

# Use a Multilateral Approach in International Tax Enforcement

By Bruce Zagaris

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In the last few months, several congressional hearings and legislative proposals have focused on closing the international tax enforcement gap regarding individuals. Several of the proposals could have positive effects. Many look at the problem from the narrow perspective of obtaining revenue, but reform must also consider the U.S. macroeconomic situation, especially the important role of foreign direct investment in the U.S. economy. If the United States acts primarily through multilateral and bilateral initiatives rather than unilateral ones, the initiatives will be more sustainable because they will engage the regulatory and enforcement resources of other governments and be more diplomatically acceptable.

## A. Multilateral

Although the United States participates in the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters, it should drop its reservations to, and participate in, the provisions on service and collection. It should also encourage other countries to join the convention.

It should also join the Council of Europe Convention on Laundering, Search, Seizure and Forfeiture of Assets. This is the most important convention on money laundering, and governments are increasingly using anti-money-laundering laws and tax law enforcement against scofflaws.

If the United States wants to impose international tax enforcement standards, such as the harmful tax practices initiative, the standards will be more sustainable if it and its allies use international organizations with universal membership, such as the IMF, rather than the OECD.

The United States should consider using Western Hemisphere organizations for strengthening tax law enforcement. The Organization of American States (OAS) Mutual Assistance in Criminal Matters Convention already has a protocol on tax matters. If the United States and its allies cannot persuade the countries in the Americas to join the Convention on Mutual Administrative Assistance in Tax Matters, it should use the OAS protocol or a regional tax information exchange agreement. It should also consider using the Inter-American Center of Tax Administration for more tax enforcement initiatives.

In the long term, the United States should promote the establishment of an international organization for taxation with universal membership and sufficient funding and authority. International tax policy is now made through the United Nations, the OECD, and the IMF, or the G-8 and G-20. Disputes are too often litigated in the WTO, which lacks the expertise to effectively adjudicate them.

## **B. Bilateral**

The United States' bilateral tax treaties and its model treaty need strengthened collection provisions like those in the U.S. treaties with Canada and the Netherlands.

The U.S. effort to secure more TIEAs has fallen short of the promises that former Treasury Secretary Paul O'Neill made to Congress. For the agreements to be sustainable, Congress must provide more carrots and fewer sticks. In 1983 President Reagan recommended investment credits when he designed the Caribbean Basin Initiative. Congress decided instead to offer only eligibility for North American Convention deductions — an incentive that is meaningful only to the one jurisdiction (the Bahamas) that has significant convention facilities. The others have neither the convention facilities nor the air traffic capacity to take advantage of the initiative.

The United States has not replaced its former incentives: eligibility for section 936 financing and eligibility to host foreign sales corporations. It could negotiate tax treaties with countries that have an income tax system and could negotiate minitreaties

— like the Bermuda-U.S., Isle of Man-Netherlands, and other recent double tax treaties — with countries that lack an income tax.

The United States could also enact legislation to allow reciprocal deductions for charitable contributions, similar to the provisions in the Mexico-U.S. double tax treaty. From the George H. Bush administration on, the United States has prioritized mobilizing the Caribbean diaspora to engage in the development of their countries. The U.S. government has also prioritized debt for environmental and development swap programs and urged the U.S. private sector to make charitable contributions to those initiatives. However, the absence of statutory or tax treaty provisions to encourage contributions has limited the initiatives. Congress could also find other, similar investment or economic cooperative measures (for example, in tourism, education, healthcare, and electronic commerce).

The United States should issue regulations that give taxpayers who are affected by requests for information from other countries the right to be notified of, and to object to, the request. Treasury promised to issue those regulations when it sought the U.S. business community's support for U.S. ratification of the Convention on Mutual Administrative Assistance in Tax Matters.

Treasury often tries, when its treaty partners request information, to obtain assistance informally by writing to people and requesting the information rather than issuing a summons. That deprives the tax information exchange process of fairness and erodes its integrity.

The United States could follow the European Union savings directive and share some of its statutory withholding tax with countries agreeing to conclude TIEAs.

### **C. Unilateral**

The United States should also consider ways to strengthen its ability to make jeopardy assessments for individuals and entities that exit the country. It should consider using a “know your client” anti-money-laundering regime for tax enforcement, like under the proposed EU savings tax directive.

The Obama administration proposals for strengthening the qualified intermediary regime and providing incentives for

transactions that use QIs and disincentives for those not using them are sensible, provided the United States persuades more countries, such as Brazil and China, to participate.

The United States should abandon the concept of an offshore secrecy jurisdiction and the effort to unilaterally sanction those countries. International law does not support the concept, and Treasury lacks the ability to develop and maintain lists of the jurisdictions. Even if it had that ability, the lists would cause dislocations in direct investment and adverse diplomatic repercussions, especially with countries whose standards in corporate transparency are superior to those of many U.S. states.

Those provisions are likely to trigger similar protectionist elements around the world and litigation in the WTO against the United States for discriminating against trade in financial services in violation of the General Agreement on Trade in Services. Financial institutions are already overburdened with anti-money-laundering and counterterrorism financial enforcement and will soon face Internet gambling regulations. The last thing they need is another compliance person to vet which transactions originate from countries on an ever-changing list of offshore secrecy jurisdictions.

The United States should broaden its program to automatically exchange with key countries information on interest paid to depositors that are residents in those countries. The proposed regulations of the Clinton administration should be made final, and consideration should be given to include other countries, such as Mexico, that have already requested those exchanges. ■