing close substitutes for a taxed activity as the goal of reducing the “marginal efficiency cost of funds,” which is lower if fewer behavioral distortions result from the imposition of a tax.⁵¹ He identifies the problem of “close substitutes” as a problem that can arise because of (1) legal line-drawing exercises that categorize, for example, debt and equity differently, and (2) the readiness to “shift[] to another transaction.”⁵²

Similarly, David Schizer has categorized the factors that may determine whether a particular “friction” prevents taxpayers from planning around a particular rule.⁵³ Schizer notes that strong and non-malleable frictions, which may come in the form of business choice preferences, technology limitations, and legal and accounting costs, can hinder or prevent the development of close substitutes.⁵⁴ The absence of close substitutes or, similarly, the existence of strong and inflexible frictions, is key to the success of a strategy that imposes high penalties on certain

⁵⁰ In the case of politicians who disclose their tax returns, adverse political interests and the media may discover and publicize discrepancies between tax returns and underlying facts. *See, e.g.*, Kristin Jensen & Edwin Chen, *Daschle Withdraws Nomination Following Tax Questions*, BLOOMBERG (Feb. 3, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ak_IcFNSWPWg (reporting Tom Daschle’s withdrawal from consideration for the position of Secretary of Health and Human Services after tax return review revealed a failure to report income attributable to the use of a car and driver).

⁵¹ David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627, 1665–68 (1999) (defining marginal efficiency cost of funds as the ratio between the revenue from a tax change with no behavioral distortion and the actual—presumably lower but still positive—revenue including the impact of behavioral effects).

⁵² *Id.* at 1661–62.

⁵³ David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 COLUM. L. REV. 1312, 1323–25 (2001).

⁵⁴ *Id.* at 1323–34.

behaviors.⁵⁵

D. *All Three Supports Needed*

All three of the supports—(i) taxpayer perception of penalties, (ii) taxpayer perception of detection of masquerading noncompliers, and (iii) an absence of close substitutes—are essential to the success of the compliance mechanisms of deterrence, separation, and/or signaling under a high-penalty regime. In the case of deterrence, the perceived (not actual) likelihood of penalty and detection are the inputs into the calculus of the expected benefits and burdens of tax evasion, and a close-substitute activity will prompt a choice that avoids the calculus altogether. The absence of any of the three provides a loophole that can ruin the whole deterrence project. For example, a very high likelihood of penalty imposition cannot effectively deter if there is a zero probability of detection of noncompliers who falsely present themselves as compliers or the presence of a costless close substitute.

Penalty credibility, detection, and close substitutes relate to separation in a way similar to the way in which they relate to deterrence. A taxpayer's decision as to whether to identify as a complier is shaped by the perceived benefits and burdens of the compliance and noncompliance regimes. First, taxpayers presumably require an incentive before they will take the trouble to self-identify as compliant. Second, absent effective detection, compliance regimes will be inappropriately extended to masquerading noncompliers. Finally, a close substitute option eliminates the necessity of choosing from the government's menu.

A robust reputation market, as well as government enforcement action, can also provide the supports of penalty credibility and masquerading noncomplier detection for the compliance mechanisms of deterrence and separation. If a relevant reputation market assigns reputation demerits to noncompliant taxpayers and can detect compliant and noncompliant taxpayers, then the utility of noncompliance decreases and noncompliant taxpayers will be deterred under the rational actor model. In addition, the existence of a visible compliance signal such as a third-party reporting requirement forces taxpayers to self-identify as compliant or noncompliant, and the reputation market may then separate the two groups by applying different sets of rules to each. If the reputation market values compliance, it will assign a more attractive set of rules to the compliant category.

In the case of signaling, these reputation supports are central to the compliance project. In order for a signaling compliance mechanism to

⁵⁵ See, e.g., Lederman, *Reducing Information Gaps*, *supra* note 9, at 1740–41 (arguing that the absence of “alternative arrangements” increases the likelihood of success of an information reporting provision).

succeed, taxpayers must perceive that the reputation market will impose penalties for noncompliance, and that the market can detect masquerading noncompliers. Taxpayers do not, however, necessarily need to believe that the government will penalize them for noncompliance, or detect noncompliers who pretend to masquerade as compliers, in order for the signaling mechanism to work. The desired outcome under the signaling goal is not mediated by the government, but rather by the reputational market populated by, for example, the taxpayer's peers and/or clients.

A close substitute can singlehandedly derail a signaling goal even if the reputational market is working well. The reason is that the close substitute behavior may become the norm that everyone gathers around. Regardless of the quality of enforcement of high penalties for prohibited behavior, a close substitute can function as a competing signal that undermines the signaling power of the enacted and enforced law, so long as the close substitute is sufficiently well known. Regulatees may gather around the workaround as an indicator of sufficiently compliant behavior, rather than around the law as enacted, just as motorists may informally agree that driving after two drinks is safe enough.

IV. EXPRESSIVE LAW, REPUTATION, AND TAX COMPLIANCE

A. *Plan B: Expressive Law*

Part III described how the three supports of credible penalties, credible detection policy, and lack of close substitutes can bring about tax compliance through the mechanisms of deterrence, separation, and/or signaling under a high-penalty regime. Effective government enforcement is one route to credible penalties and credible detection policy. But what if effective government enforcement is not possible? In the starting-point scenario that this Article considers—specifically, where there is no pre-existing norm of tax compliance—advertising tax compliance carries few initial reputational benefits and signaling has little force. In other words, the reputation market cannot provide credible penalties and masquerading noncomplier detection. At least it cannot do so until a norm of tax compliance is created. Enter expressive law.⁵⁶

⁵⁶ See Cooter, *supra* note 19, at 607 (“Law provides an instrument for changing social norms by expressing commitments.”); Posner, *supra* note 14, at 1798–99 (observing that the government is a player in the norm creation game and can send signals that affect taxpayer behavior); Cass R. Sunstein, *Legal Interference with Private Preferences*, 53 U. CHI. L. REV. 1129, 1137–38 (1986) (explaining that law helps to determine preferences and exploring related democratic theory problems). It is not necessary here to argue that government expressions about the law must have moral content; it is enough to conceive of expressive law as an instrumental tool that can alter social norms. See Matthew D. Adler, *Expressive Theories of Law: A Skeptical Overview*, 148 U. PA. L. REV. 1363, 1497 (2000) (arguing that “the proper methodology for assessing governmental speech is scientific, not moral,” although a “moral framework” is necessary in order to evaluate the results of government speech).

There may be circumstances where a government must choose between an enforced high-penalty strategy and an expressive law approach. Resource constraints, or a situation where both strategies were available but one is not compatible with the other, might force such a choice. But this Article does not advance any criteria for such a choice. Rather, it considers a simpler situation, where the government has already committed resources to a high-penalty regime, and where it cannot construct the penalty and detection supports with enforcement (for example, because of a lack of jurisdiction). In this case, at least, it should consider the use of an expressive law Plan B.

B. *Reputation-Sensitive Tax Evaders*

The idea of targeting an expressive law strategy at an apparently determined noncomplier may seem silly. For example, the offshore account holders or bank secrecy-focused non-U.S. banks discussed in Parts V, VI, and VII have historically not complied with U.S. requirements to disclose the existence of U.S.-held non-U.S. bank accounts. Existing accounts of expressive law might categorize such taxpayers or intermediaries as “dedicated cheaters.”⁵⁷ Alex Raskolnikov calls this the “gamer” category, and endeavors to find a way to ensure that a taxpayer’s true gamer nature is revealed by a separation mechanism to permit, among other things, the application of more draconian penalties to this group.⁵⁸ Eric Posner concludes that signaling strategies will not work as applied to “people in deviant communities,” either because tax compliance lacks salience as a reputational strategy, or because “people already have a low opinion about that person.”⁵⁹

These analyses suggest that expressive law strategies are futile as applied to determined evaders. How could expressive law and norm development affect a taxpayer who views tax law as a game and does not care about his reputation? The answer lies in the fact that a key assumption is incorrect. In particular, it is possible that a historically committed tax evader cares quite a bit about reputation, and this possibility opens the door for an expressive law strategy.

In a situation where there is a tax noncompliance norm, an evader who cares about reputation may well suffer no reputational blow from failing to comply with applicable tax requirements. The cash business situation provides an example. If a store owner evades taxes, and all of his small-business friends do likewise, the tax-evading store owner may experience camaraderie or respect for a particularly clever evasion strategy, rather than

⁵⁷ Kahan, *supra* note 35, at 84.

⁵⁸ Raskolnikov, *supra* note 13, at 691.

⁵⁹ Posner, *supra* note 14, at 1795.

a blow to her reputation.⁶⁰ The offshore account situation explored further in Parts V, VI, and VII provides other examples. The U.S. individual with a Swiss bank account might be seen by her peers as rich, clever, or cosmopolitan; and the Swiss bank that found a dodgy way around a requirement to disclose U.S. account holders might be seen as offering excellent, personalized client service while respecting its longstanding national bank secrecy tradition.

If a historically committed tax evader cares about reputation, and it is possible to build a norm that casts tax compliance as the reputation-enhancing behavior, then the reputation-sensitive historic tax evader might start to experience reputation benefits from signaling consistency with the new tax compliance norm. This appears to have happened recently in the tax haven context, where efforts to brand tax havens as nefarious have apparently produced countries' agreement to signal their compliance with a new norm involving at least some commitment to information disclosure and transparency. Section V.B discusses this story in more detail.

C. Norm Entrepreneurship and Tax Compliance

1. Norm Building in the Tax Context

Building a norm—by which I mean, following Robert Ellickson, a “rule supported by a pattern of informal sanctions”⁶¹—requires some kind of communication. Expressive law norm-building has been described as a “[c]ommunication [that] establishes a public space of meanings and shared understandings between the speaker and addressee.”⁶² Law can express moral principles, such as race equality or animal rights.⁶³ It can also express a solution to a collective action problem,⁶⁴ which has been called the “least controversial case for the expressive function of law.”⁶⁵ A law might provide a focal point for cooperative decision-making, for example

⁶⁰ See Morse, Karlinsky & Bankman, *supra* note 2, at 65–66 (describing tax noncompliance behavior of small businesses as consistent with group norms).

⁶¹ Robert C. Ellickson, *Law and Economics Discovers Social Norms*, 27 J. LEGAL STUD. 537, 549 n.58 (1998).

⁶² Elizabeth S. Anderson & Richard H. Pildes, *Expressive Theories of Law: A General Restatement*, 148 U. PA. L. REV. 1503, 1574 (2000).

⁶³ See Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2043–44 (1996) (discussing the connection between public norms and private norm entrepreneurs).

⁶⁴ See, e.g., Cooter, *supra* note 19, at 607–08 (describing norm development as a way to accomplish a Pareto self-improvement through cooperation); Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649, 1654–58 (2000) (describing expressive law as a way to solve coordination games); Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697, 1729–36 (1996) (considering ways in which the government could foster the replacement of inefficient norms with efficient norms).

⁶⁵ Sunstein, *supra* note 63, at 2033.

by requiring cars to drive on one side of the road.⁶⁶ Or a law might provide an honorable excuse for individuals to avoid mutually destructive activity, for example by prohibiting individuals convicted of dueling from holding public office.⁶⁷

Moral expressive law strategies do not have a large following when it comes to the problem of tax compliance. Exhorting large groups of individual taxpayers to pay their taxes because it is the right thing to do may have met historical success in the extreme context of wartime crisis, which provides an opportunity for messages with unparalleled salience as well as consensus with respect to public goods⁶⁸ and reciprocity.⁶⁹ However, outside that context, few seem to consider a normative approach to tax compliance a very promising strategy. Available empirical evidence is sparse and mixed.⁷⁰

Tax compliance might seem to be a classic collective action problem. Perhaps we should expect taxpayers to comply if they know that others will also comply, so that the funding of public goods will be a successful collective exercise. But in many cases of interest taxpayers do not experience tax compliance as a collective action problem.

First, the collective action problem likely lacks salience for stakeholders in the tax compliance case because the public benefit produced by better tax compliance—a marginal improvement to the public finance system—is confusing, remote, and somewhat boring. It is cognitively difficult for taxpayers to appreciate this marginal public benefit.⁷¹ Related research investigating the relationship between tax compliance and perceived government legitimacy, or trust in government, reaches inconsistent results regarding whether these factors are positively correlated with tax compliance.⁷²

⁶⁶ See McAdams, *supra* note 64, at 1667 (illustrating a coordination problem in lawmaking using a basic driving example).

⁶⁷ See Lawrence Lessig, *The Regulation of Social Meaning*, 62 U. CHI. L. REV. 943, 968–72 (1995) (discussing dueling in the American South).

⁶⁸ See Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 BUFF. L. REV. 685, 686–87 (1989) (discussing how tax propagandists encouraged tax compliance during World War II).

⁶⁹ See STEVEN A. BANK ET AL., *WAR AND TAXES* 172–74 (2008) (describing “shared sacrifice” rhetoric and its use in wartime tax policy).

⁷⁰ See, e.g., Marsha Blumenthal et al., *Do Normative Appeals Affect Tax Compliance? Evidence from a Controlled Experiment in Minnesota*, 54 NAT’L TAX J. 125, 130–32 (2001) (reporting positive, but statistically insignificant, improvements in tax compliance for taxpayers who received letters either stating that nearly all Minnesota taxpayers were compliant or listing certain public benefits paid for by tax revenues).

⁷¹ See Schenk, *supra* note 7, at 270–72 (exploring reasons for taxpayers’ ignorance of taxes).

⁷² Compare 1 TAXPAYER COMPLIANCE: AN AGENDA FOR RESEARCH 129 (Jeffrey A. Roth et al. eds., 1989) (reporting little correlation between perceived government legitimacy and tax compliance), and Kornhauser, *supra* note 16, at 738 (noting pervasive and historic “antitax schemas” in American culture), with James Alm et al., *Fiscal Exchange, Collective Decision Institutions and Tax Compliance*,

Second, even a decision of all noncompliant taxpayers to shift their compliance behavior and start to comply may not result in a net benefit to the taxpayers who change their behavior. Most U.S. taxpayers have no choice about their compliance: their taxable income is automatically withheld upon or at least automatically reported to the government. The difficult compliance questions relate to taxpayers who have the opportunity to evade tax and have historically done so. But the public benefits of increased compliance (e.g., lower overall tax rates)⁷³ would be spread over all taxpayers, not just those whose compliance increases—and the vast majority of U.S. taxpayers have no choice but to comply.

Moral appeals and collective action solutions targeted at the taxpayer population in general may lack promise in the tax compliance context. But the connection between expressive law and potential reputation benefits may nevertheless be exploited. It is important to distinguish here between normative rhetoric aimed at large groups of individual taxpayers and normative messaging that engages smaller groups of larger taxpayers, including tax intermediaries. In the individual taxpayer situation—although the experiment has not been run with enough energy and creativity to reject it out of hand—normative rhetoric is less promising because it lacks the support of a strong reputation signaling mechanism. This is because individual reputation is mediated by small-group norms that can be difficult for the government to penetrate,⁷⁴ and because usually no one observes individuals' tax compliance behavior.⁷⁵ Large tax intermediaries, however, typically must defend their reputation in a larger

22 J. ECON. BEHAV. & ORG. 285, 288 (1993) (reporting experimental results showing a correlation between tax compliance and support for public goods), and Joel Slemrod, *Cheating Ourselves: The Economics of Tax Evasion*, 21 J. ECON. PERSP. 25, 40 (2007) (citing survey evidence of a correlation between disapproval of tax evasion and declared trust in government, but noting that such survey results could reflect rationalizations of pre-existing compliance decisions).

⁷³ Various kinds of public benefits are possible, including lower enforcement expenditures; less tax planning deadweight loss; and greater economic productivity due to better allocation of resources. See JOEL SLEMROD & JON BAKIJA, *TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES* 177–80 (4th ed. 2008) (citing problems of tax evasion, including inequitable sharing of tax burdens and economic costs).

⁷⁴ See Morse, *supra* note 16, at 505–06 (arguing that small-group norms among similar taxpayers have a clearer link to tax compliance than large-group or national norms); Susan Morse, *Tax Compliance and the Love Molecule*, ARIZ. ST. L.J. BLOG (Sept. 26, 2011), <http://asulawjournal.lawnews-asu.org/?p=356> (arguing that narrative communications that engage small-group reciprocity have promise as a tax compliance strategy). As Lynn Stout has explained in the course of exploring the relationship between law and conscience, the several evolutionary biology explanations for “prosocial” behavior support the conclusion that “altruistic cooperation tends to occur only with *other members of one's in-group*.” LYNN STOUT, *CULTIVATING CONSCIENCE: HOW GOOD LAWS MAKE GOOD PEOPLE* 144–45 (2011). The in-group concept, although “plastic,” might not easily encompass the whole citizenry absent a moment of national war or other crisis. *Id.* at 146–47.

⁷⁵ See, e.g., Doran, *supra* note 6, at 135–38 (arguing that tax compliance and noncompliance are private behaviors); Posner, *supra* note 26, at 468 (outlining the problem of communicating tax compliance as a signal).

national or global market, and their compliance behavior is often visible. Such intermediaries are thus good candidates for reputation signaling.

The government's expressive law task is to persuade some taxpayers to internalize a new tax compliance norm and act as private norm entrepreneurs within the context of a reputation market. The informal sanctions of such a market can then provide the credible penalty and credible detection supports needed for successful deterrence, separation, and signaling strategies. Moreover, signaling has a virtuous-circle capacity to self-reinforce. First, the more taxpayers comply, the stronger the positive reputation signal, the stronger the incentive for other taxpayers to comply as well, and the higher the likelihood that a reputation market will recognize compliance as an important input into heuristics like the categorization of firms into different "tiers." Second, taxpayers who comply, for whatever reason, should experience a commitment consistency attachment to compliant behavior.⁷⁶

The question of how a norm is internalized is thorny and interesting, but not crucial to the analysis here. It is possible that a private norm entrepreneur could support a government expressive law strategy for cold rational reasons, for example because the actor recognizes a promising branding opportunity offered by developing the norm as a positive reputational signal.⁷⁷ A rational path could also feature collective action among a subset of previously noncompliant taxpayers who find that all of them will gain from cooperation, even though the complete group of noncompliant taxpayers might not experience a net gain from compliance.⁷⁸

It is also possible for a private norm entrepreneur to be motivated by some higher ideal, such as the morality of paying taxes, or the idea of honesty, even though inconsistent with its own self-interest, so that the norm is born outside the bounds of the rational actor model.⁷⁹ But immediately the norm can be understood as a preference for tax compliance that can be understood to fall within the bounds of the rational actor model.⁸⁰ The norm could also quickly support positive reputation signaling, also conceptualized within the bounds of a rational actor

⁷⁶ See *supra* Section II.B.

⁷⁷ See Alex Geisinger, *A Belief Change Theory of Expressive Law*, 88 IOWA L. REV. 35, 42–43 (2002) (noting the debate over whether norms are internalized in the course of individuals' pursuit of rational interests).

⁷⁸ Cf. *infra* note 109 and accompanying text (describing the OECD's harmful tax practice project as a cooperative project among a subset of nations).

⁷⁹ See Geisinger, *supra* note 77, at 49–52 (analyzing theories of expressive law and internalization).

⁸⁰ Cf. LOUIS KAPLOW, *THE THEORY OF TAXATION AND PUBLIC ECONOMICS* 45 (2008) (comparing different social welfare functions derived from different philosophical outlooks).

model.⁸¹

2. *Norm-Building Tactics: Reputation Referencing, Salience, Management Targeting, and Incrementalism*

The goal of an expressive law strategy is to stimulate signaling and encourage reputational sanctions for a failure to signal. Whatever message the government uses should reference reputation, demonstrate high salience, and provide opportunities for taxpayers to show their commitment to the norm. The fact that the articulation of the norm needs to reference reputation likely means that the language will have a moral tone. But that does not mean that the internalization mechanism is moral rather than rationally self-interested.

In addition, if directed at organizations, such as large tax intermediaries, an expressive law strategy should target the people at the top. This is because group norms within a business organization are heavily influenced by the views of the leaders of the organization.⁸² Group members tend to defer to information offered by others instead of forming their own opinions, especially when the person who offers the information is a peer or supervisor.⁸³ Donald Langevoort gives the example of large corporations' hierarchy-led tendency to develop optimism biases that lead to overcommitment and overbidding for assets,⁸⁴ but nothing prevents this organizational behavior tendency from reinforcing compliance norms.

Tax compliance measures aimed at large enterprises present some of the same problems as the regulation of large enterprises in general. Corporations, for example, may act only through the individuals that comprise them, but these individuals are strongly incentivized to conform to the corporate hierarchical example, which is typically formed at least in part by the corporation's profit motive. Corporate employees may "not become as purely self-interested as Economic Man, [but] may at least behave like his second cousin, Corporation Man";⁸⁵ for example, they may be less swayed by independent moral norms in their corporate lives compared to their individual lives.

But the strength of the corporate hierarchy can be used to engage

⁸¹ See *supra* note 15 and accompanying text (citing work relating to norms within an economic framework).

⁸² See, e.g., JAMES G. MARCH & HERBERT A. SIMON, *ORGANIZATIONS* 99–100 (2d ed. 1993) (noting that disproportionate weight may be accorded to norms held by senior group members).

⁸³ See Cass R. Sunstein, *Group Judgments: Statistical Means, Deliberation, and Information Markets*, 80 N.Y.U. L. REV. 962, 1012–13 (2005) (discussing possible benefits and detriments of group decision-making).

⁸⁴ See Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Misperceive Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101, 131, 139–40 (1997) (noting that corporations themselves "develop belief systems" and can amplify "optimistic biases").

⁸⁵ STOUT, *supra* note 74, at 169.

virtuous as well as vicious cycles, for example by government moves that incent compliant behavior at the top of the corporate hierarchy. Elsewhere, I have argued that Sarbanes-Oxley managed to perform this task in a way that contributed significantly to the general demise of the public corporation tax shelter business that had flourished in the 1990s.⁸⁶ Sarbanes-Oxley and other regulatory movements have in the last decade or so produced the proliferation of Chief Compliance Officers at large firms.⁸⁷ It is these individuals, among others, who should be targeted by an expressive law strategy.

Finally, an expressive law strategy may lend itself to incrementalism.⁸⁸ The idea is that once a norm gains a toehold, reputational signaling may strengthen it through the virtuous circles described above. A norm that begins on a small scale may be capable of expansion over time as more and more firms adopt it.

V. AN EXAMPLE: OFFSHORE ACCOUNT INFORMATION ASYMMETRY

A. *The Problem*

The remainder of this Article uses the example of offshore accounts to illustrate both the compliance support factors outlined in Part III and the expressive law theory described in Part IV. This Part introduces the problem of offshore accounts and describes the OECD's successful expressive law effort to weaken bank secrecy laws that enable the evasion of income related to these accounts. Part VI contends that the Report of Foreign Bank and Financial Reports, or FBAR, reporting requirements applicable to U.S. taxpayers who hold offshore accounts can be successful based in large part on supports of perceived credible penalties and masquerading noncomplier detection provided by government enforcement. Part VII argues that U.S. government enforcement cannot provide the supports of credible penalties and detection necessary to make a success out of the Foreign Account Tax Compliance Act ("FATCA"),

⁸⁶ See Susan Cleary Morse, *The How and Why of the New Public Corporation Tax Shelter Compliance Norm*, 75 *FORDHAM L. REV.* 961, 984 (2006) (arguing that concerns among top executives about liability and adverse publicity under Sarbanes-Oxley, as well as tax shelter-related litigation, increased the tax compliance of corporations).

⁸⁷ See Harry Hurt III, *Drop that Ledger! This is the Compliance Officer*, *N.Y. TIMES*, May 15, 2005, Section 3 (Sunday Business), at 5 (quoting Scott Cohen, editor and publisher of the trade journal *Compliance Week*: "The big story is that Sarbanes-Oxley has shifted the power center at public companies by homogenizing the roles of the general counsel and the compliance officer").

⁸⁸ The idea of incrementalism comports with Robert Cooter's argument that different compliance equilibria exist and that the changing prevalence of a compliance norm can produce a "tipping point" that motivates a shift between equilibria. See Robert Cooter, *Do Good Laws Make Good Citizens? An Economic Analysis of Internalized Norms*, 86 *VA. L. REV.* 1577, 1587 (2000) (theorizing that peer-to-peer influences induce shifts between compliance equilibria).

which imposes information disclosure rules on non-U.S. financial institutions for accounts owned by U.S. holders. Instead, FATCA invites the application of the expressive law theory described in Part IV.

A 2002 Treasury report estimated that there were about one million offshore accounts held by U.S. taxpayers and that less than twenty percent of foreign bank account reports, or FBARs,⁸⁹ were duly filed as required annually.⁹⁰ Estimates of the value of offshore accounts range from \$1.5 trillion to about \$10 billion.⁹¹ Low-end estimates of the U.S. tax collection shortfall resulting from the failure to pay tax on offshore accounts come in at about \$50 billion annually.⁹² However, the number of FBAR filings has increased. In 2004, taxpayers filed 217,699 FBARs and in 2009 534,043.⁹³

The IRS has said that account holders come from “all walks” of (relatively wealthy) life.⁹⁴ One official has been reported as saying that of 50,000 accounts targeted by the UBS subpoena discussed below⁹⁵—which requested all accounts with U.S. connections at a certain bank, without any filtering mechanism as to size or otherwise—a few thousand were enormous accounts of tens or hundreds of millions of dollars, and the vast majority smaller accounts of less than ten million dollars.⁹⁶

Offshore account holders include heirs, immigrants, and expatriates

⁸⁹ See *infra* Part VI for a more detailed discussion of FBARs.

⁹⁰ See SEC'Y OF TREAS., A REPORT TO CONGRESS IN ACCORDANCE WITH § 361(b) OF THE UNITING AND STRENGTHENING AMERICA BY PROVIDING APPROPRIATE TOOLS REQUIRED TO INTERCEPT AND OBSTRUCT TERRORISM ACT OF 2001 (USA PATRIOT ACT) 6 (Apr. 26, 2002) (noting that the IRS estimated the number of foreign bank accounts at one million and the number of annual FBAR filings at about 180,000).

⁹¹ See *Banking Secrecy Practices and Wealthy American Taxpayers: Hearing of the Select Revenue Measures Subcommittee of the House Ways and Means Committee*, 111th Cong., 1st Sess. (Mar. 31, 2009) (statement of Reuven S. Avi-Yonah) [hereinafter *Avi-Yonah Statement*] (deducing U.S. residents' holdings from broader Boston Consulting Group estimate); see also RONEN PALAN ET AL., *TAX HAVENS: HOW GLOBALIZATION REALLY WORKS* 62–63 (2010) (citing estimates of about \$10 billion in financial assets held offshore by U.S. and non-U.S. taxpayers).

⁹² See *Avi-Yonah Statement*, *supra* note 91 (assembling various estimates of cash and securities deposits offshore and translating those figures into an estimate of approximately \$50 billion in unpaid U.S. federal income tax annually); Martin A. Sullivan, *U.S. Citizens Hide Hundreds of Billions in Cayman Accounts*, 103 TAX NOTES 956, 958 (May 24, 2004) (citing \$70 billion estimate). A widely cited \$100 billion Senate Finance subcommittee report encompasses both corporate “abuses” and individual “evasion.” See U.S. SENATE, PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, *TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 & n.1* (2008). See also PALAN ET AL., *supra* note 91, at 63 (reaching a revenue loss estimate of \$255 billion annually worldwide).

⁹³ See TREAS. INSPECTOR GEN. FOR TAX ADMIN., *NEW LEGISLATION COULD AFFECT FILERS OF THE REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS, BUT POTENTIAL ISSUES ARE BEING ADDRESSED* 7 (Sept. 29, 2010) [hereinafter *TIGTA Report*].

⁹⁴ See I.R.S. Information Release IR 2003–95 (July 30, 2003) (“People from all walks of life applied for the [2003 voluntary disclosure] program, including lawyers, dentists, business executives, estate heirs and numerous other occupations.”).

⁹⁵ See *infra* Section VI.B.1.

⁹⁶ Laura Saunders, *IRS Extends Deadline to Declare Foreign Accounts*, WALL ST. J., Sept. 21, 2009, at C1.

with some personal connection to the location of their offshore account.⁹⁷ Account holders who lack any non-U.S. connection may have various reasons for opening the account, including misguided acceptance of an unscrupulous planner's advice,⁹⁸ or nontax asset protection, as well as determined and conscious tax evasion. Moreover, determined tax evaders may have legal or illegal sources for their deposited funds, tax-paid or not.

Offshore account noncompliance presents a problem of information asymmetry, rather than an issue of legal uncertainty. It is perfectly clear that U.S. citizens and residents must pay U.S. taxes on their worldwide income, including income that accrues to an offshore account.⁹⁹ The challenge is to make or persuade offshore account holders—and/or the foreign banks where they do business—to disclose the relevant information.

B. *The OECD's Expressive Law Harmful Tax Project*

1. *The OECD's Project*

In the 1990s, the OECD began to study the problem of “harmful tax competition.” The developed nations who make up the OECD's membership generally have an interest in more robust residence-based taxation,¹⁰⁰ and the harmful tax competition project (later renamed

⁹⁷ See Jeremiah Coder, *IRS Extends Offshore Voluntary Disclosure Deadline*, 124 TAX NOTES 1297 (2009) (reporting practitioner report of inquiries from “immigrants or their children who created accounts before coming to the United States”); cf. Fred Feingold, *Further Guidance Needed for the Required Reporting of Foreign Bank and Financial Accounts*, 54 TAX NOTES INT'L 605 (2009) (arguing that many FBAR nonfilers failed to file due to ignorance of the requirement).

⁹⁸ At a Senate committee hearing in 2002, for example, lawmakers heard testimony from an orthopedic surgeon and federal inmate. He had gotten into financial trouble, refused the offers of several tax protestor promoters, and then entered into an offshore “business trust” arrangement supported by “legal opinions and letters from several attorneys.” He thought things were legal, he claimed, until he discovered that the trust routed funds from Utah to the Isle of Man and then to Austria and provided false receipts for the funds. He stated that he was attempting to extricate himself from the situation when he was found out. *Schemes, Scams and Cons: The IRS Strikes Back: Hearing Before the S. Committee on Finance*, 107th Cong. 6–8 (2002) (statement of Dr. Daniel Bullock).

⁹⁹ A U.S. citizen or resident alien may exclude certain income earned abroad from the performance of services, but this foreign earned income exclusion does not exempt investment income from U.S. tax. I.R.C. § 911 (2006).

¹⁰⁰ Diane Ring, *Who is Making International Tax Policy?: International Organizations as Power Players in a High Stakes World*, 33 FORDHAM INT'L L.J. 649, 710–11, 716 (2010) (explaining the role of the OECD in this project and noting OECD “revenue-protecting countries” and the “vocal backlash” from the “business community” and “tax haven jurisdictions”). Thirty-four developed countries make up the membership of the OECD. These nations are concentrated in Europe but also include Australia, Canada, Japan, and the United States. *Members and Partners*, OECD, <http://www.oecd.org> (last visited Dec. 16, 2011). Some criticize what they describe as the inappropriate meddling of the OECD in the affairs of tax haven countries, which are often less developed than the members of the OECD. See, e.g., Vaughn E. James, *Twenty-First Century Pirates of the Caribbean: How the Organization for Economic Cooperation and Development Robbed Fourteen CARICOM Countries of Their Tax and Economic Policy Sovereignty*, 34 U. MIAMI INTER-AM. L. REV. 1, 50 (2002) (“[T]he OECD

“harmful tax practices” project)¹⁰¹ initially aimed at both low-tax regimes that might attract business activity and secrecy regimes that permitted the hiding of passive investment income.¹⁰² But the first goal of “stopping tax havens from ‘poaching’ mobile capital” fell out, reportedly as a result of the objections of tax havens and others, including the United States and some Commonwealth nations.¹⁰³ The most prominent feature of the remaining passive investment income portion of the project was the use of a tax haven blacklist, first published in draft form in 2000.¹⁰⁴ The OECD used the blacklist to press tax havens to move towards more information reporting, and less bank secrecy.

The OECD and its member states were not about to use force to reduce bank secrecy. Even if the days of gunboat diplomacy are not over, this project, headed by the technocratic and consensus-building OECD, would not have provoked its use.¹⁰⁵ Nor did the OECD offer tax havens a monetary side payment in exchange for compliance.¹⁰⁶ Moreover, the “defensive measures” promised by the OECD for countries on the list were not particularly threatening for those havens singled out for helping residents of high-tax OECD countries hide passive investment income. Reduced foreign tax credits, for example, would not affect such tax benefits. Some other provisions, such as requiring information reporting, imposing withholding taxes, or enhancing audit activity or applicable penalties for investments in tax havens, had more relevance.¹⁰⁷ But all of these ideas faced very significant implementation obstacles, including the necessity of coordinating national tax legislation among OECD members, addressing jurisdictional limitations to enforce any requirements placed on

countries . . . can smile at their success in once again robbing the Caribbean of its gold—its sovereign right to determine its tax and economic policies, and the rights of its people to shape their destiny.”). Others contend that tax haven activity violates distributive justice principles. See, e.g., NICHOLAS SHAXSON, TREASURE ISLANDS: UNCOVERING THE DAMAGE OF OFFSHORE BANKING AND TAX HAVENS 7 (2011) (calling tax havens “a project of elites” and the “fortified refuge of Big Finance”).

¹⁰¹ See J.C. SHARMAN, HAVENS IN A STORM: THE STRUGGLE FOR GLOBAL TAX REGULATION 88–89 (2006) (describing the OECD’s retreat from the controversial implication that “competition” could be harmful).

¹⁰² See Alex Easson, *Harmful Tax Competition: An Evaluation of the OECD Initiative*, 34 TAX NOTES INT’L 1037, 1038 (2004) (describing 1998 report). Secrecy, as along with low taxes, is widely recognized as a tax haven badge. See PALAN ET AL., *supra* note 91, at 33–35.

¹⁰³ SHARMAN, *supra* note 101, at 74.

¹⁰⁴ See OECD, 2000 PROGRESS REPORT: TOWARDS GLOBAL TAX CO-OPERATION: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES 17 (2000).

¹⁰⁵ See SHARMAN, *supra* note 101, at 53–55 (describing the “military non-option” for settling disputes over tax competition).

¹⁰⁶ Compare OECD, *supra* note 104, at 25 (outlining only defensive measures for dealing with tax havens), with Steven Dean, *Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation*, 58 HASTINGS L.J. 911, 954–56 (2007) (recommending a side payment to banking jurisdictions to align tax compliance incentives).

¹⁰⁷ See OECD, *supra* note 104, at 25 (listing the range of possible defensive measures used as common approaches to uncooperative tax havens).

offshore banks, and gathering the offshore information necessary to support an audit and enforcement strategy.¹⁰⁸

This was not a situation where government-enforced penalties and detection would likely produce successful deterrence, separation, or signaling compliance mechanisms. Instead, the endeavor evolved into an expressive law project, undertaken by a small group of countries,¹⁰⁹ to persuade governments to signal their opposition to tax evasion. The result—tax havens’ agreement to enter into lukewarm tax information exchange agreements—may appear to represent defeat for the OECD when measured against the initial ambitious goals of stopping tax competition for mobile active investment capital and achieving automatic information exchange for passive investments.¹¹⁰ But when viewed as a piece of an incremental global information reporting project, the fact that the OECD persuaded previously secretive jurisdictions to acknowledge that other nations’ tax evasion concerns could trump client confidentiality counts as a battle triumph.¹¹¹

¹⁰⁸ Cf. SHARMAN, *supra* note 101, at 59–61 (describing tax havens’ successful attempts to convince some OECD members that sanctions would violate sovereignty). The situation resembles Anne-Marie Slaughter’s understanding of horizontal and vertical international networks of regulators. Although the individual nations that are OECD members possess “hard power” to enforce, fine, imprison, and so forth, there is no mechanism available for the OECD to force the member nations to take such action. Indeed, there would not necessarily be any such mechanism even if the OECD had “formal legal authority” over the member states. ANNE-MARIE SLAUGHTER, *A NEW WORLD ORDER* 168 (2004). Instead, as she suggests, the OECD must rely on soft power such as “information, persuasion, [and] socialization.” *Id.*

¹⁰⁹ The harmful tax competition project is thus consistent with Robert Keohane’s observation that small groups may form international regimes (defined broadly and including “principles, norms, rules and procedures”) to further their shared interests but perhaps at the expense of other international actors, including other nations. ROBERT KEOHANE, *AFTER HEGEMONY: COOPERATION AND DISCORD IN THE WORLD POLITICAL ECONOMY* 59, 79 (1984).

¹¹⁰ The model OECD tax information exchange agreement requires governments to disclose information only upon request—not automatically—and requires the requesting government to provide considerable information about the targeted taxpayer. OECD, *AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS*, art. 5, § 4 (2002). It is not yet clear how the provisions will work in practice. See, e.g., Maria Flavia Ambrosanio & Maria Serena Caroppo, *Eliminating Harmful Tax Practices in Tax Havens: Defensive Measures by Major EU Countries and Tax Haven Reforms*, 53 *CAN. TAX J.* 685, 717 (2005) (noting that very few tax haven jurisdictions had implemented national legislation to accord with new information exchange requirements).

¹¹¹ See SHARMAN, *supra* note 101, at 152–53 (noting the failure of the initiative’s original broad goals, but the possible success of the “scaled back project”). The modest success was also remarkable because of the backdrop of a historic reluctance to enforce other countries’ tax laws. See William S. Dodge, *Breaking the Public Law Taboo*, 43 *HARV. INT’L L.J.* 161, 170–77, 202–06 (2002) (giving history of “revenue rule” refusal to enforce other countries’ tax laws and absence of mutual collection assistance provisions from tax treaties). In 2005, the U.S. Supreme Court restricted the application of the revenue rule when it held, in a five to four decision, that a scheme to evade Canadian excise taxes qualified as fraud under U.S. law and hence could support a wire fraud conviction. *Pasquantino v. United States*, 544 U.S. 349, 356, 364 (2005).

2. Norm Building Tactics: Reputation Referencing, Salience, Management Targeting, and Incrementalism

The OECD's harmful tax practices project thus stands as an example of a successful expressive law strategy that worked by triggering reputation signaling. The endeavor worked partly because its targets—tax haven governments—are and were extremely reputation-sensitive.¹¹² It also worked because, despite various missteps and course changes, it was effectively implemented. The project referenced reputation; used high-salience communication techniques that gave targeted governments clear opportunities to show their commitment to the norm; targeted people at the top of governments; and modified its initial, overly-broad approach to a winnable incremental strategy.

The OECD led the harmful tax practice project with normatively loaded language by targeting “harmful tax competition.”¹¹³ At first, the OECD's target encompassed tax regimes applicable to active business income.¹¹⁴ But later, the tax haven blacklist changed and simplified the message. The countries proposed for the list were a who's who of small passive income havens with robust bank secrecy laws,¹¹⁵ rather than developing countries seeking to attract foreign direct investment with tax holidays and other incentives. Restricting the project scope to passive income tax evasion clarified the message as, “good banks don't lie.” It plainly targeted bank secrecy in the absence of significant business activity.

The list device gave the targeted countries an opportunity to provide a clear, positive reputation signal by removing themselves from the blacklist. To avoid being listed, a country had to (1) evidence a willingness to exchange information (on request, not automatically) with OECD countries

¹¹² See SHARMAN, *supra* note 101, at 107–14 (explaining the importance of reputation to tax haven countries based on an extensive series of interviews and other corroborating research).

¹¹³ See Arthur J. Cockfield, *Protecting Taxpayer Privacy Rights Under Enhanced Cross-Border Tax Information Exchange: Toward a Multilateral Tax-Payer Bill of Rights*, 42 UNIV. OF BRIT. COLUM. L. REV. 419, 428–29 (summarizing OECD's harmful tax competition project); Adam H. Rosenzweig, *Why Are There Tax Havens?*, 52 WM. & MARY L. REV. 923, 928 (2010) (suggesting that tax havens have been “singled out by institutions such as the OECD and G20 as the root cause of many of the fiscal shortfalls plaguing the governments of the world”).

¹¹⁴ For example, one red flag listed in the OECD's 1998 report was “ring fencing,” or offering tax preferences to nonresidents only, a not-uncommon approach to attracting foreign direct investment. OECD, *HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE* 27 (1998).

¹¹⁵ The 2000 report listed 35 havens: Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bahrain, Barbados, Belize, the British Virgin Islands, the Cook Islands, Dominica, Gibraltar, Grenada, Guernsey, the Isle of Man, Jersey, Liberia, Liechtenstein, the Maldives, the Marshall Islands, Monaco, Montserrat, Nauru, the Netherlands Antilles, Niue, Panama, Samoa, the Seychelles, St. Lucia, St. Christopher and Nevis, St. Vincent and the Grenadines, Tonga, Turks and Caicos, the U.S. Virgin Islands, and Vanuatu. OECD, *supra* note 104, at 17. Several others, including Bermuda and the Cayman Islands, avoided being placed on the list through pre-commitments to the OECD's requests. See Easson, *supra* note 102, at 1042.

who wished to do so and (2) ensure that its account holdings were sufficiently transparent so that its supervising government had access to beneficial owner information.¹¹⁶ The information exchange portion of this commitment had a further level of salience, as it generally involved signing tax information exchange agreements (“TIEAs”) for which the OECD provided a model.¹¹⁷ And OECD meetings provided opportunities to put pressure on senior decisionmakers in each country.¹¹⁸

Finally, the OECD’s process was incremental. It began in the 1990s with the articulation of harmful tax competition as a problem in a vague formulation that was difficult to disagree with. It moved in 2000 to the publication of a draft tax haven listing of thirty-five countries, which could remove themselves from the list by promising to eliminate their harmful tax practices before a deadline that was later extended three times. In April 2002, there were only seven countries left and in 2004 only five.¹¹⁹ Subsequently, under the auspices of the OECD’s follow-up project of encouraging information exchange (though only on receipt of a fairly detailed request), dozens of bilateral TIEAs have been entered into by countries historically known as tax havens.¹²⁰

Reputation signaling explains why low-tax countries took pains to avoid the OECD blacklist.¹²¹ There is also evidence that the reputation signaling foothold gained by the tax competition project had self-reinforcing qualities that prompted countries that had supported the OECD project to favor disclosure over bank secrecy more generally. Arguably the project has caused a “good banks don’t lie” norm to acquire some power as a signaling touchstone. One indication of this virtuous circle effect is the Swiss government’s eventual decision to stretch the Swiss bank secrecy laws almost to their breaking point¹²² in order to permit the disclosure of

¹¹⁶ See Easson, *supra* note 102, at 1045–46.

¹¹⁷ See Geisinger & Stein, *supra* note 19, at 119 (discussing treaty ratification and treaty compliance as signals of conformity to a prevailing international norm).

¹¹⁸ Cf. SHARMAN, *supra* note 101, at 99–100 (explaining that tax haven states were brought into the OECD consensus-building process as “participating partners”).

¹¹⁹ Easson, *supra* note 102, at 1039.

¹²⁰ See Charles Gnaedinger, *OECD Tax Official Calls G-20 Summit an “Outstanding Success,”* TAX NOTES (2009), available at LEXIS, Tax Notes library, 2009 TNT 186-5 (reporting the execution of ninety tax information exchange agreements and the amendment of sixty tax treaties and the launch of the OECD Global Forum on Transparency and Exchange of Information, formed to conduct peer reviews of the implementation of the agreements).

¹²¹ See SHARMAN, *supra* note 101, at 101 (arguing that reputation was the only issue for tax havens); cf. KEOHANE, *supra* note 109, at 105 (noting that “under conditions of uncertainty and decentralization . . . [a] good reputation makes it easier for a government to enter into advantageous international agreements”).

¹²² See 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 N.W. J. INT’L L. & BUS. 1, 3–6, 18–19 (2010) (describing historic Swiss commitment to bank secrecy and connection to Swiss legal rule that tax evasion is a civil, not criminal, offense).

U.S. account holder names in the UBS case, as discussed below,¹²³ and to enter into a TIEA-based information exchange treaty protocol with the United States.¹²⁴

This evidence does not mean that the countries that repealed bank secrecy laws will definitely renounce their bank secrecy practices. Some commentators have labeled putative tax haven countries' responses to the OECD project "ritualistic" and "superficial," for example, and noted that more "savvy" countries capitulated more rapidly to OECD demands, perhaps because they more quickly came to the conclusion that there was not much substance in them.¹²⁵ The OECD's TIEA model, for example, only removes the shield of bank secrecy to require the disclosure of taxpayer information when the requesting country has provided a detailed request naming the taxpayer. As a result, TIEAs might not actually increase information flow in any material way. Moreover, the OECD initially considered a country to have made sufficient progress to stay off the blacklist if it had signed twelve TIEA agreements, regardless of the size or trading importance of the counterparty countries.¹²⁶ Some countries entered into agreements with only a minimum number of small countries to comply with the letter of the law.¹²⁷

Even so, the fact that countries took steps to avoid the blacklist provides an excellent example of stakeholders taking actions for clearly reputational reasons. Once they have done so, the groundwork is laid for a successful high-penalty regime, kicked off by signaling but also perhaps involving deterrence and separation. The harmful tax competition project represents an incremental victory for the OECD.

¹²³ See *infra* notes 150–54 and accompanying text (describing the UBS account holder disclosure saga).

¹²⁴ See Michael McIntyre, *How to End the Charade of Information Exchange*, 125 TAX NOTES 615 (2009) (calling the protocol "painful" for Switzerland, despite low expectations for significant resulting information exchange).

¹²⁵ See PALAN ET AL., *supra* note 91, at 205–07, 215.

¹²⁶ See OECD, GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES, TERMS OF REFERENCE TO MONITOR AND REVIEW PROGRESS TOWARDS TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES 8 n.26 (2010) ("As agreed by the Global Forum's Sub-group on Level Playing Field . . . a country is considered to have substantially implemented the standard of exchange of information for the purposes of this Global Forum assessment if it has in place signed agreements or unilateral mechanisms that provide for exchange of information to standard with at least 12 OECD countries. This benchmark was considered to be an appropriate dividing line at that point in time, between those countries that are implementing the standards and those that are not. However, this benchmark was recognised as part of a staged process and would have to be re-evaluated as circumstances evolved.").

¹²⁷ See Nicholas Shaxson & John Christensen, *Time to Black-List the Tax Haven Whitewash*, FIN. TIMES, Apr. 4, 2011 (reporting the practice of signing TIEAs with small countries such as "Greenland, Iceland and the Faroes" and "between tax havens themselves" to comply with OECD requirements).

VI. THE FBAR AS AN ENFORCED HIGH-PENALTY REGIME

A. *The FBAR*

National efforts also currently attempt to address the problem of offshore accounts, including the U.S. foreign bank account reporting, or FBAR, rules. Under a regulation promulgated under the Bank Secrecy Act,¹²⁸ U.S. owners of offshore accounts must annually file Reports of Foreign Banks and Financial Accounts, or FBARs, with respect to their non-U.S. holdings. This requirement links to the individual income tax return through Line 7a of Form 1040, Schedule B, which requires a taxpayer to specify whether he or she has “an interest in or a signature or other authority over a financial account in a foreign country.”¹²⁹ In addition, recently enacted I.R.C. § 6038D—a “shadow FBAR” provision—imposes similar self-reporting requirements.¹³⁰ Section 6038D is important to the government’s offshore account audit strategy, as discussed below.

The Bank Secrecy Act originated as an anti-money-laundering statute,¹³¹ but there are at least three partially overlapping reasons for its provisions, including the FBAR requirements. First, the depositor may have illegally obtained the funds that go into an offshore account. Second, the depositor, whether or not he or she has obtained the funds illegally, may not have properly paid taxes with respect to them. Third, the

¹²⁸ See 31 U.S.C. § 5314 (2006); 31 C.F.R. § 103.24 (2010) (“Each person subject to the jurisdiction of the United States . . . having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the Commissioner of the Internal Revenue for each year in which such relationship exists, and shall provide such information as shall be specified in a reporting form”); see also STEVEN MARK LEVY, FEDERAL MONEY LAUNDERING REGULATION: BANKING, CORPORATE AND SECURITIES COMPLIANCE § 3.02[B] (2003 & Supp. 2011–12) (explaining that Title I of the Bank Secrecy Act, codified in Title 12 of the United States Code, requires banks to maintain certain records and that Title II, codified in Title 31 of the United States Code, requires certain reporting of “secret foreign bank transactions”).

¹²⁹ I.R.S. Form 1040, Schedule B, Line 7a.

¹³⁰ I.R.C. § 6038D (Supp. 2011). The provision is effective for tax years beginning after the date of enactment, March 18, 2010. Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 § 511(c) (2010); see also TIGTA Report, *supra* note 93 (contrasting § 6038D and FBAR requirements). This Article focuses on the banking-law-based FBAR requirement rather than the § 6038D requirement because FBAR reporting more clearly fits the high-penalty model which is the focus of this Article, assuming that a willfulness-based penalty is a credible possibility. The basic § 6038D penalty is \$10,000, increasing to a maximum of \$50,000 after notification by the Secretary. I.R.C. § 6038D(d). Another provision increases the substantial underpayment penalty for any transaction involving an undisclosed foreign financial asset from twenty percent to forty percent. I.R.C. § 6662(j)(3). But these penalties do not approach the size of FBAR penalties such as the fifty-percent-of-account-value willful civil penalty, and the possibility of imprisonment. See *infra* note 141 and accompanying text.

¹³¹ See LEVY, *supra* note 128, § 3.02 (“The grande dame of money laundering regulation is the statute commonly known as the Bank Secrecy Act of 1970.”).

depositor may fail to pay taxes on the income from the accounts.¹³² The second and third issues are tax enforcement concerns. The Financial Crimes Enforcement Network (“FinCEN”) division of the Treasury had enforcement responsibility for FBAR compliance until 2003, when enforcement authority was transferred to the IRS under a Memorandum of Understanding.¹³³

The FBAR regulations are broad. They require “[e]ach person subject to the jurisdiction of the United States . . . having a financial interest in, or signature or other authority over, a bank, securities or other financial account” to file a report.¹³⁴ Under a *de minimis* rule, a report is required if the aggregate value of the financial accounts exceeds \$10,000 at any time during the calendar year.¹³⁵ Filings are required of entities such as corporations, partnerships, and trusts,¹³⁶ and with respect to holdings in or through corporations, partnerships, trusts, or other entities.¹³⁷ Taxpayers must report information that should be readily available to them: in

¹³² The legislative history of the 1970 enactment of the Bank Secrecy Act includes a concern for these tax evasion issues. Swiss bank accounts are not a recent phenomenon. “One of the most damaging effects of an American’s use of secret foreign financial facilities is its undermining of the fairness of our tax laws. Secret foreign financial facilities, particularly in Switzerland, are available only to the wealthy. To open a secret Swiss account normally requires a substantial deposit, but such an account offers a convenient means of evading U.S. taxes. . . . [I]t is grossly unfair to leave the secret foreign bank account open as a convenient avenue of tax evasion.” H.R. Rep. No. 91-975 (1970), reprinted in 1970 U.S.C.C.A.N. 4394, 4397–98.

¹³³ See 31 C.F.R. § 103.56(g); IRS News Release IR 2003-48 (Apr. 10, 2003); see also Letter from New York State Bar Association to Neal S. Wolin, Deputy Secretary, Department of the Treasury, et al. (July 17, 2009), available at LEXIS, Tax Notes library, 2009 TNT 137-13, at nn.6–7 and accompanying text (describing delegation of authority to the IRS).

¹³⁴ 31 C.F.R. § 103.24(a) (2010).

¹³⁵ Treasury Department Form 90-22.1 Instructions, General Instructions, Who Must File an FBAR [hereinafter FBAR Instructions].

¹³⁶ An entity account may be required to be reported because of a U.S. person’s financial interest in or signatory authority over such account. See FBAR Instructions, *supra* note 135, General Definitions, Financial Interest & Signature Authority; see also BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATE & GIFTS ¶ 65.6.4 (2011). Various other requirements to report ownership in and transactions with foreign entities also exist. See, e.g., I.R.S. Instructions for Form 5471, Category 3 Filer (requiring the filing Form 5471 for U.S. persons owning stock in foreign corporations meeting the ten percent requirement); Treasury Department Form 5472, General Instructions, Who Must File (requiring the filing of Form 5472 for corporations having reportable transactions with foreign or domestic related parties); Treasury Department Form 3520-A, Part III Foreign Trust Balance Sheet, 2010 Foreign Grantor Trust Owner Statement, & 2010 Foreign Grantor Trust Beneficiary Statement (requiring an accounting of assets held in a foreign trust); Treasury Department Form 8865, Schedule A-1 (Certain Partners of Foreign Partnership) & Schedule N (Transactions Between Controlled Foreign Partnership and Partners or Other Related Entities) (requiring reporting of transactions with foreign partnerships).

¹³⁷ See I.R.S., *FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Financial Accounts* (Sept. 30, 2011, 8:00 PM), <http://www.irs.gov/businesses/small/article/0,,id=210249,00.html> (requiring persons with a financial interest in, or signatory authority over, a foreign commingled fund such as a mutual fund to file an FBAR).

particular, the existence and size of an offshore account.¹³⁸ The focus here is on the core requirement to report bank accounts financially owned by individual U.S. taxpayers directly or through a corporation or other entity over which the U.S. owner has signatory authority.¹³⁹

There are several civil and criminal statutory penalties specified for FBAR violations.¹⁴⁰ This analysis focuses on the civil willful violation penalty, which equals the greater of \$100,000 or fifty percent of the balance in the account “at the time of the violation.”¹⁴¹ This is a huge potential penalty, and significantly more than before the statute was amended in 2004.¹⁴²

B. Applying the High-Penalty Analytical Framework to the FBAR

1. Penalty Credibility

Part III argued that penalty credibility is one factor necessary to support the success of a high-penalty regime as a deterrence, separation, and/or signaling mechanism. In the case of the FBAR, the government has done a good job so far of establishing the credibility of government-enforced penalties in the minds of taxpayers. Government efforts to articulate and publicize applicable penalties crystallized in litigation relating to accounts at the Swiss bank UBS, and in the administration of the 2009 FBAR voluntary disclosure program. In particular, the government’s strategy has leveraged availability bias and persuaded taxpayers of the likelihood of imposition of large civil penalties. The government now faces the task of maintaining momentum.

A central purpose of audit and compliance publicity is to increase

¹³⁸ The FBAR form requires the reporting of the maximum amount in the account during the year reported. FBAR Instructions, *supra* note 135, Part II: Information on Financial Account(s) Owned Separately.

¹³⁹ Final regulations do not disturb the FBAR filing requirement in this paradigm case. See Financial Crimes Enforcement Network: Amendment to the Bank Secrecy Act Regulations—Reports of Foreign Financial Accounts, 76 Fed. Reg. 10234 (Feb. 24, 2011) (to be codified at 31 C.F.R. Part 1010).

¹⁴⁰ See 31 U.S.C. §§ 5321(a)(1), 5322 (a)–(b) (2006) (specifying civil and criminal penalties). There is also a voluminous list of possible penalties for tax evasion and other offenses that may be linked to failure to file an FBAR. See I.R.S., Voluntary Disclosure Questions and Answers, Questions and Answers 14 and 15, available at www.irs.gov/newsroom/article/0,,id=210027,00.html (listing possible civil and criminal penalties for not disclosing voluntarily and being charged by the I.R.S.) (last visited Dec. 16, 2011).

¹⁴¹ 31 U.S.C. § 5321(a)(5)(C)–(D); see also *id.* § 5321(a)(5)(B)(i)–(ii) (implementing a \$10,000 civil penalty with a reasonable cause exception); *id.* § 5322(a)–(b) (implementing criminal penalties including imprisonment); see generally BITTKER & LOKKEN, *supra* note 136, at ¶ 65.6.2 (summarizing penalties).

¹⁴² The legislative history indicates that the increased penalty responded to the Treasury’s reporting of widespread disregard for the FBAR filing requirement. See JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 108TH CONGRESS 377–78 (2005) (providing explanation for section 821 of the Act, codified at 31 U.S.C. § 5321).

taxpayers' or tax preparers' perception of the risk of detection.¹⁴³ These efforts should leverage the well-established cognitive availability bias, which prompts us to estimate the "likelihood of an event on the basis of how quickly instances or other associations come to mind."¹⁴⁴ Studies support the existence of an "indirect" audit effect related to taxpayers' decisions to comply because they hear news of others getting caught.¹⁴⁵

Associations come more quickly to mind if the stories are familiar,¹⁴⁶ so a publicity strategy should effectively communicate to taxpayers that people like them get caught by the IRS or settle with the IRS because of a fear of being caught.¹⁴⁷ The offshore account plea bargain publicity since 2008 has done a nice job of providing this kind of availability bias-based communication. It started with a scandalous news item: ex-UBS investment banker Bradley Birkenfeld's revelation of elaborate James-Bond-worthy secrecy practices in the cross-border private banking division

¹⁴³ See, e.g., Andreoni et al., *supra* note 12, at 844–46 (summarizing tax compliance studies associating a high subjective probability of detection with significantly higher compliance rates).

¹⁴⁴ Hanson & Yosifon, *supra* note 22, at 39–41 (quoting SUSAN T. FISKE & SHELLY E. TAYLOR, SOCIAL COGNITION 384 (2d ed. 1991)); see also Joshua D. Blank, *In Defense of Taxpayer Privacy*, 61 EMORY L.J. (forthcoming 2012) (manuscript at 127) (describing heuristics relevant to tax compliance including anchoring and availability biases); Edward J. McCaffery & Joel Slemrod, *Toward an Agenda for Behavioral Public Finance*, in BEHAVIORAL PUBLIC FINANCE 15–18 (Edward J. McCaffery & Joel Slemrod eds., 2006) (explaining the importance of behavioral science to tax policy).

¹⁴⁵ See, e.g., James Alm et al., *Getting the Word Out: Enforcement Information Dissemination and Compliance Behavior*, 93 J. PUB. ECON. 392, 401 (2009) (reporting results of laboratory study showing that subject-to-subject communication about audit outcomes significantly affects compliance decisions); Jeffrey A. Dubin, *Criminal Investigation Enforcement Activities and Taxpayer Noncompliance*, 35 PUB. FIN. REV. 500, 516, 518 (2007) (concluding from a longitudinal study of state segmented data that audits and criminal investigations significantly influence compliance behavior); see also James Alm & Mohammad Yunus, *Spatiality and Persistence in U.S. Individual Income Tax Compliance*, 62 NAT'L TAX J. 101, 121 (2009) (finding correlation between geographic residence and evasion behavior). Estimates of the ratio between the dollars brought in because of other taxpayers' compliance compared to the additional collections resulting from the audit itself are in the range of 11 or 15:1. See ALAN H. PLUMLEY, L.R.S. PUBLICATION 1916: THE DETERMINANTS OF INDIVIDUAL INCOME TAX COMPLIANCE: ESTIMATING THE IMPACTS OF TAX POLICY, ENFORCEMENT, AND IRS RESPONSIVENESS 35 (1996) (estimating the indirect audit effect at 11.6 times the direct audit effect); see also Dubin, *supra*, at 519 (reporting result of 15.1:1 under simulation of doubling audit rates).

¹⁴⁶ See SUSAN T. FISKE & SHELLY E. TAYLOR, SOCIAL COGNITION 270–71 (1984) (noting "retrieval biases," "strength of association" biases, and ease of imagining events as biasing factors); Amos Tversky & Daniel Kahneman, *Availability: A Heuristic for Judging Frequency and Probability*, in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 163, 176 (Daniel Kahneman et al. eds., 1982) (explaining that individuals estimate the likelihood of an event based in large part on other instances they know of and the similarity of those instances to their own circumstances); see also Ronald Chen & Jon Hanson, *Categorically Biased: The Influence of Knowledge Structures on Law and Legal Theory*, 77 S. CAL. L. REV. 1103, 1179 (2004) ("[C]ues that are prominent or catch our attention are more likely to activate associated categories and schemas.").

¹⁴⁷ See Morse, *supra* note 16, at 510 ("[An audit] publicity campaign featuring more typical taxpayers would have more salience.").

at UBS.¹⁴⁸ Birkenfeld disclosed that UBS had deliberately designed workarounds to avoid the requirements to disclose U.S. account holders that were built into the “qualified intermediary,” or QI, agreement that UBS had entered into with the U.S. government.¹⁴⁹

Birkenfeld’s information led to a U.S. criminal fraud investigation of UBS, which ended with a \$780 million fine and a deferred prosecution agreement in February 2009.¹⁵⁰ The U.S. government then submitted a request for enforcement of a broad subpoena to disclose the names of over 50,000 U.S. clients of UBS.¹⁵¹ This caused significant difficulties in Switzerland because of the direct conflict between the disclosure request and secrecy laws, which the Swiss government, as well as Swiss bankers

¹⁴⁸ Birkenfeld said, for example, that “he once transported diamonds, bought with client money abroad, into the United States in a tube of toothpaste.” Mark Hosenball & Evan Thomas, *Cracking the Vault*, NEWSWEEK, Mar. 23, 2009, at 32. Birkenfeld pled guilty in June 2008 to conspiring to help wealthy American Igor Olenicoff evade taxes. Lynnley Browning, *U.S. Is Said to Expand Tax Inquiry*, N.Y. TIMES, Dec. 2, 2008, at B1. In August 2009, he received a 40-month prison sentence. Joanna Chung, *Former UBS Banker Given Prison Term*, FIN. TIMES, Aug. 21, 2009.

¹⁴⁹ The QI rules mainly intend to facilitate information transfer about non-U.S. account holders to permit accurate withholding on U.S.-source investment income (e.g., in order to comply with treaty rules). See Susan C. Morse & Stephen E. Shay, *Qualified Intermediary Status: A New U.S. Withholding Role for Foreign Financial Institutions Under Final U.S. Withholding Regulations*, 27 TAX MGMT. INT’L J. 331, 331–33 (1998) (noting U.S. account holder targets of QI rules); see also REUVEN S. AVI-YONAH, *INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME* 27, 28, 68–77 (2007) (outlining exceptions to the default thirty percent U.S. withholding tax on U.S.-source investment income). Over 5000 foreign banks, such as UBS, Credit Suisse, and Deutsche Bank, have signed QI agreements with the U.S. Letter from New York State Bar Association to Sen. Max Baucus et al. (Sept. 10, 2009) [hereinafter NYSBA Sept. 10, 2009 Letter], available at LEXIS, Tax Notes library, 2009 TNT 175-67.

Importantly, there is no presumption of U.S. status for purposes of backup withholding with respect to gross security sale proceeds. See 26 C.F.R. § 1.6049-5(d)(3)(ii) (2010). In addition, the QI agreement includes a less-than-airtight provision that requires foreign banks to disclose U.S. account holders. See Rev. Proc. 2000-12, 2000 C.B. 387 § 6.01. It was this U.S. disclosure requirement that UBS helped clients to deliberately plan around. According to internal documents, UBS recommended to U.S. clients that they hold accounts through a nominee blocker corporation in a tax haven, thus ensuring the treatment of the account holder as non-U.S. under 26 C.F.R. §§ 1.1441-1(c)(3) (which defines foreign corporation as a foreign beneficial owner) or divest U.S. assets, perhaps trading in U.S. treasuries for British gilts, thus following a workaround suggested by the QI agreement itself. See Rev. Proc. 2000-12, 2000 C.B. 387 § 6.02; see also UBS, *QUALIFIED INTERMEDIARY SYSTEM: U.S. WITHHOLDING TAX ON DIVIDENDS AND INTEREST INCOME FROM U.S. SECURITIES 1* (Oct. 2004) (“A QI has to ensure that *US Persons* . . . either declare themselves to the US tax authorities . . . or are no longer permitted to invest in US securities.”).

¹⁵⁰ Lynnley Browning, *U.S. Reports Agreement with UBS in Tax Case*, N.Y. TIMES, Aug. 13, 2009, at B3.

¹⁵¹ *Id.* The U.S. John Doe summons request did not discriminate based on the size of the account. See Memorandum in Support of *Ex Parte* Petition for Leave to Serve John Doe Summons at 8, *In re Tax Liabilities of John Does* (No. 08-21864) (S.D. Fla. June 30, 2008) (describing John Doe class as any U.S. taxpayer with “signature or other authority . . . with respect to any financial accounts,” except for taxpayers who had supplied UBS with Forms W-9 and been subject to Form 1099 reporting).

and their clients, took very seriously.¹⁵² In August 2009, after the intervention of the Swiss government as amicus in the case and top-level negotiations, the civil case settled under an agreement requiring UBS to disclose over 4000 names through the information exchange provisions of the treaty between the United States and Switzerland.¹⁵³ After considerable debate, the Swiss parliament approved the agreement in June 2010, and Switzerland's highest court later confirmed the constitutionality of the disclosure.¹⁵⁴

Meanwhile, the U.S. government ran a voluntary disclosure program aimed at offshore account holders, which resulted in 15,000 applications by October 2009.¹⁵⁵ A follow-up voluntary disclosure program launched

¹⁵² See, e.g., Haig Simonian, *Swiss Minister Defiant over Demand for UBS Names*, FIN. TIMES, Feb. 22, 2009 (describing the political uproar in Switzerland over the requested disclosure).

¹⁵³ See Browning, *supra* note 150, at B3 (noting agreement by Swiss government to "turn over about 5,000 names"). The Swiss government argued that Swiss bank secrecy laws prohibited UBS from complying with the summons and that the information request should be processed through applicable treaty provisions. Brief for Government of Switzerland as Amici Curiae Supporting Defendants at 13–15 *United States v. UBS AG* (No. 09-CV-20423) (S.D. Fla. Apr. 30, 2009). The settlement with the Swiss government requires the U.S. to submit information requests under Article 26 of the U.S.-Swiss treaty which permits the exchange of information necessary to prevent tax fraud. *Id.* at 11–13. Historically, the treaty has not been used for broad summons requests undertaken without previous specific suspicions about a particular taxpayer. *Id.* at 15–19.

¹⁵⁴ Lynnley Browning, *Swiss Approve Deal for UBS to Reveal U.S. Clients Suspected of Tax Evasion*, N.Y. TIMES, June 18, 2010, at B3; Jaclyn Belczyk, *Switzerland High Court Upholds UBS Disclosure of Client Information*, JURIST (Jul. 15, 2011, 11:46 AM), <http://jurist.org/paperchase/2011/07/switzerland-high-court-upholds-ubs-disclosure-of-client-information.php>. This followed a decision by the Swiss Federal Administrative Court that the failure to file a W-9 with UBS for transmission to the U.S. tax authorities did not constitute "tax fraud and the like" and therefore did not meet a requirement under a 1996 treaty for an exception to bank secrecy protection. See Daniel Pruzin, *Switzerland for Now to Hand Over Data on Only 250 Secret Accounts with UBS*, BNA TAX MANAGEMENT WEEKLY REPORT 144–45 (Feb. 1, 2010). In July 2011, the lower court's decision was reversed, preventing UBS account holders from claiming damages for breach of bank secrecy from UBS. *Swiss Court Says was Right to Give U.S. Bank Data*, REUTERS (July 15, 2011), <http://www.reuters.com/article/2011/07/15/ubs-idUSLDE76E12W20110715> (noting the court's view that the U.S. indictment that could have resulted absent the Swiss regulator's order for the handover of the information "would have led to the bankruptcy of the bank which in turn would have caused serious and virtually uncontrollable economic repercussions for Switzerland . . ."). As of August 2010, the IRS had received information regarding about 2000 UBS clients. Lynnley Browning, *I.R.S. to Drop Suit Against UBS over Tax Havens*, N.Y. TIMES, Aug. 27, 2010, at B6.

¹⁵⁵ See Memorandum from Linda E. Stiff, Deputy I.R.S. Commissioner for Services and Enforcement, to Commissioner, Large and Mid-Size Business Division and Commissioner, Small Business/Self-Employed Division (March 23, 2009) (setting forth settlement terms); I.R.S. News Release IR 2009-84 (Sept. 21, 2009) (extending deadline to October 15, 2009); see also Marie Sapirie, *New Era of Enforcement Follows UBS Saga*, 59 TAX NOTES INT'L 501 (2010) (noting 14,700 disclosures under the program).

The 2009 program followed the offshore credit card initiative of 2002–03, which sought information from payment processors such as MasterCard and Visa, see Rev. Proc. 2003-11, 2003-4 I.R.B. 311, and which culminated in only ten or so prosecuted cases, plus settled cases that did not get publicized. See Heather Bennett, *IRS Offshore Compliance Initiative Collects US \$170 Million So Far*, 102 TAX NOTES 517 (2004) (reporting that the initiative collected 1300 applications and \$170 million).

in February 2011.¹⁵⁶ During the same time period, the Department of Justice used the UBS case and information to support the high-profile criminal prosecution of several offshore account holders, and it obtained a number of plea bargains, which then supported well-executed availability-bias-based publicity. The publicity was not supported by huge numbers of convicted taxpayers. But their stories were well-covered by the national media and presented a high-availability story of average rich people getting caught.¹⁵⁷ Reports released while the voluntary disclosure program was pending indicated that smaller UBS clients were included on the list selected for disclosure.¹⁵⁸

The government chose a high monetary penalty benchmark for its 2008–09 and 2011 special offshore account voluntary disclosure programs. It used twenty percent of account value in 2008–09 and twenty-five percent in 2011 as the price for entering the voluntary disclosure program.¹⁵⁹ This represents a discount from the statutory civil willfulness penalty of fifty percent of the account balance for each annual failure to file.¹⁶⁰ But it is not clear that a court would have upheld the application of

It was considered a limited success. *See, e.g.*, JOINT COMMITTEE ON TAXATION, TAX COMPLIANCE AND ENFORCEMENT ISSUES WITH RESPECT TO OFFSHORE ACCOUNTS AND ENTITIES 48–49 (Mar. 30, 2009) (reporting the view that the lack of parallel enforcement actions and publicity limited the success of the 2003 program). In general the 2002–03 initiative did not face a bank secrecy obstacle, since it targeted U.S. payment processors. *See, e.g.*, *Dorsey v. United States*, 2004-1 U.S.T.C. ¶ 50,164 83, 231–32 (D. Md. 2004) (refusing to quash summons under § 7602; bank secrecy issue not raised).

¹⁵⁶ *See* I.R.S. News Release, IR 2011-14 (Feb. 8, 2011).

¹⁵⁷ *See* Morse, *supra* note *, at 58 (citing a string of news stories).

¹⁵⁸ *See* Laura Saunders, *IRS Extends Deadline to Declare Foreign Accounts*, WALL ST. J., Sept. 22, 2009, at C1 (reporting “no discernible pattern as to which customers were selected” for required disclosure under the UBS settlement and repeating practitioner’s comment that “[s]everal of our clients with ‘plain vanilla’ accounts well under \$1 million have gotten these letters”). The U.S. John Doe summons request did not discriminate based on the size of the account. *See* Memorandum in Support of Ex Parte Petition for Leave to Serve John Doe Summons, *supra* note 151, at 8 (describing John Doe class as any U.S. taxpayer with “signature or other authority . . . with respect to any financial accounts,” except for taxpayers who had supplied UBS with Forms W-9 and been subject to Form 1099 reporting).

¹⁵⁹ In addition to requiring taxpayers to file returns going back six years and pay all back taxes, interest, and either accuracy or delinquency penalties, participants in the 2008–09 offshore account voluntary disclosure program paid penalties of twenty percent of the account balance for the year (of the six years covered) with the highest balance. *See* Memorandum from Linda E. Stiff, *supra* note 155 (setting forth settlement terms). In 2011, a lower 12.5% penalty was also established for smaller accounts whose value did not exceed \$75,000 in any covered year. I.R.S. News Release IR 2011-14 (Feb. 8, 2011). State taxes and penalties may also apply. *See* I.R.S., *Voluntary Disclosures: Questions and Answers*, *supra* note 140, at Question 12. *See generally* LEANDRA LEDERMAN & STEPHEN W. MAZZA, *TAX CONTROVERSIES: PRACTICE AND PROCEDURE* 80–92 (3d ed. 2009) (describing penalties for civil tax violations and defenses).

¹⁶⁰ *See* 31 U.S.C. § 5321(a)(5)(c)(i)(I)–(II) (2006) (providing for a penalty of the greater of \$100,000 or fifty percent of the balance in the account at the time of the violation). Prior to 2004, the maximum penalty for a willful violation was the *lesser* of \$100,000 or the account balance at the time of violation. *See* BITTKER & LOKKEN, *supra* note 136, at ¶ 65.6 n.87 (describing 2004 Congressional action).

such a willfulness penalty, particularly for failures to file before the government had widely publicized the FBAR requirement.

Under the holding in *Cheek v. United States*,¹⁶¹ a “willful” violation of a legal duty to file a tax form generally requires that the defendant know of the legal duty.¹⁶² It is conceivable, given the historic lack of publicity about, and enforcement of, the FBAR filing requirements, that a defendant might be able to show a lack of willfulness.¹⁶³ One circuit court case, decided under the *Cheek* standard, rejected an “ostrich” defense theory in an FBAR filing case, but it involved egregious facts.¹⁶⁴

The government apparently intends to apply the penalty across the board.¹⁶⁵ It has declined to recognize a distinction between business accounts and savings and investment accounts,¹⁶⁶ and an anticipated reduction to a five percent penalty apparently meant to apply to inherited accounts is reportedly not granted.¹⁶⁷ Guidance accompanying the 2011 program explicitly stated that the twenty-five percent penalty would not be subject to negotiation or the discretion of IRS personnel.¹⁶⁸ Despite the uncertain applicability of the willfulness standard, the government

¹⁶¹ 498 U.S. 192 (1991).

¹⁶² *See id.* at 201–02 (“Willfulness, as construed by our prior decisions in criminal tax cases, requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty.”).

¹⁶³ *See, e.g.,* Feingold, *supra* note 97, at 605 (arguing that many FBAR nonfilers failed to file due to ignorance of the requirement).

¹⁶⁴ *See United States v. Sturman*, 951 F.2d 1466, 1476–77 (6th Cir. 1991) (holding that actions taken to conceal assets from the government, including the use of different corporations to transfer funds, together with admitted “knowledge of and failure to answer a question concerning signature authority at foreign banks on Schedule B of his income tax return . . . provid[ed] a sufficient basis to establish willfulness on the part of the defendant”). *But see Ratzlaf v. United States*, 510 U.S. 135, 147 (1994) (reversing the conviction of a defendant who avoided the Bank Secrecy Act’s cash transaction reporting requirement by purchasing a series of cashier’s checks, on the grounds that although the defendant knew of the reporting requirement, he did not know that structuring the cashier check purchases was illegal).

¹⁶⁵ *See, e.g.,* Memorandum from Monica L. Baker, Dir., SBSE Examination & Rosemary Sereti, Dir., Int’l Individual Compliance to All OVDI Exam’rs Re: Use of Discretion on 2009 OVDI Cases (Mar. 1, 2011) (stating that discretion to reduce penalty from twenty percent in 2009 OVDI program would be allowed in restricted cases only, such as when the possibility of a reduction had already been discussed).

¹⁶⁶ IRS, Voluntary Disclosure: Questions and Answers, *supra* note 140, at Question 32.

¹⁶⁷ In guidance, the IRS stated that a five percent penalty might apply to accounts that the taxpayer “did not open or cause . . . to be opened, [where] there has been no activity . . . during the period the account . . . was controlled by the taxpayer, and . . . all applicable U.S. taxes have been paid on the funds [deposited] in the accounts.” Memorandum from Linda E. Stiff, *supra* note 155, at 2. An inherited account, for example, might fit these criteria. However, practitioners report that as a practical matter taxpayers cannot persuade the government to apply only a five percent penalty. *See, e.g.,* Remarks of Frank Agostino, Kathryn Keneally & Bryan Skarlatos, The Prosecution and Defense of Offshore Bank Accounts, ABA Tax Section Teleconference & Live Audio Webcast (Mar. 3, 2010).

¹⁶⁸ *See* IRS, Voluntary Disclosure: Questions and Answers, *supra* note 140, at Question 35 (providing, however, that the assessed penalties would not exceed the maximum penalties that would be assessed under law outside the voluntary disclosure initiative).

managed to establish twenty percent, and then twenty-five percent, of the account value as a credible penalty—in other words, it successfully publicized that penalty level in its program, and voluntarily disclosing taxpayers accepted it as a benchmark.

For the typical offshore account holder, news about indictments and plea bargains of the merely very wealthy, rather than the Forbes 400, may have salience and tap effectively into availability bias, but in order for the news to be effective it must continue.¹⁶⁹ The IRS should continue to publicize different kinds of taxpayers that have gotten caught to the extent it legally can.¹⁷⁰ The government's apparent focus on marshaling simple and easily decided (or plea bargained) charges makes sense, as does its emphasis on continuing its prosecution, plea bargain, and publicity program,¹⁷¹ and on covering banks other than UBS.¹⁷²

The government appears aware of the need to broaden the net beyond UBS and has instituted criminal proceedings against another large bank, HSBC, and at least two of its clients,¹⁷³ as well as against Credit Suisse

¹⁶⁹ See *supra* note 146 and accompanying text (describing the importance of recalled similar events to an individual's probability estimates).

¹⁷⁰ Publicizing taxpayers who have been caught is likely more important than publicizing the audit rate or the compliance rate, both of which draw mixed results in terms of their ability to promote additional compliance. Taxpayers may interpret the audit rate either as communicating that audit activity exists or communicating that an audit is too unlikely to worry about. Cf. Alm et al., *supra* note 145, at 401 (noting conflicting results for "official" publication of audit information in laboratory study). The IRS does publish audit rates, though it keeps the factors that affect its audit selection mechanism secret.

The typically cited problem with publicizing the compliance rate, as opposed to telling stories about tax cheats who got caught, is the "chump" problem, meaning that taxpayers can interpret the compliance rate as communicating that "a clever minority cheats" instead of that the strong norm is to pay one's taxes. Morse, *supra* note 16, at 506. In one real-life experiment, Minnesota taxpayers received a letter from the Minnesota Department of Revenue stating that nearly all taxpayers—ninety-three percent—were compliant. Increased compliance, measured by reference to actual tax returns filed, was not statistically significant for those who received the letter. The possibility that the audience will self-identify with or aspire to be part of the "clever minority" makes this a risky strategy. See Blumenthal et al., *supra* note 70, at 134.

¹⁷¹ See Alison Bennett, *Tax Crimes: Efforts Continuing to Track Down Individuals, Banks Hiding Offshore Assets, Officials Say*, 29 TAX MGMT. WKLY. REP. 100, 100 (Jan. 25, 2010) (noting 150 ongoing offshore account criminal investigations and that "hundreds of taxpayers are still coming in under IRS's basic procedures for voluntary disclosures"). Plea bargain publicity has continued to emerge, and continues to feature the average wealthy taxpayer. See, e.g., Lynnley Browning, *UBS Client Pleads Guilty to Tax Fraud*, N.Y. TIMES, Apr. 13, 2010, at B4 (reporting guilty plea of Harry Abrahamsen of Oradell, New Jersey, whose UBS account was allegedly financed by claiming \$1.3 million in inflated expenses—which would have produced a tax benefit of perhaps \$500,000).

¹⁷² See Lee Sheppard, *Now What? Dealing With UBS Account Disclosures*, 124 TAX NOTES 847, 854 (2009) (suggesting that the IRS should pursue and publicize fifty UBS cases and twenty from other banks).

¹⁷³ See Lynnley Browning, *U.S. Widens Tax Inquiry Into HSBC*, N.Y. TIMES, July 10, 2010, at B1 (reporting criminal investigation of London-based bank and two of its clients); David D. Stewart, *U.S. Offshore Enforcement Likely to Focus on Asia, Practitioners Say*, TAX NOTES (2010), available at LEXIS, TNT library, 2010 TNT 64-1 (reporting on David Rosenbloom and Scott Michel's efforts to

bankers. On the heels of the 2011 announcement of the follow-up voluntary disclosure program came news that the U.S. offshore account investigations now also targeted Asian and Israeli banks. These targets presumably emerged from information provided by taxpayers about offshore accounts on FBAR forms submitted under the 2009 voluntary disclosure program or by UBS through its disclosed accounts.¹⁷⁴ In November 2011, following the indictment of several Credit Suisse bankers, the Swiss bank agreed to disclose some U.S. clients' names to the IRS.¹⁷⁵

The IRS is fortunate in this case that various media outlets are following this story closely, because § 6103 of the Code, which prohibits the IRS from disclosing confidential taxpayer "return information,"¹⁷⁶ limits the government's direct publicity efforts.¹⁷⁷ The enumerated exceptions in the statute do not even include explicit permission for the IRS to publicize return information that has already been disclosed publicly, whether through a posted lien, civil or criminal litigation, taxpayer discussion of the case in a public forum, or otherwise.¹⁷⁸ However, in light of the case law¹⁷⁹ the IRS has become comfortable with

warn the financial industry in Hong Kong and Singapore of the likelihood of UBS-like investigations in Asia).

¹⁷⁴ See Kara Scannell & Haig Simonian, *U.S. Probe Into Tax Evasion Widens*, FIN. TIMES, Feb. 27, 2011 (reporting connection between UBS information and new investigations).

¹⁷⁵ See Haig Simonian, *Credit Suisse to Hand Over U.S. Clients' Names*, FIN. TIMES, Nov. 8, 2011.

¹⁷⁶ I.R.C. § 6103(2) (2006). The statute defines "return information" very broadly and it "includes any information developed or obtained by the IRS during the course of an audit or investigation of the taxpayer, as well as the mere fact that the taxpayer's return has been or is being audited or investigated." Stephen W. Mazza, *Taxpayer Privacy and Tax Compliance*, 51 KAN. L. REV. 1065, 1091 (2003). A series of exceptions permits disclosure of return information in certain specific circumstances, which include several third-party disclosure permissions necessary to effective administration. For example, the IRS may disclose information in connection with judicial proceedings, I.R.C. § 6103(h)(4), under certain circumstances to obtain relevant information, *id.* § 6103(k)(6), or to put an interested party on notice, *id.* § 6103(e).

¹⁷⁷ See, e.g., I.R.C. § 6103(b)(2) (permitting disclosures to the general public when it publicizes "data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer"); *id.* § 6103(k)(1) (allowing disclosure "to permit inspection of any accepted offer-in-compromise under section 7122").

¹⁷⁸ See, e.g., Mazza, *supra* note 176, at 1121 ("The IRS's current efforts to communicate strong and meaningful deterrence messages are hampered by the lack of an exception in section 6103 permitting disclosure of return information relevant to criminal tax proceedings.").

¹⁷⁹ The circuit courts have divided into three camps. The Sixth and Ninth Circuits have adopted a "public records" exception that permits the IRS to publicize taxpayer information that has been disclosed in litigation, including in an indictment or other filing that precedes a final determination. See *Rowley v. United States*, 76 F.3d 796, 801 (6th Cir. 1996) (holding that taxpayer's return information loses its confidentiality through filing and recording of a judicial lien, and that the IRS may republish it); *William E. Schrambling Accounting Co. v. United States*, 937 F.2d 1485, 1488-89 (9th Cir. 1991) (concluding that the filing of a tax lien destroyed confidentiality); *Lampert v. United States*, 854 F.2d 335, 338 (9th Cir. 1988) (focusing on press releases relating to charges and final resolutions and declining to use a "strict, technical reading of the statute" because such a reading would "defeat the purposes of the statute"). The Fourth Circuit has expressed support for the technical statutory reading

the strategy of posting press releases on its website.¹⁸⁰ Categorical publicity or fictional advertising are also options open to the IRS under current law.¹⁸¹

2. Detection and Information Strategies

A key possible weakness in a high-penalty regime is the possibility that taxpayers who wish to game the system may pretend to be compliers.¹⁸² Excellent audit of FBAR filers is therefore essential, as is publicity of successful audits. The availability of data and the nature of the FBAR filing group as a small population with established publicity avenues can shape the detection strategy in this case.

In the short term, audit filters must derive from statistical models containing the information on FBAR filings themselves. The good news is that the taxpayers targeted by the FBAR filing requirement are not an enormous group—perhaps one or two million. The actual audit rate, for wealthier taxpayers—6.42% for fiscal year 2009 for taxpayers with annual income in excess of one million dollars—exceeds substantially the 1.03% rate for individual taxpayers on average.¹⁸³ And the IRS has formed a

rejected by the Ninth Circuit and holds that no disclosure of return information is permitted regardless of the public disclosure of such information elsewhere. *Mallas v. United States*, 993 F.2d 1111, 1120–21 (4th Cir. 1993) (finding a violation of § 6103 under a strict statutory reading and on facts, including the disclosure of other facts than those that appeared in the court opinion, which was subsequently unanimously reversed by an *en banc* Fourth Circuit decision). The Fifth, Seventh, and Tenth Circuits have adopted forms of an “immediate source” exception, which permits disclosure if the IRS in fact drew the relevant information from court or other public proceedings and not from inside agency information. *E.g.*, *Rice v. United States*, 166 F.3d 1088, 1091 (10th Cir. 1999) (finding no § 6103 violation where IRS press official had obtained press release information from public findings and trial and sentencing proceedings); *Johnson v. Sawyer*, 120 F.3d 1307, 1325–26 (5th Cir. 1997) (finding a violation of § 6103 where information disclosed by IRS employee “came either from [the taxpayer’s] return file or from information ‘in [the IRS employee’s] head’”); *Thomas v. United States*, 890 F.2d 18, 21 (7th Cir. 1989) (noting that § 6103 “is not a prohibition of any kind against the disclosure of opinions of the Tax Court”); *cf. Mazza, supra* note 176, at 1105–14, 1121–22 (analyzing case law and related cases in other contexts considering when public disclosure diminishes privacy rights and describing and evaluating Joint Committee and Treasury recommendations “which essentially adopt the Ninth Circuit’s public records exception”).

¹⁸⁰ See *Offshore Tax Avoidance and IRS Compliance Efforts*, IRS, <http://www.irs.gov/newsroom/article/0,,id=110092,00.html> (last visited Sept. 21, 2011) (announcing the names of UBS clients found guilty of various tax-related offenses).

¹⁸¹ Joshua Blank and Daniel Levin have recently shown that the federal government appears to pursue a strategic publicity strategy by issuing a significantly higher volume of press releases during the weeks before April 15 of each year. Joshua D. Blank & Daniel Z. Levin, *When is Tax Enforcement Publicized?*, 30 VA. TAX REV. 1, 4 (2010). In a related article, Blank argues that taxpayer privacy allows the government to select what information may be disclosed, thus shaping the manipulation of taxpayers’ perceptions of enforcement. See Blank, *supra* note 144 (manuscript at 132–33).

¹⁸² See Raskolnikov, *supra* note 13, at 724 (noting that high noncompliance regime penalties will induce gamblers, particularly aggressive gamblers, to try to hide behind the compliance regime).

¹⁸³ See IRS, FISCAL YEAR 2009 ENFORCEMENT RESULTS 2, 3, available at <http://www.irs.gov/newsroom/article/0,,id=217442,00.html> (examining individual return closures and coverage rates).

special group to coordinate offshore account examinations for high-net-worth individuals.¹⁸⁴ The small size and high-net-worth characteristics of the target population also facilitate effective publicity of the likelihood that non-compliers masquerading as compliers will be caught. In fact, the government has a proven publicity strategy: the distribution of press releases on which national and international newspapers then report.

The bad news is that the IRS is constrained by the fact that the FBAR is a creature of banking law. Because taxpayer information is confidential, “when the IRS is operating solely on its designated authority . . . while enforcing FBAR provisions, it is precluded from using tax return or tax return information or information systems derived from that information.”¹⁸⁵ The shadow FBAR filing required under § 6038D of the Internal Revenue Code is intended to solve this problem. The IRS can develop a program to match automatically § 6038D data with other tax return information.¹⁸⁶

The possible future availability of third-party data should shape the way in which the government collects FBAR and § 6038D data now. In particular, data fields should be standardized for FBAR and FATCA filings.¹⁸⁷ And they should be simple, especially given the potential global nature of an ultimately successful offshore-account information-reporting project.¹⁸⁸ The essential contents of an FBAR or § 6038D form filed on behalf of an individual can be reduced to four information fields: taxpayer identity, which should often reduce to a TIN; the identity of the financial institution at which the account is held; the maximum value of the account for the year; and the account number.¹⁸⁹

Even if electronic filing—which would require statutory

¹⁸⁴ See David D. Stewart, *New IRS Group to Examine Wealthier Individuals Using Offshore Arrangements for Evasion*, TAX NOTES (2009), available at LEXIS, Tax Notes library, 2009 TNT-168-1.

¹⁸⁵ TIGTA Report, *supra* note 93, at 8.

¹⁸⁶ See *id.* at 9–10 (discussing planned § 6038D guidance).

¹⁸⁷ Robert Foley of State Street Bank has suggested that taxpayers at least be able to elect electronic filing, citing in part the ability of the IRS to more effectively use electronically submitted data. E-mail from Robert J. Foley to Notice Comments (Aug. 27, 2009), available at LEXIS, Tax Notes library, 2009 TNT 173-19.

¹⁸⁸ See Itai Grinberg, *Beyond FATCA: An Evolutionary Moment for the International Tax System* 32–54 (Feb. 16, 2012) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1996752 (setting forth arguments in favor of automatic global tax reporting rather than anonymous withholding).

¹⁸⁹ Boxes 3–13 capture the identity of the individual taxpayer; box 15 asks for the maximum value of the account during the year reported; box 18 asks for the account number or other designation; and boxes 17 and 19–23 identify the foreign financial institution. Treasury Department Form TD F 90-22.1.

authorization¹⁹⁰—is not yet feasible, assigning numeric codes for these fields would facilitate data entry and sorting based on paper source documents. For example, foreign financial institutions should have identification numbers to be used on FBAR and other filings.¹⁹¹ Without these simplification and automation measures, the government may face a situation where it has gobs of paper FBAR information about taxpayers and does not know what to do with it.¹⁹²

3. *The Close Substitute of Quiet Disclosure*

As Section III.C discussed, the problem of close substitutes can also bar a high-penalty regime from achieving its deterrence, separation, and/or signaling goals. This is an issue for the FBAR filing requirement. The possibility of a “quiet disclosure” option may exist as a close substitute alternative to voluntary disclosure.

“Quiet disclosure” is the practice of simply filing amended tax returns for the years in question.¹⁹³ It is not endorsed by any government guidance, in contrast to official “voluntary disclosure,” which is described in the Internal Revenue Manual.¹⁹⁴ Voluntary disclosure includes a list of conditions and features an undertaking by the IRS to consider the fact of disclosure when deciding whether to forward a case to the Department of Justice for criminal prosecution, such as for tax evasion. In practice, it is generally thought that voluntary disclosure prevents criminal prosecution.¹⁹⁵

Even though quiet disclosure is not officially endorsed,¹⁹⁶ it is a fairly

¹⁹⁰ I.R.C. § 6011(e) (2006) generally specifies the Secretary’s ability to require electronic filing. As amended, it gives broad authority to require financial institutions to file returns relating to withholding tax for which the institution is liable under §§ 1461 or 1474(a). *Id.* § 6011(e).

¹⁹¹ The applicable regulation delegates to the Secretary of the Treasury the authority to prescribe the information that must be listed on the form. 31 C.F.R. § 103.24(a) (2010). Others have proposed uniform numbering. *E.g.*, William L. Burke, *Tax Information Reporting and Compliance in the Cross-Border Context*, 27 VA. TAX REV. 399, 411, 415 (2007) (suggesting that each foreign corporation be assigned a distinctive taxpayer identification number that must be used in all subsequent filings).

¹⁹² *Cf.* Blank, *supra* note 49, at 1632 (describing the problem of overdisclosure under tax shelter disclosure rules).

¹⁹³ *See* Treas. Reg. § 1.451-1(a) (2004) (“If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due.”); LEDERMAN & MAZZA, *supra* note 159, at 90 (describing generally the amended return practice).

¹⁹⁴ IRS, IRM 1.451-1(a) (Dec. 2, 2009).

¹⁹⁵ *See, e.g.*, Letter from Stuart E. Abrams et al. to The Honorable Douglas H. Shulman, Comm’r of Internal Revenue & John DiCicco, Acting Assistant Attorney Gen., Dep’t of Justice, Tax Div. (Mar. 30, 2010) (asserting that to maintain consistency with taxpayer and practitioner expectations, the government should ensure that taxpayers who attempt voluntary disclosure in “good faith” are not prosecuted, even if their disclosures are technically late).

¹⁹⁶ *See* MICHAEL I. SALTZMAN & LESLIE BOOK, IRS PRACTICE AND PROCEDURE § 12.07[3][d]–[e] (rev. 2d ed. Supp. 2011) (distinguishing quiet disclosure from voluntary disclosure and noting

well established practice,¹⁹⁷ and taxpayers' expectation that quiet disclosure offers at least some protection against criminal prosecution is also entrenched.¹⁹⁸ The no-penalty quiet disclosure avenue presents a possible close substitute problem when compared with high-penalty participation in the offshore account voluntary disclosure program. A taxpayer's ability to choose quiet disclosure could weaken the FBAR filing requirement if a taxpayer decides not to file the FBAR form, but rather to hide his or her offshore account from the government with the intention of pursuing quiet disclosure later if it looks like he or she will get caught. This presents a problem for the integrity of the high-penalty FBAR rules because the voluntary disclosure option does not subject the taxpayer to the significant willful-failure-to-file-derived penalties that the IRS has applied to voluntarily disclosing taxpayers. The quiet disclosure option also weakens the ability of the high-penalty FBAR regime to serve its deterrence and separation, and, if relevant, signaling functions.

The deterrence power of the FBAR—grounded in taxpayers' comparison of the risks and rewards of filing and not filing—depends on taxpayers' belief that failure to file the FBAR will lead to the government imposing penalties. The no-penalty quiet disclosure option suggests that there is little cost in failing to file the form initially, and that the taxpayer may wait to see whether the government seems to have the ability to discover his or her offshore accounts by other means. If the government does, then quiet disclosure is an easy after-the-fact solution.¹⁹⁹

The separation goal of a high-penalty system is similarly undermined by the quiet disclosure option. Compliant taxpayers might choose up-front compliance, by filing the FBAR; or delayed compliance, through quiet disclosure. The quiet disclosure option does not clearly identify compliant taxpayers in the way that filing an FBAR does, and therefore makes it more difficult for the government to target taxpayer service or tailored detection strategies to the compliant group. To the extent that the FBAR rules, despite the fact that they do not require public reporting, include any reputational signaling component, quiet disclosure also might muffle the signaling potential of the high-penalty FBAR system, because quiet

disadvantages such as the waiver of Fifth Amendment protection and the possibility of an additional violation if the amended returns are incorrect).

¹⁹⁷ Frank Agostino, Agostino & Associates, Remarks at the Prosecution and Defense of Offshore Bank Accounts, *supra* note 167 (describing long-standing “quiet disclosure” approach based on private practice experience).

¹⁹⁸ See LAWRENCE R. JONES, JR., DEALING WITH THE IRS COLLECTION DIVISION § 1412, at 235–36 (1995) (stating that a taxpayer has a very limited chance of criminal prosecution if failure to file is corrected by filing tax returns and recommending the resolution of “all questionable items on the delinquent tax return . . . in favor of the IRS”).

¹⁹⁹ Of course, the taxpayer's willingness to choose the quiet disclosure option instead of the voluntary disclosure option, with its more explicit commitment to avoid a criminal prosecution recommendation, depends in part on the taxpayer's risk aversion.

disclosure constitutes a competing signal around which taxpayers may gather instead.

To permit FBAR reporting to function as a high-penalty regime that promotes deterrence and separation, and perhaps also signaling, this quiet disclosure close substitute should be removed. The government has taken the first step toward doing so by saying plainly in its guidance that it will not respect quiet disclosure—in contrast to voluntary disclosure—as a reason to refrain from criminal prosecution in the offshore account context.²⁰⁰ However, as with other elements of a high-penalty regime, taxpayers' perception is what counts. Therefore, the plan for eliminating a quiet disclosure option should include appropriate, availability-bias-motivated publicity, such as publicity of taxpayers subject to significant penalties despite efforts at quiet disclosure. To date, the government has not widely publicized any such case.

C. *FBAR Reporting as a Successful High-Penalty Regime*

The recent enforcement of the FBAR rules has established a good starting point, due to taxpayer perception of government enforcement, to serve the high-penalty purposes of deterrence, separation, and signaling. Tax administrators should continue to work to increase taxpayers' perception of the credibility of the penalties specified under the FBAR system, by expanding the reach of their criminal and civil investigations to other banks and by continuing to publicize cases where taxpayers failed to file FBARs and got caught. The government should develop its FBAR audit strategy, with help from the shadow FBAR requirements of § 6038D, and publicize its ability to detect noncompliant taxpayers attempting to masquerade as compliant taxpayers by filing incomplete FBARs. Finally, it should use publicity persuasively to eliminate the close substitute option of quiet disclosure as a remedy for the failure to file an FBAR in the future.

VII. AN EXPRESSIVE LAW FATCA STRATEGY

A. *What FATCA Is*

The Foreign Account Tax Compliance Act, or FATCA, requires non-U.S. financial institutions to tell the U.S. government about their U.S. account holders.²⁰¹ In general, FATCA applies to payments of investment

²⁰⁰ See IRS, Voluntary Disclosure Questions and Answers, *supra* note 140, at Question 10 (“Those taxpayers making ‘quiet’ disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years.”).

²⁰¹ This Article refers to the statute, codified at I.R.C. §§ 1471–1474 (Supp. 2011), or Chapter 4 of the Code, as “FATCA” although it was not codified as such. The law was proposed by the Obama administration in the 2010 Greenbook as a modification to the qualified intermediary (“QI”) and nonqualified intermediary (“NQI”) rules applicable to payments of U.S.-source investment income to

income or gain made from the United States to “foreign financial institutions,” or FFIs.²⁰² Unless the FFI—including each of its affiliates—has agreed to obtain and report information about U.S. account holders and submit to “verification and due diligence procedures,”²⁰³ thirty percent withholding applies to U.S.-source portfolio income streams and gross proceeds from the sale of certain securities that produce U.S.-source portfolio income, regardless of whether those payments are made to U.S. or non-U.S. accounts at the FFI.²⁰⁴ If the FFI has entered into such an agreement, thirty percent withholding applies only to accounts held by “recalcitrant account holders” who refuse to provide information necessary to ascertain whether they are U.S. persons and/or who do not waive bank secrecy law obstacles to the disclosure of their identity consistent with FATCA.²⁰⁵ The law gives the Treasury broad discretion to craft appropriate agreements and exceptions.²⁰⁶

FATCA builds on the precedent of the negotiated development of the

non-U.S. persons. DEPT OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2010 REVENUE PROPOSALS 41-45 (May 2009). Bills proposing to enact a “Foreign Account Tax Compliance Act” followed in late 2009. *See, e.g.*, H.R. 3933, 111th Cong. (1st Sess. 2009). Legislation then passed as part of a larger jobs-oriented tax package in March 2010. *See* Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 501, 124 Stat. 71 (2010).

²⁰² *See* I.R.C. § 1471 (describing rules applicable to payments to foreign financial institutions). Withholding may also apply to payments to other foreign entities. *Id.* § 1472. The statute provides an effective date of January 1, 2013, but subsequent guidance indicates that various stages of implementation will be delayed. *See, e.g.*, I.R.S. Notice 2011-53, 2011-32 I.R.B. 124 (July 15, 2011). The government promulgated proposed regulations under FATCA as this Article went to press. *See* Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities, 77 Fed. Reg. 9022 (proposed Feb. 15, 2012) [hereinafter “Proposed FATCA Regs”].

²⁰³ *See id.* § 1471(b)(1) (describing agreement requirements); *id.* § 1471(e) (requiring all affiliates of a financial institution to enter into the requisite agreement in order for payments to the financial institution to escape withholding). Subsequent guidance has offered more information about specific information required to be reported and affiliate reporting, among other matters. *See* I.R.S. Notice 2011-34, 2011-19 I.R.B. 765 (May 9, 2011) (announcing, explaining, and requesting comments on the implementation of FATCA); I.R.S. Notice 2010-60, 2010-37 I.R.B. 329 (Sept. 13, 2010) (same).

²⁰⁴ *See* I.R.C. § 1471(a) (applying thirty percent tax to any “withholdable payment” to a “foreign financial institution”); *id.* § 1473(1) (defining “withholdable payment”). The withholding penalty applies to payments of U.S.-source interest, dividends, rents, royalties, and other payments of passive or investment income. It also applies—unlike penalty withholding rules under the QI regime—to “gross proceeds from the sale or other disposition of property of a type which can produce interest or dividends from sources within the United States.” *Id.* § 1473(1)(A). It does not apply to amounts connected with a U.S. trade or business. *Id.* § 1473(1)(B).

²⁰⁵ *Id.* §§ 1471(b)(1)(D)(i)-(ii) & 1471(d)(6).

²⁰⁶ Some statutory language is quite specific. *See, e.g., id.* § 1471(c)(1) (requiring the name, address, and TIN of each U.S. account holder, the account number, the account balance of value and gross receipts, and gross withdrawals). But discretion is sprinkled throughout the statute and in particular in § 1471(b)(2)(A), which provides broad authority to the Treasury Secretary to “deem[]” financial institutions to meet requirements so long as Secretary-prescribed “procedures” and “requirements” are met. *Id.* § 1471(b)(2)(A).

model qualified intermediary, or QI, agreement,²⁰⁷ which implemented rules permitting non-U.S. QI banks to forward non-U.S. client information to the United States on a summary basis to obtain reduced rates of withholding on U.S. source payments.²⁰⁸ Starting in 1998, the IRS negotiated with bank trade associations, primarily in Europe, to draft the Model QI Agreement.²⁰⁹ The bank associations extracted some favorable provisions, including permission to rely on existing know-your-customer, or KYC, procedures,²¹⁰ and the provisions described above²¹¹ that could be interpreted by banks to permit the retention of a U.S. account holder if the account holder divested non-U.S. assets.²¹²

FATCA applies to every FFI that holds U.S. securities, not just those that prefer QI to NQI status. The New York State Bar Association has pointed out, for example, that “[t]here are no QIs in a number of countries that represent significant sources of inbound investment to the United States, including China, Brazil and Mexico” as well as New Zealand; there are reportedly “very few [QIs] in Japan.”²¹³

B. Applying the High-Penalty Analytic Framework to FATCA

It appears at first glance that for any FFI with clients who hold investments in U.S. securities, FATCA’s withholding penalty is so onerous that it simply must be avoided at all costs.²¹⁴ Thirty percent withholding

²⁰⁷ See J. Richard Harvey, *Offshore Accounts: Insider’s Summary of FATCA and Its Potential Future*, 57 VILL. L. REV. (forthcoming 2012) (manuscript at 3–14) (describing the origins of FATCA); see also Melissa A. Dizdarevic, Comment, *The FATCA Provisions of the HIRE Act Boldly Going Where No Withholding Has Gone Before*, 79 FORDHAM L. REV. 2967, 2978–80 (2011) (explaining how weaknesses in the QI program prompted FATCA); Chad P. Ralston, Comment, *Going it Alone: A Pragmatic Approach to Combating Foreign-Effectuated Tax Evasion*, 24 EMORY INT’L L. REV. 873, 896–97 (2010) (describing strengths and weaknesses of the QI program).

²⁰⁸ See *supra* note 149 (outlining QI rules). The government has emphasized its openness to foreign banks’ input and its willingness to listen to their concerns with respect to FATCA. See, e.g., Kristen A. Parillo, *IRS Official Foresees Release of FATCA Guidance in Stages*, TAX NOTES (Apr. 29, 2010), available at LEXIS, Tax Notes library, 2010 TNT 83-2 (“[I]t’s helpful for institutions to provide submissions and give us comments telling us what they already do and help us understand what assurance those measures provide.”) (quoting Treasury attorney-advisor Itai Grinberg).

²⁰⁹ See Susan C. Morse & Stephen E. Shay, *Qualified Intermediary Status, Act II: Notice 99-8 and the Role of a Qualified Intermediary*, 28 TAX MGMT INT’L J. 259, 259–60 (1999) (describing the process of collecting comments from foreign banks before proposing QI agreement); see also Marnin J. Michaels et al., *Nine Months of Working With the QI Agreement: What Has the IRS Wrought?*, 11 J. INT’L TAX’N 4 (2000).

²¹⁰ See Morse & Shay, *supra* note 209, at 262 (describing the typical practice of a country’s bank association guiding KYC rules to IRS approval).

²¹¹ See *supra* notes 70–71 (describing provisions relating to the disclosure of U.S. holders’ identity).

²¹² See *supra* note 149 (identifying holes in QI rules).

²¹³ See NYSBA Sept. 10, 2009 Letter, *supra* note 149, at 20, 23.

²¹⁴ See Dizdarevic, *supra* note 207, at 2985 (noting FATCA’s apparent penalty, as opposed to enforcement, purpose).

on gross proceeds—that would lose customers fast. A thirty percent withholding penalty far exceeds any penalty typically prescribed for U.S. banks required to report to U.S. customers.²¹⁵

But, in fact, the U.S. government is not—and should not be—generally prepared to impose this withholding tax.²¹⁶ Doing so could produce significant unwanted capital market disruptions and require commitment of international relations resources.

With respect to the capital markets point, there is a zero withholding tax baseline provided for most returns on U.S.-issued securities held by non-U.S. investors. In particular, the portfolio interest exemption provides a zero withholding tax on payments to non-U.S. persons of interest on most U.S.-issued debt securities,²¹⁷ while the residence-of-the-seller sourcing rule for capital gain also takes gain on a non-U.S. person's sale of U.S.-issued debt and equity securities out of the U.S. income tax base.²¹⁸ The flow of global capital into U.S. debt and equity markets—including the market for government-issued debt—rests in part on the assumption that U.S. withholding tax will apply only in narrow and well-defined cases. For example, the many-layered provisions of the standardized agreement used by derivative traders are scrupulously designed to ensure that holders of derivatives will not see their investment return changed by an unexpected withholding tax.²¹⁹ Imposing FATCA withholding taxes would disturb the capital markets' expectation of no withholding tax on most returns on U.S. securities and discourage global investment in U.S. capital markets.

International relations resources could also be required to smooth things over. Interestingly, the resolution to the UBS case was announced at the conclusion of a visit to Switzerland by Secretary of State Hillary

²¹⁵ No withholding requirement applies to usual-course bank and financial account reporting to U.S. account holders within the United States. See Lily Kahng, *Investment Income Withholding in the United States and Germany*, 10 FLA. TAX REV. 315, 324–26 (2010) (noting the absence of investment income withholding in the U.S.). Withholding is only required if an account holder repeatedly fails to pay taxes on income reported from an account. See Treas. Regs. §§ 1.6041–1 (explaining back-up withholding notices).

²¹⁶ U.S. government representatives have said that they want “transparency,” not withholding, to result from FATCA. See, e.g., Tom Braithwaite, *U.S. Delays Reporting Rules for Foreign Banks*, FIN. TIMES, July 15, 2011 (quoting IRS Commissioner Doug Shulman); Lee Sheppard, *Questions Posed by the FATCA Notice*, TAX NOTES (2010), available at LEXIS, Tax Notes library, 2010 TNT 205 (reporting government official's suggestion that a bank might not need to build automatic withholding into its computer systems but could address any withholding requirements manually).

²¹⁷ See I.R.C. § 871(h) (2006) (providing “portfolio interest” exemption).

²¹⁸ See *id.* § 865(a) (providing default residence-of-seller gain source rule).

²¹⁹ See INT'L SWAPS AND DERIVATIVES ASS'N, MASTER AGREEMENT (1992). Part Two of the Schedule to the ISDA Master Agreement, executed in connection with specific transactions, generally includes a representation that no withholding will be due on payments under the derivative agreement, based on representations about the residence of the recipient and the delivery of certain documentation. *Id.*

Clinton.²²⁰ Application of a punitive withholding tax to force client disclosure would likely also raise significant bank secrecy or other conflicts that could require diplomatic resources to help resolve. FATCA rules are simply inconsistent with many local bank secrecy laws. Broadly enforced withholding tax penalties under FATCA are just not credible, even if withholding might result in egregious isolated cases.

In addition, jurisdictional limitations constrain the ability of the United States to detect noncompliant banks that masquerade as compliant banks.²²¹ The United States may develop audit selection models but will not be able to apply them directly. In the companion QI context, audit responsibility is generally delegated to a third-party auditor, frequently a large accounting firm or an affiliate of such a firm.²²² Historic jurisdictional limitations, now memorialized in the QI agreement, prevent the IRS from directly accessing the financial institution's records to perform a direct audit.

It is unclear whether the question of close substitutes presents a problem. Foreign banks have three options under FATCA: disclose, withhold, or divest U.S. assets. The withholding penalty does not apply if a foreign bank divests all U.S. assets and invests solely in non-U.S. securities, because in this situation no withholdable payments to the divested foreign bank—whether paid directly from a U.S. withholding agent or through other FFIs—would exist. The success of FATCA thus depends on the stickiness of global investment in U.S. securities. Widespread investment in U.S. government debt and other U.S. securities throughout the world suggests that non-U.S. banks will have a sufficient incentive to negotiate with the United States.²²³ The banks are not entirely without an alternative, however, and on the margin, some banks might divest U.S. assets, which could adversely impact U.S. capital markets.²²⁴

²²⁰ Sue Fleming & Deborah Charles, *Clinton Says Agreement "in Principle" with UBS*, REUTERS (July 31, 2009), <http://www.reuters.com/article/idUSN3142328120090731> (reporting Hillary Clinton's announcement of a litigation settlement agreement and her related meeting with the Swiss foreign minister).

²²¹ Historically, U.S. jurisdiction over non-U.S. banks for the purpose of discovering information about U.S. tax evasion or other criminal activity allegedly facilitated by such banks has been based on the physical nexus of a U.S. representative office. See PALAN ET AL., *supra* note 91, at 198; see also Burke, *supra* note 191, at 421–22, 436 (articulating jurisdictional barriers to solving cross-border compliance problem); Dodge, *supra* note 111, at 170–77 (explaining historic reluctance under the revenue rule to enforce other countries' tax laws).

²²² See Rev. Proc. 2000–12, 2000–1 C.B. 387, 408 § 10 (detailing external audit procedures).

²²³ In addition, the broad definition attached to "passthru payments" subject to the statute brings considerable indirect U.S. fund flows under FATCA. See, e.g., I.R.C. § 1471; I.R.S. Notice 2011–34, *supra* note 203.

²²⁴ In response to KPMG survey questions asking whether a fund "could intend to disinvest" from the U.S. equity market, six percent of the non-U.S. fund managers surveyed answered "yes," and twenty-six percent replied that it depended on the detailed implementation rules. KPMG, FATCA AND THE FUNDS INDUSTRY: DEFINING THE PATH 6 (2011), available at www.kpmg.com/

Another possible close substitute is a shift in U.S. investment from banks that go along with FATCA's audit requirements in good faith to banks that do not, for example, banks in jurisdictions with more distant relationships with the United States. This concern may be mitigated by the relationships among nations that are established and successful tax havens, if such established nations that "offer political and legal stability" to investors²²⁵ decide as a group to go along with FATCA. This would be consistent with European nations' fairly coordinated action in QI negotiations and with tax havens' cooperative approach in the face of the OECD harmful tax practices project.²²⁶ U.S. investors would then be left with no sufficiently safe non-FATCA offshore alternative.

There may also be other substitute strategies available under the statute. The approach of entering into an agreement but accepting withholding tax imposition on "recalcitrant account holders" provides one possibility.²²⁷ Depending on regulatory guidance, a foreign bank might be able to enter into an agreement with the United States Treasury Department, but steer all recalcitrant account holders (presumably all U.S. taxpayers) toward investment exclusively in non-U.S. securities.²²⁸ Under this approach, non-U.S. account holders and U.S. account holders willing to have their names disclosed could retain their investments in U.S. securities; only recalcitrant account holders would be required to divest.

The U.S. government cannot remove the substitute of divestiture from the menu of options available to non-U.S. banks, but this may not be fatal to FATCA's strategy. The reason is that divestiture is costly; U.S. securities remain attractive investments for various reasons. Other close substitutes, such as the possibility of placing U.S. account holders in the "recalcitrant" category, should be removed if possible. The government is aware of at least some of these problems.²²⁹

C. Administering FATCA with Expressive Law in Mind

Since FATCA does not work as a U.S.-government-enforced high-

Global/en/issuesAndInsights/ArticlesPublications/Documents/fatca-and-the-funds-industry-defining-the-path.pdf. Some journalistic accounts predict divestiture. See, e.g., David T. Moldenhauer, *Overseas Bank Law Could Drive Away Investment in U.S.*, FISCAL TIMES (May 12, 2011), available at www.thefiscaltimes.com/Articles/2011/05/12/Overseas-Bank-Law-Could-Drive-Away-Investment-in-US.aspx#page1 ("FATCA is proving to be so intrusive and far-reaching that it will likely prompt many foreign banks and investment companies to abandon the U.S. investment market . . .").

²²⁵ Michael J. Burns & James McConvill, Comment, *An Unstoppable Force: The Offshore World in a Modern Global Economy*, 7 HASTINGS BUS. L.J. 205, 219 (2011).

²²⁶ See PALAN ET AL., *supra* note 91, at 204 (describing actions of the Committee on Fiscal Affairs of the OECD and its publication of those jurisdictions practicing harmful tax competition).

²²⁷ I.R.C. §§ 1471(b)(1)(D), 1471(d)(6).

²²⁸ *But see* I.R.S. Notice 2011-34, *supra* note 203, at 769 (noting that the Treasury may terminate FFI Agreements because of the number of recalcitrant account holders after a certain amount of time).

²²⁹ *Id.*

penalty regime within the bounds of the rational actor model, and since the U.S. government has already committed resources to the administration of FATCA, it makes sense to consider an expressive law strategy. The idea is to create a norm that prompts reputation-based signaling. This can, in turn, produce deterrence and separation mechanisms enforced by the reputation market. If a robust reputation market supports the perceptions that noncompliance carries reputational penalties and that masquerading noncompliers will be detected, then it might make the high-penalty FATCA regime a success even in the absence of effective government enforcement.

The government could follow an expressive law strategy that includes the factors outlined above: reputation referencing, salience, management targeting, and incrementalism.²³⁰ Such a strategy would articulate the norm in a way that references reputation, perhaps building on the subtext of “good banks don’t lie” conveyed by the OECD’s harmful tax practices project, to develop the message that “good banks tell the truth.” It would maximize the salience of the norm and provide opportunities for targeted tax intermediaries to show publicly their commitment to the norm. Since the audience consists of large enterprises, the best expressive law strategy would target the people at the top, in particular the top compliance officers that most firms now include in their executive management team.²³¹ Finally, it would embrace incrementalism, following the theory that signaling can trigger self-reinforcing virtuous circles that should make it easier to expand the application of the regime once the underlying norm has gained a foothold.²³²

1. *Reputation Referencing*

A relevant model for reputational signaling in the third-party reporting context is the Form 1099 reporting regime applicable to domestic payments made by U.S. financial institutions. The statutes include both high monetary penalties—up to ten percent of the aggregate amount of the items required to be reported correctly for intentional disregard²³³—and

²³⁰ See *supra* Section IV.C.2.

²³¹ See *supra* note 87 and accompanying text (noting chief compliance officer appointments).

²³² Signaling can produce virtuous circles because a more widely accepted norm is a stronger norm and also because signaling should trigger a commitment consistency effect that strengthens the compliance behavior of the signaler. See *supra* text accompanying notes 22, 88, 122–24 (describing potential virtuous-circle effect in connection with expressive law strategy and giving the example of countries’ responses to the OECD’s harmful tax practices project).

²³³ See I.R.C. § 6721(e) (2006) (providing intentional disregard penalty of ten percent of amount required to be reported for requirements including the reporting of interest and dividends under § 6041 and penalty of five percent of such amount for requirements including the reporting of gross proceeds under § 6045). A maximum annual penalty per person of \$250,000 is imposed for a corrected failure to file an information return within thirty days that is not excused under a reasonable cause standard. *Id.* §§ 6721(b)(1)(B), 6724(a).

criminal penalties²³⁴ for failure to file information returns such as the annual submission of 1099 forms informing investors of the amount of dividends, interest, gross proceeds, and other payments.²³⁵ But these penalties are almost never applied, particularly to large financial institutions. So why do such firms uniformly comply with the reporting requirements?

One possibility is that these firms are subject to regular audit and so believe that the penalties will be applied if they fail to report. But another possibility is that large firms are risk-averse with respect to their reputations and their client relationships. The possible revelation of a failure to report would carry an enormous penalty, one only partly contained within the statute and augmented by factors such as the likely public relations problems resulting from the necessity of, for example, sending corrected, late information returns to clients. Another related reputational idea is that the action of reporting carries with it an important signaling message about the reputation of the reporting firm: “we’re a good bank, our records are accurate, we tell the truth by January 31 every year.”

The example of U.S. banks—as well as the U.S. experience of signing up foreign banks as QIs and the fact that banking tax havens scrambled to stay off the OECD blacklist—suggests that non-U.S. banks do have significant reputational interests that a signaling strategy can tap into. And in fact there is plenty of reputational content and salience in the “good banks tell the truth” norm that FATCA administrators should advocate. The trouble, of course, is that “good banks keep their clients’ secrets” more closely resembles the historic bank secrecy-based norm among many non-U.S. banks.²³⁶

One might argue that the clients of U.S. domestic banks value tax compliance signals from their banks because the clients self-select for financial institution compliance, while clients of offshore banks self-select for noncompliance. Under this theory, a tax compliance signal from an offshore bank will alienate, rather than impress, the offshore bank’s clients, thus causing the reputational signaling strategy to backfire. This is indeed a risk. If an expressive law strategy is successful, it will almost certainly

²³⁴ See *id.* § 7203 (providing misdemeanor characterization for failure to file information return and prescribing penalties including up to one year’s imprisonment); *cf.* *Pappas v. United States*, 216 F.2d 515, 518–19 (10th Cir. 1954) (sustaining jury conviction of partners who failed to supply required balance sheet and other information on partnership return despite maintaining careful “cash count” and other records under a predecessor to § 7203).

²³⁵ See I.R.C. § 6041(d) (providing that the total amount of payments due to a person must be reported in a statement); *id.* § 6041A(e) (providing that the total amount of payments of remuneration for services and direct sales due to a person must be reported in a statement); *id.* § 6042(c) (providing that the total amount of dividends and corporate earnings and profits due to a person must be reported in a statement).

²³⁶ See, *e.g.*, Bondi, *supra* note 122, at 3–6 (describing historic Swiss commitment to banking secrecy and connection to Swiss legal rule that tax evasion is a civil, not criminal, offense).

be because it has successfully associated the notion of tax compliance with non-tax qualities valued by a bank's clients, such as trustworthiness or good management. At the national level, the compliance of bank secrecy tax havens with the demands emerging from the OECD's harmful tax practices project provides some precedent suggesting that the association of tax compliance with non-tax reputational values is possible.

2. *Salience*

The FATCA administration strategy must also include opportunities for non-U.S. banks and other foreign financial intermediaries to signal their compliance with the norm. The statute itself offers two such signaling mechanisms: entry into an agreement between the U.S. government and an FFI,²³⁷ and annual reporting of the required information.²³⁸ These mechanisms will be stronger signaling devices if they are public and simple. Thus the banks who have agreements with the government might be publicly listed on the IRS website, and the reporting form should be as streamlined as possible.

A requirement that non-U.S. banks must send FATCA reports to U.S. account holders as well as to the U.S. government would maximize the visibility of the banks' compliance action and target the largest group of potential reputation market participants—the banks' customers. The statute does not specify whether client reporting is required,²³⁹ though IRS guidance could do so. Non-U.S. banks might oppose client reporting as an undesirable added administrative burden on top of already challenging compliance demands, but such a requirement would be consistent with the expressive law project of FATCA administration.

3. *Management Targeting*

Because FATCA seeks to influence the reputation signaling behavior of large institutions, its administration should take into account the organizational behavior features of large institutions.²⁴⁰ The penalty for failing to agree or report as required under FATCA does not target top managers, but instead provides for withholding on particular payments made to accounts. Yet reputation signaling strategies could target top management, for example by gathering them at public events related to the development of FATCA guidance, or by signing FATCA agreements, or by including information about the top management of a particular firm in

²³⁷ I.R.C. § 1471(b).

²³⁸ *Id.* § 1471(c).

²³⁹ The statute does not specify whether account holders will receive reports, *see id.* § 1471 (requiring simply "reporting"). It would be consistent with domestic 1099 reporting, but inconsistent with NQI rules, to require forms to be sent to account holders as well.

²⁴⁰ *See supra* notes 82–84 and accompanying text.

publicity about compliance or noncompliance with FATCA.

4. Incrementalism

Finally, the promise of an incremental expressive law strategy should inform the details of FATCA implementation. Incrementalism would suggest starting with the lightest, least intrusive interpretation possible consistent with the regulatory goals. The United States wants a norm that a significant number of non-U.S. banks will agree with. After they have agreed with it, the United States can expand its application. This path would resemble the connection between the ten-year-old QI/NQI rules, directed at payments of U.S.-source income to offshore accounts held by non-U.S. residents, and FATCA's attempt to institute automatic reporting for offshore accounts held by U.S. residents. Since non-U.S. banks are used to giving some information to the U.S. tax system under the QI/NQI system, the idea of providing more information under FATCA is not as distasteful.

For example, one issue under current regulatory guidance is granting exemptions from FATCA for certain classes of institutions or accounts. Exemptions may be granted, for example, by classifying an entity as a deemed-compliant FFI or as an excepted non-foreign financial entity. Categories likely to be excepted include certain insurance companies (but perhaps not with respect to whole life policies) and non-U.S. pension funds, as well as certain local entities.²⁴¹

FATCA guidance must also provide due diligence guidelines for FFIs to determine whether an account is held by a U.S. person. The existing items of guidance do not always require an FFI to obtain U.S. withholding forms (which would be a significant departure from current practice), but they alter the usual withholding agent rule that one may rely facially on information provided by a payee²⁴² by requiring further investigation if due diligence suggests a U.S. link. Such a link might be indicated by various bits of information, such as a U.S. address listed in almost any connection with the account.²⁴³ If this due diligence indicates U.S. status, the FFI must investigate further. Less onerous due diligence standards apply for

²⁴¹ See I.R.S. Notice 2010-60, *supra* note 203, at 331 (describing entities that would receive exemptions from the IRS's definition of Financial Institutions); Proposed FATCA Regs, *supra* note 202, at 9025 (describing expanded categories of "deemed-compliant FFIs," including certain "truly local entities").

²⁴² Cf. *Int'l Lotto Fund v. Va. State Lottery Dep't*, 800 F. Supp. 337, 342 (E.D. Va. 1992) ("The role of a withholding agent is ministerial in nature The agent is not granted the discretion by the I.R.S. to conduct an audit-like inquiry upon submission of a properly completed Form 1001.").

²⁴³ For example, under the proposed FATCA regs, a U.S. address or telephone number or U.S. place of birth constitutes "reason to know" that non-U.S. documentation is inaccurate. Prop. Treas. Reg. 1.1471-3(e)(4), 77 Fed. Reg. 9022, 9069 (proposed Feb. 15, 2012).

existing accounts.²⁴⁴

These due diligence rules illustrate the idea of incremental regulation nicely. They may not be airtight, especially with respect to pre-existing accounts. But the more understanding approach is consistent with the idea that the United States wants to persuade banks to tell it what the banks know in a minimally invasive way, rather than the prospect that the United States will require mountains of paper-based historical diligence. Good banks tell the truth. Good banks should not spend vast resources on unnecessary paperwork.

Developing FATCA's reporting system will necessarily involve decisions about cooperation and compromise. The QI experience provides good examples of this. In particular, it resulted in compromise agreements to permit reliance on KYC rules to determine account owner identity and to permit bank secrecy workarounds as alternatives to divulging U.S. account owner identities. The KYC rules are shaped by concerns about ferreting out crimes such as money laundering and may not reliably distinguish accounts held, for example, through shell companies. This bank secrecy workaround provided an entry point to a number of avoidance strategies used by UBS and other banks to conceal U.S. clients' identities or move them to accounts without U.S. securities.²⁴⁵ But it also encouraged many non-U.S. banks to go along with the QI program, which in turn laid the groundwork for FATCA.

The goal of articulating the least burdensome policy possible, consistent with the norm that good banks tell the truth, suggests that exemptions should be fairly broadly granted and due diligence phased in. But there are contrary considerations. First, granting exemptions and exceptions raises the possibility of a close-substitutes problem. Second, if regulated financial institutions perceive a lack of equity in their treatment versus the treatment of other institutions, they may be less willing to perceive the norm as fair. Third, regulatees may experience an incremental solution as unsatisfactory because of a higher degree of uncertainty about the shape of the final rules. Fourth, layering on additional rules later could cause additional expense relative to including those rules in the first place.

A partial solution to these problems may be to reserve on and postpone, rather than definitively exempt, various categories of financial institutions. This is similar to the approach taken in the administration of the nonresident withholding regulations that became effective in 2000. The QI rules, targeted at large foreign banks, came first, for example; the rules applicable to withholding foreign partnerships and withholding

²⁴⁴ See Proposed FATCA Regs, *supra* note 202, at 9025 (comparing revised requirements for new and existing accounts and accounts that meet different value thresholds).

²⁴⁵ See Morse & Shay, *supra* note 209, at 262–64 (describing the QI agreement's reliance on KYC rules and the limits of that approach).

foreign trusts came later.

A separate problem is the possible increased risk of interest group influence if an incremental regulatory approach is taken. A central tenet of theories of regulatory capture and public choice is that “regulatory policies . . . benefit narrow interests at the expense of broad interests,”²⁴⁶ because any member of the public has insufficient reason to care about small regulatory changes about which regulatees (non-U.S. banks and other FFIs, in the case of FATCA) care very much. Hence, regulatees should be expected to exercise disproportionate influence over an incremental regulatory process. Strong regulatory or bureaucratic cultures or institutions, however, may reduce the risk of capture. Full consideration of this tension between the increased capture risks of incrementalism and its expressive law advantages lies beyond the scope of this Article.

Despite these countervailing factors, viewing the problem through the expressive law lens makes an incremental approach to FATCA guidance relatively attractive, under the assumption that persuading non-U.S. banks of the reputational advantages of FATCA is necessary to gain foothold acceptance of the norm by countries and/or financial institutions and that it does not open up a close substitute avenue. Otherwise, the norm may simply not develop.

D. *Seeking Multinational Enforcement*

The possibility that FATCA is a stepping stone to a global mechanism for automatic income tax reporting also deserves mention.²⁴⁷ The limits that push U.S. administrators away from a government enforcement solution and toward an expressive law strategy for FATCA are jurisdictional, particularly the United States’ inability to audit banks in order to detect masquerading noncompliers. Sufficient cooperation with other governments could solve this jurisdictional problem. For example, the United States might agree on some kind of mutual audit program under which the United States would certify U.S. banks as compliant and other countries would certify their respective non-U.S. banks as compliant.

Both the importance of multinational cooperation to an eventually successful enforcement strategy and the possible immediate expressive law reputation and norm-focused strategy should motivate U.S. tax administrators to find all the help they can get from non-U.S. governments

²⁴⁶ Steven P. Croley, *Theories of Regulation: Incorporating the Administrative Process*, 98 COLUM. L. REV. 1, 35 (1998).

²⁴⁷ See Grinberg, *supra* note 188, at 32–54 (emphasizing the importance of an automatic global reporting system). Diane Ring has considered the possibility that contemporaneous events in a number of jurisdictions may prompt a growing move toward global information reporting. Diane Ring, *Backdoor Harmonization: Implications of the New Era of Tax Information* (June 1, 2011) (unpublished manuscript at 20–21) (on file with author).

and non-U.S. organizations to communicate FATCA's "good banks tell the truth" norm and its connection to reputation. This need arises particularly because the United States has only recently taken the initiative in the project of increasing tax haven transparency; European countries had previously carried the project, particularly during the George W. Bush administration when the U.S. government declined to fully support the OECD harmful tax practices project.²⁴⁸ U.S. membership in several consortia seeking to foster multinational cooperation with respect to certain problems of international tax enforcement may provide some starting points for such a project.²⁴⁹

Any country whose residents have significant offshore account holdings has strong fiscal reasons to support the norm that "good banks tell the truth" (and the related tax principle of residence-based income taxation for individuals) and they therefore make up a subgroup for whom the norm would represent a collective action solution.²⁵⁰ The OECD experience with the harmful tax practices project suggests that non-U.S. countries might cooperate in communicating the new norm. Other nations' efforts to find out about their own residents' offshore account holdings, such as by demanding disclosure of offshore credit card accounts,²⁵¹ purchasing data from ex-bank employees,²⁵² and entering into TIEAs,²⁵³ provide examples

²⁴⁸ See PALAN ET AL., *supra* note 91, at 8, 217–18 (describing U.S. policy under the Bush Administration, which was to not support efforts aimed at challenging negative tax competition).

²⁴⁹ Relevant multinational working groups include the OECD's Treaty Relief and Compliance Enhancement, or TRACE, project, see OECD, CENTRE FOR TAX POLICY AND ADMINISTRATION, http://www.oecd.org/document/9/0,3746,en_2649_33767_45700745_1_1_1_1,00.html (last visited Dec. 16, 2011), and the Joint International Tax Shelter Information Centre, or JITSIC, a collaboration among the tax agencies of Australia, Canada, China, Japan, the UK, and the U.S., IRS, JOINT INT'L TAX SHELTER INFO. CTR., <http://www.irs.gov/businesses/international/article/0,,id=223291,00.html> (last visited Dec. 16, 2011).

²⁵⁰ As this Article went to press, the U.S. government announced an agreement in principle with France, Germany, Italy, Spain, and the UK to accept reporting under FATCA from these nations' governments and to reciprocate. See U.S. TREASURY DEP'T, JOINT STATEMENT FROM THE UNITED STATES, FRANCE, GERMANY, ITALY, SPAIN AND THE UNITED KINGDOM REGARDING AN INTERGOVERNMENTAL APPROACH TO IMPROVING INTERNATIONAL TAX COMPLIANCE AND IMPLEMENTING FATCA (Feb. 7, 2012). See generally KEOHANE, *supra* note 109, at 79 (noting that governments may form agreements on international regimes in situations that involve "shared interests" and "dense policy spaces"); SLAUGHTER, *supra* note 108, at 172–77 (exploring different models of international regulatory convergence supported by horizontal and cross-border networks of regulators); Ring, *supra* note 100, at 684–89 (explaining the "lobbying," "uniting," "diversifying," and "researching" roles multinational organizations may take).

²⁵¹ See PALAN ET AL., *supra* note 91, at 83, 231 (describing U.K. order to Barclays to disclose offshore credit card information in 2006, and various other countries' attempts "to collect revenue lost to tax havens").

²⁵² See, e.g., *id.* at 239–41 (describing "the Liechtenstein debacle"); *The Liechtenstein Connection*, SPIEGEL ONLINE (Feb. 16, 2008), <http://www.spiegel.de/international/business/0,1518,535768,00.html> (reporting on the German government's acquisition of data about Liechtenstein accounts held by "[a]s many as 900 wealthy Germans—many of them well-known").

of actions that support the norm that FATCA administrators are attempting to generate. Likewise, U.S. acquiescence to requests from other countries, including Mexico, asking the United States to disclose information about their residents or citizens would support the FATCA norm.²⁵⁴

Of course, a uniform reporting system would be much easier to implement multilaterally. Multinational cooperation raises the problem of reconciling system designs that differ from FATCA,²⁵⁵ as well as implementation challenges that would arise whether or not different nations' systems designs were similar.²⁵⁶ If today's project of developing an expressive law strategy to support FATCA successfully morphs into more familiar government enforcement territory, various system design changes demanded by other governments may be part of the new arrangement. But an effort under FATCA to persuade non-U.S. banks that information reporting is consistent with good reputation signaling should smooth the way toward implementation of a global reporting system. The support, or at least the moderation of objection, from financial institutions in various nations' domestic politics could encourage acceptance of multilateral enforcement responsibilities as well as the current unilateral U.S. FATCA effort. In this way, an expressive law strategy could support effective government enforcement in the long term as well as reputation market compliance mechanisms in the shorter term.

VIII. CONCLUSION

For the compliance mechanisms of deterrence, separation, and/or signaling to succeed, a high-penalty regime should feature the three

²⁵³ *China Signs TIEA With Argentina*, CHINA BRIEFING (Dec. 16, 2010), available at <http://www.china-briefing.com/news/2010/12/16/china-signs-tiea-with-argentina.html> (reporting China's TIEAs with Argentina, the Bahamas, the British Virgin Islands, the Isle of Man, Guernsey, Jersey, and Bermuda).

²⁵⁴ See McIntyre, *supra* note 124, at 258–59 (expressing “guarded optimism” on the future of information exchange based in part on the Mexican request for U.S. bank data); Kevin Preslan, *Turnabout is Fair Play: The U.S. Response to Mexico's Request for Bank Account Information*, 1 GLOB. BUS. L. REV. 203, 224–26 (2011) (recommending that the U.S. comply with the Mexican information request and exploring different routes to a solution).

²⁵⁵ One example is the Swiss-proposed solution reportedly named “Project Rubik,” which calls for the imposition by the Swiss government of withholding taxes on undisclosed accounts and the remittance of the taxes to the governments of the accounts' beneficial owners' residence or citizenship. Niels Jensen, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 VAND. L. REV. 1823, 1852–55 (2010). A similar confidentiality-preserving approach has been used, for example, in an agreement struck between Switzerland and the U.K. See Vanessa Houlder, *Britons to be Taxed on Secret Billions*, FIN. TIMES, May 2, 2011.

²⁵⁶ See OECD, REPORT OF THE INFORMAL CONSULTATIVE GROUP ON THE TAXATION OF COLLECTIVE INVESTMENT VEHICLES AND PROCEDURES FOR TAX RELIEF FOR CROSS-BORDER INVESTORS ON POSSIBLE IMPROVEMENTS TO PROCEDURES FOR TAX RELIEF FOR CROSS-BORDER INVESTORS 16 (2009) (noting three different possible structures for global information reporting).

supports of persuasive penalties, an effective mechanism for detecting noncompliers who attempt to masquerade as compliers, and a lack of close-substitute choices. The FBAR offshore account self-reporting regime could include all of these features, based on government enforcement. Publicity and audit efforts have enhanced and can continue to enhance taxpayers' perception of the likelihood of penalty imposition and noncompliance detection, and it is possible to remove the problematic close substitute of quiet disclosure on a prospective basis.

If government enforcement cannot provide these three supports for a high-penalty regime, it may be possible for a robust reputational market to do so. At the starting point of a historic noncompliance norm, reputational signaling lacks effect. But an expressive law strategy might generate a norm that can then support reputational signaling, which can in turn foster deterrence and separation mechanisms if grounded in a robust reputation market. The Foreign Account Tax Compliance Act, which requires non-U.S. banks to report U.S. account holders to the U.S. government, provides an example of a situation appropriate for an expressive law strategy.

The U.S. tax administrators enforcing FATCA should articulate a norm with reputational content; one likely subtext is "good banks tell the truth." FATCA administrators should seek the endorsement of other countries of this norm instead of the existing norm of bank secrecy, and avoid obfuscating the norm with extra paperwork. They should also recognize the goal of persuading the top management of non-U.S. banks that adherence to the new norm is a good reputational signal, and should make the exercise of providing that signal as simple and salient as possible. And they should consider incremental regulation and compromise in order to progress the goal of norm development, ideally reserving the possibility of later expansion. An expressive law approach is the best immediate strategy for administering FATCA, both because it may persuade non-U.S. financial institutions that compliance can enhance their reputation and because it may help persuade other countries to join the project of developing an enforced, automatic, and global information reporting system.