

1-1-2012

The Opaque Future of Tax Information Sharing between the United States and China: An Analysis of Bank Secrecy Laws and the Likelihood of Entrance into a Tax Information Exchange Agreement

Emily Wang

Follow this and additional works at: https://repository.uchastings.edu/hastings_international_comparative_law_review

 Part of the [Comparative and Foreign Law Commons](#), and the [International Law Commons](#)

Recommended Citation

Emily Wang, *The Opaque Future of Tax Information Sharing between the United States and China: An Analysis of Bank Secrecy Laws and the Likelihood of Entrance into a Tax Information Exchange Agreement*, 35 HASTINGS INT'L & COMP. L. REV. 411 (2012).
Available at: https://repository.uchastings.edu/hastings_international_comparative_law_review/vol35/iss2/4

This Note is brought to you for free and open access by the Law Journals at UC Hastings Scholarship Repository. It has been accepted for inclusion in Hastings International and Comparative Law Review by an authorized editor of UC Hastings Scholarship Repository. For more information, please contact wangangela@uchastings.edu.

The Opaque Future of Tax Information Sharing Between the United States and China: An Analysis of Bank Secrecy Laws and the Likelihood of Entrance into a Tax Information Exchange Agreement

By EMILY WANG*

Table of Contents

- I. Introduction..... 412
- II. How Offshore Accounts Facilitate Tax Evasion 414
- III. Bank Secrecy Overview 415
 - A. Bank Secrecy Laws in Mainland China and Hong Kong 416
 - B. Bank Secrecy in the United States 417
- IV. OECD’s Global Tax Transparency Efforts 418
- V. The Launch of Tax Information Exchange Agreements..... 419
 - A. The Scope of Tax Information Exchange Agreements..... 420
 - B. TIEA’s Exchange of Information on Request 421
- VI. Tax Information Exchange Agreements Overrides Bank Secrecy 422
- VII. Would the United States or China Give Up on Bank Secrecy and Enter into a TIEA for Greater Information Exchange? 423
 - A. The U.S. Perspective 423
 - B. China’s Perspective 425
- VIII. Tax Information Exchange Agreement Viewed Ineffective.... 427
- IX. Conclusion 427

I. Introduction

Offshore tax havens and secrecy jurisdictions worldwide hold over \$11 trillion of high net-worth individuals' assets.¹ Of that figure, \$1 trillion offshore are held by United States citizens.² As a result of offshore accounts, the U.S. government estimates it loses \$100 billion a year in tax revenue stashed in offshore accounts.³

Offshore tax evasion is an increasing problem in the enforcement of U.S. tax laws.⁴ The majority of these offshore accounts are located in the financial institutions of tax haven countries.⁵ A "tax haven" country is defined as a country having low tax rates compared to the United States and a high level of bank or commercial secrecy that the country refuses to breach, even under an international agreement.⁶

A significant portion of these accounts are located in the

* J.D. Candidate 2012, University of Hastings College of the Law; B.B.A., B.A., The University of Texas at Austin, 2007. I dedicate this Note to my mother, Haixia Zhang, my fiancé Jeffery Lee, and the rest of my family for unlimited love and support. I would especially like to thank Professor Susan C. Morse for her generous guidance and encouragement with this Note. Lastly, I would like to thank the entire team of devoted editors and staff of HICLR for making the publication of this Note possible.

1. See, e.g., *Briefing Paper The Price of Offshore*, TAX JUSTICE NETWORK (Mar. 2005), available at http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf (estimating that offshore assets of high net worth individuals now total \$11.5 trillion).

2. COMM. ON HOMELAND SECURITY & GOVERNMENTAL AFFAIRS, PERMANENT SUBCOMM. ON INVESTIGATIONS, TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY: MINORITY & MAJORITY STAFF REPORT 1 (2006), available at http://hsgac.senate.gov/public/_files/TAXHAVENABUSESREPORT107.pdf.

3. Trevor Cole, *How I Learned to Hide Money from the Taxman in the Shell-Company Capital of the World, With Help from A Cabbie Named Shorty, A Jet-Setting Fraud Investigator and A Curious Cast Of Caribbean Bankers*, GLOBEADVISOR.COM (Jan. 28, 2011), <https://secure.globeadvisor.com/servlet/ArticleNews/story/gam/20110128/ROBMAG-FEB11-P44-50> (last visited Apr. 4, 2012).

4. Cynthia Blum, *Sharing Bank Deposit Information With Other Countries: Should Tax Compliance Or Privacy Claims Prevail?*, 6 FLA. TAX REV. 579, 590 (2004) (quoting *Treasury Thanks Lawmakers for Letter on NRA Interest-Reporting Rules*, 2003 TNT 124-61 (letter sent by Pamela F. Olson, Assistant Secretary of the Treasury for Tax Policy, to twenty-four members of the House of Representatives)).

5. William M. Sharp, Sr. et al., *U.S. Tax Information Exchange Agreements: A Comparative Analysis*, 97 TAX NOTES 827, 827 (2002).

6. Blum, *supra* note 4, at 591.

financial institutions of the People's Republic of China and in the special jurisdiction of Hong Kong.⁷ Although China is no longer recognized as an official tax haven country by the Organisation for Economic Co-operation and Development (OECD)⁸, its secrecy jurisdiction, Hong Kong, has become a serious player in offering attractive offshore banking to the world's wealthy.⁹ To this day, Hong Kong still offers some of the world's most secret accounts, and U.S. tax authorities are increasingly wary of Hong Kong as an attractive offshore banking center.¹⁰

A daunting task for the Internal Revenue Service (IRS) is obtaining the necessary information to enforce tax laws where international transactions are involved when the taxpayer does not cooperate.¹¹ When information is located in a foreign jurisdiction such as China, it is often beyond the reach of the IRS.¹² Addressing the potential for tax evasion through use of offshore accounts is critical to maintaining the fairness of the U.S. tax system.¹³

Similarly, it has been estimated that households in China hide as much a 9.3 trillion yuan (\$1.5 trillion) of income that is unreported to the Chinese tax administration.¹⁴ A large amount of this unreported income is deposited in bank accounts in the United States.¹⁵ Financial institutions in the United States are widely

7. See Justin Dabner, *How should Asia respond to the OECD's harmful tax regimes project?*, 18 J. INT'L TAX'N 42, 49 (2007) (discussing the harmful tax practices of Hong Kong and mainland China).

8. The Organisation for Economic Co-operation and Development (OECD) is an international economic organization of thirty-four countries founded in 1961 to stimulate economic progress and world trade. One of its objectives is to promote global tax transparency by launching initiatives to combat against international tax evasion.

9. Lynnley Browning, *Seeking Bank Secrecy in Asia*, N.Y. TIMES (Sept. 22, 2010), <http://www.nytimes.com/2010/09/23/business/global/23swiss.html>.

10. *Id.*

11. Richard A. Gordon et al., *An Analysis of Tax Information Exchange Agreements Concluded by the U.S.*, 22 TAX MGMT INT'L J. (1991).

12. *Id.*; see also Blum, *supra* note 4, at 592.

13. Blum, *supra* note 4, at 590 (quoting *Treasury Thanks Lawmakers for Letter on NRA Interest-Reporting Rules*, 2003 TNT 124-61 (letter sent by Pamela F. Olson, Assistant Secretary of the Treasury for Tax Policy, to twenty-four members of the House of Representatives)).

14. *China's Rich Have \$1.5 Trillion In Hidden Income*, THE STRAITS TIMES (Aug. 12, 2010), http://www.straitstimes.com/SME+Spotlight/Lifestyle/Story/STIStory_565373.html

15. Derek Scissors, *Chinese investment in US: \$2 trln and counting*, REUTERS (Mar.

regarded as more secure, better regulated, and better managed compared to the rest of the world.¹⁶ As a result, investments held by Chinese residents in the United States have amounted to over \$1.6 trillion since June 2010.¹⁷

This Note will first explain how offshore accounts make tax evasion possible and the significant role of domestic bank secrecy laws in facilitating tax evasion in the United States and China. Next, it will introduce the Tax Information Exchange Agreement proposed by the OECD and its past and current efforts to increase global tax information sharing.

Lastly, it will conclude by exploring how despite the current offshore tax evasion crisis occurring between these two countries, the Tax Information Exchange Agreement (TIEA) is an ineffective mechanism and will neither truly eliminate tax evasion.

II. How Offshore Accounts Facilitate Tax Evasion

Under U.S. tax law, every taxpayer must report his or her domestic source of income to the IRS, including all bank account interest or other income.¹⁸ Consequently, deposits made by U.S. residents in foreign bank accounts are also subject to taxation.¹⁹ The Bank Secrecy Act requires that U.S. residents with an offshore account exceeding \$10,000 to report to the IRS through the Foreign Bank and Financial Account Report.²⁰ They must also report this income on Schedule B of Form 1040.²¹

Bank accounts in bank secrecy jurisdictions, such as Hong Kong, are ideal for concealment of illegally earned funds.²² Future earnings can be concealed from the home country's taxes.²³ It may be impossible for the IRS or other creditors to collect debts against

2, 2011), available at <http://blogs.reuters.com/india-expertzone/2011/03/02/chinese-investment-in-us-2-trln-and-counting/>

16. Robert Goulder, *News Analysis: How the U.S. is a Tax Haven for Mexico's Wealthy*, 124 TAX NOTES 739, 740 (2009).

17. Scissors, *supra* note 15.

18. See Goulder, *supra* note 16, at 741.

19. *Id.*

20. The report is on Form TD F 90-22.1, entitled "Report of Foreign Bank and Financial Accounts." Section 5314 of the Bank Secrecy Act authorizes the Treasury to issue regulations requiring these reports. 31 U.S.C. § 5314 (2010).

21. Blum, *supra* note 4, at 596 n.54.

22. *Id.*

23. *Id.*

these assets.²⁴ The role of bank secrecy will be further explored in the following section.

Also, U.S. banks facilitate foreign account tax evasions. An individual's interest income earned from U.S. bank deposits is not subject to tax in the United States, although it generally will be subject to tax in the nonresident's country of residence.²⁵ Therefore, a Chinese resident who holds a bank account in the United States is not subject to taxation in the United States. However, she must report her income to the Chinese government and would likely be taxed in China, the country of her residence.²⁶

III. Bank Secrecy Overview

"Bank secrecy is an area of dispute between two groups of countries: one group that permits its banks to keep depositors' identities secret, and the rest of the world that wants to enforce taxation of the income earned by those accounts."²⁷ Bank secrecy is a professional obligation that financial institutions assume and provide confidentiality to a customer's financial information acquired in the course of business.²⁸ Bank secrecy laws give financial institutions the right to resist a third party's inquiries in order to protect the customer's interests, the most prominent third party being the government.²⁹

Tax evasion is often achieved through hiding assets in jurisdictions that have strict bank secrecy laws.³⁰ Americans who desire to evade taxes generally seek offshore jurisdictions with a high level of bank secrecy laws to keep their bank deposits concealed. Offshore jurisdictions with stringent bank secrecy regimes such as Hong Kong will keep the IRS from inquiring into their American bank customers' information and consequently

24. *Id.*

25. Goulder, *supra* note 16, at 741; 26 U.S.C. § 881(d) (2010).

26. See Paul DiSangro & Wendy Liu, *India, like China, is taxing offshore acquisitions*, NIXON PEABODY (Sept. 15, 2010), http://www.nixonpeabody.com/publications_detail3.asp?ID=3482.

27. Robert Carroll, *Bank Secrecy, Tax Havens and International Tax Competition*, 167 TAX FOUND. 2 (2009).

28. He Ping, *Banking Secrecy and Money Laundering*, 7 J. MONEY LAUNDERING CONTROL 376, 376 (2004).

29. *Id.*

30. Lee A. Sheppard, *Getting Serious About Offshore Evasion?*, 125 TAX NOTES 493, 495 (2009).

protect their American customers from the possibility of being taxed by the U.S. tax authorities. As a result, bank accounts in bank secrecy jurisdictions are ideal for the concealment of funds that represent unreported income in the residence country.³¹

The reason that bank secrecy laws are enacted is because these countries benefit from them. By enacting stringent bank secrecy laws that help foreign wealthy individuals transfer their assets to their country, banks attract capital to promote growth in the country's financial industry. Countries that receive extensive foreign investment have enjoyed very rapid economic growth due to the development of their financial sector.³²

A. Bank Secrecy Laws in Mainland China and Hong Kong

In China, banking secrecy laws exist and are provided for under the Law of the People's Republic of China on Commercial Banks.³³ Although there seem to have been numerous efforts³⁴ by the Chinese government to relax bank secrecy laws to promote transparency in the past, to this date bank secrecy laws are still reinforced by the Chinese statutes.³⁵ There may be exceptions in which tax authorities have access to bank information to response to a request for exchange of information based on the China-U.S. Income Tax Treaty,³⁶ but the treaty does not require the requested state to "carry out administrative measures at variance with the laws" of the requested party.³⁷

31. Blum, *supra* note 4, at 596.

32. Dhammika Dharmapala et al., *Which Countries Become Tax Havens?* (National Bureau of Economic Research, Working Paper No. 12802, 2006), available at <http://www.nber.org/papers/w12802>.

33. Ping, *supra* note 28, at 379.

34. Erik Eckholm, *China to End Bank Secrecy In Effort Against Corruption*, N.Y. TIMES (Jan. 21, 2000), <http://www.nytimes.com/2000/01/21/world/china-to-end-bank-secrecy-in-effort-against-corruption.html>; OECD, *OECD Assessment Shows Bank Secrecy As A Shield For Tax Evaders Coming to An End*, http://www.oecd.org/document/40/0,3746,en_2649_33767_43582376_1_1_1_1,00.html (last visited Apr. 4, 2012) (Macao and China have passed legislation intended to enable them to implement the internationally agreed-upon tax standard.)

35. OECD, *Tax Co-operation 2010: Towards a Level Playing Field*, OECD PUB. 143 (Feb. 7, 2012), available at http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/tax-co-operation-2010_taxcoop-2010-en.

36. *Id.* at 169; Agreement for the Avoidance of Double Taxation and the Prevention of Tax Evasion on Income, U.S.-China, Apr. 30, 1984, 23 I.L.M. 677 [hereinafter China-U.S. Treaty].

37. China-U.S. Treaty, art. 25.

However, there are conflicting opinions regarding how bank secrecy laws are carried out. On one hand, China launched a series of initiatives in 2003 to lift bank secrecy laws and counter suspicious foreign transactions and money-laundering.³⁸ China seems to be implementing the OECD standards.³⁹ However, who makes decisions and manages China's banking system is unknown.⁴⁰ The government and the Communist Party are "intimately entwined managers of China's financial institutions."⁴¹

Nevertheless, Hong Kong is known for its very stringent bank secrecy laws that promote its growth as an international offshore bank center.⁴² Although Hong Kong has returned to China since 1997, the city's financial activity remains relatively unchanged, a reflection of Beijing's need for Hong Kong as its financial powerhouse.⁴³ It does not tax capital gains or deposit interest and allows the formation of opaque companies that often serve as conduits for tax evasion.⁴⁴ Thus, it is simple for the wealthy who want to save tax dollars to move their bank accounts to Hong Kong. With recent crackdowns of Swiss offshore banks, many experts believe that Hong Kong will be the next tax haven destination for the rich to hide their income.⁴⁵

B. Bank Secrecy in the United States

Technically speaking, the United States does not have a formal bank secrecy regime,⁴⁶ but the United States provides *de facto* bank

38. See Zhou Xiaochuan, Governor of the People's Bank of China, Speech at the First Meeting of the Ministerial Joint Conference on Anti-money Laundering (Aug. 27, 2004), available at <http://www.bis.org/review/r040920a.pdf>.

39. See OECD, *Fighting Tax Evasion: Questions and Answers*, http://www.oecd.org/document/49/0,3746,en_2649_33745_45599793_1_1_1_1,00.html#qa13 (last visited Apr. 4, 2012).

40. Vlad Frants, *The Competence of the Chinese Taxation System*, 18 CURRENTS: INT'L TRADE L.J. 30, 37 (2010).

41. *Id.*

42. Laurence E. Lipsher, *Asian Tax Review: Hong Kong: Still Clinging to Bank Secrecy*, 55 TAX NOTES INT'L 643, 645 (2009).

43. See Robert E. Bauman, *Where Are They Now? The World's Top Asset Havens...Still On Top*, ESCAPEARTIST.COM, http://www.escapeartist.com/efam/60/Best_Banking_offshore.html (last visited Apr. 4, 2012).

44. Browning, *supra* note 9.

45. *Id.*

46. Goulder, *supra* note 16, at 739.

secrecy to foreign persons holding assets in the U.S.⁴⁷ “*De facto* bank secrecy” results when the source-country government, in this case the United States, does not have the relevant information to exchange with a tax treaty partner.⁴⁸ The U.S. *de facto* bank secrecy regime therefore allows any foreigner to make deposits in U.S. banks without disclosing income earned on those deposits to his home government.⁴⁹ All U.S. banks engage in *de facto* bank secrecy when they accept deposits from a nonresident alien.⁵⁰ Therefore, bank secrecy is evident whenever banking occurs under these circumstances.⁵¹

IV. OECD’s Global Tax Transparency Efforts

Recognizing the demand for global tax transparency, the OECD intended to provide a framework to combat the current tax evasion crisis in tax haven countries.⁵²

In 1998, the OECD launched a new initiative campaign addressing “harmful tax practices” in both member and nonmember countries.⁵³ The U.S. is a member of the OECD while China has yet to join.⁵⁴ More recently, the OECD has been demanding greater tax information exchange in all aspects from Hong Kong.⁵⁵

Initially, the Bush Administration was heavily lobbied to reject the 1998 initiative.⁵⁶ On May 10, 2001, the Secretary of the Treasury, Paul O’Neill, publicly disagreed with the OECD’s effort to harmonize world tax systems due to OECD’s overly board

47. David E. Spencer, *Fatca and Automatic Exchange of Tax Information*, 21 J. INT’L TAX’N 62, 64 (2010).

48. David E. Spencer, *Tax Information Exchange and Bank Secrecy (Part 2)* 16 J. INT’L TAX’N 22, 24 (2005).

49. *Id.*

50. Goulder, *supra* note 16, at 740.

51. *Id.*

52. OECD, *Fighting Tax Evasion*, http://www.oecd.org/document/21/0,3746,en_2649_37427_42344853_1_1_1_37427,00.html.

53. For a thorough discussion of the campaign, see Michael Allen, *Tax Evaders Beware: Rich Countries Prepare for Crackdown on Havens*, WALL ST. J. (May 21, 1998), at A12.

54. See OECD, *List of OECD Member countries Ratification of the Convention on the OECD*, http://www.oecd.org/document/1/0,3343,en_2649_201185_1889402_1_1_1_1,00.html (last visited Apr. 4, 2012).

55. Lipsher, *supra* note 42, at 644–45.

56. Blum, *supra* note 4, at 597.

initiatives.⁵⁷ As a result, the OECD initiative underwent modifications in June 2001⁵⁸ and only required tax haven countries to commit to transparency and effective information exchange.⁵⁹

In April 2002, the OECD released its Model Tax Information Exchange Agreements,⁶⁰ the "TIEA," to reflect standards of effective exchange of information, which will be fully discussed in the next section. As of 2011, thirty-two cooperating countries have agreed to engage in the exchange of such information with respect to criminal and civil tax matters, beginning in 2006.⁶¹

During 2001 and 2002, the Bush Administration negotiated exchange of information agreements with tax haven countries,⁶² such as the Netherlands, Antilles, the British Virgin Islands, Bahamas, Antigua and Barbuda, and the Cayman Islands.⁶³ In 2003, the U.S. entered into an agreement with Switzerland,⁶⁴ a notorious tax haven country that troubles the tax authorities of the rest of the world.⁶⁵

V. The Launch of Tax Information Exchange Agreements

The Tax Information Exchange Agreement is a treaty developed by the OECD Global Forum Working Group to promote international cooperation for exchange of information.⁶⁶ To assist countries in the negotiation of TIEAs, the OECD published a model Tax Information Exchange Agreement in April 2002.⁶⁷

57. Treasury Secretary O'Neill Statement on OECD Tax Havens, Treasury News, PO-366 (May 10, 2001).

58. See Michael M. Phillips, *Accord is Reached by U.S. and Allies on Tax Havens*, WALL ST. J. (June 28, 2001), at A4.

59. Blum, *supra* note 6, at 598–99 n.62.

60. See OECD, *Agreement on Exchange of Information on Tax Matters*, <http://www.oecd.org/dataoecd/15/43/2082215.pdf> (last visited Apr. 4, 2012).

61. See OECD, *OECD Report, Improving Access to Bank Information for Tax Purposes: The 2003 Progress Report* (2003), at 18.

62. The OECD has identified those countries as tax haven countries.

63. Blum, *supra* note 4, at 600.

64. *Id.* at 600–01.

65. See Michael J. McIntyre, *How to End the Charade of Information Exchange*, 125 TAX NOTES INT'L 695, 695 (stating that Switzerland's economy has depended heavily on the revenue derived from the servicing of international tax cheats).

66. See *Tax Information Exchange Agreements (TIEAs)*, http://www.oecd.org/document/7/0,3746,en_2649_33767_38312839_1_1_1_1,00.html (last visited Apr. 4, 2012).

67. Blum, *supra* note 4, at 599; see also OECD PUB., *Agreement on Exchange of*

In essence, the TIEA typically has three specific qualities. First, it provides for the exchange of information on requests for both criminal and civil tax matters.⁶⁸ Second, it provides for the exchange of information even if such information relates to a person who is not a resident or national of the United States or a TIEA partner.⁶⁹ Lastly, it provides for the disclosure of information regardless of local confidentiality laws that may prohibit such disclosure, including laws relating to bank secrecy or bearer shares.⁷⁰

In the past decade, the United States has entered into TIEAs with fourteen jurisdictions which were initially labeled by the OECD as tax haven countries.⁷¹ China has signed with seven jurisdictions, including Argentina, Bermuda, and the Bahamas.⁷² However, these jurisdictions are mostly small tax haven countries that faced international pressure to comply with the objectives of the OECD. China and the United States do not have much at stake when entering TIEAs with these jurisdictions. In contrast, China and the United States have not yet entered into a TIEA with each other.⁷³

A. The Scope of Tax Information Exchange Agreements

The intended purpose of the TIEA is to provide tax authorities with the right to collect tax information that is “foreseeably relevant”⁷⁴ to tax evasion and crimes from the contracted party.

Article 1 of the Model TIEA provides that the “competent authorities of the Contract Parties shall provide assistance through exchange of information that is foreseeably relevant to the administration and enforcement of the domestic laws of the

Information on Tax Matters, art. 1 [hereinafter Model TIEA], <http://www.oecd.org/dataoecd/15/43/2082215.pdf>.

68. Timothy V. Addison, *Shooting Blanks: The War on Tax Havens*, 16 IND. J. GLOBAL LEGAL STUD. 703, 717 (2009).

69. *Id.*

70. *Id.*; see also Chris Horton, *The UBS/IRS Settlement Agreement and Cayman Island Hedge Funds*, 41 U. MIAMI INTER-AM. L. REV. 357, 372 (2009).

71. Addison, *supra* note 68, at 717.

72. See *China Signs TIEA with Argentina*, CHINA BRIEFING (Dec. 16, 2010), <http://www.china-briefing.com/news/2010/12/16/china-signs-tiea-with-argentina.html> (last visited Apr. 4, 2012).

73. See OECD, *Tax Information Exchange Agreements (TIEAs)*, http://www.oecd.org/document/7/0,3746,en_2649_33767_38312839_1_1_1_1,00.html (indicating that the U.S. and China have not signed a TIEA).

74. Model TIEA, *supra* note 67, art. 1.

Contract Parties concerning taxes covered by this Agreement.”⁷⁵ This information includes the determination, assessment and collection of taxes, the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters.⁷⁶

Article 3 further lays out the scope of tax information to be reported and exchanged according to the agreement.⁷⁷ The taxes typically covered are national income taxes of each country. For example, the TIEA between China and Argentina provides exchange of individual and enterprise income taxes,⁷⁸ and the TIEA between the United States and Panama provides the exchange of U.S. federal income taxes and Panamese national taxes.⁷⁹

B. TIEA’s Exchange of Information on Request

Article 5 is the key and operative provision that enables the TIEA parties to exchange information.⁸⁰ It provides that “the requested”⁸¹ party shall provide information for the purposes referred to in Article 1 upon request.⁸² If the requested party does not receive sufficient information to allow it to comply with the request, the requested party must notify the applicant⁸³ party and suggest the additional information needed to fulfill the request.⁸⁴ The requested party must “take all relevant information gathering

75. *Id.*

76. *Id.*

77. *Id.*

78. See Agreement Between the Government of the Argentine Republic and the Government of the People’s Republic of China for the Exchange of Information Relating to Taxes, Arg. – China, art. 3(1)(a)-(b), Dec. 13, 2010, <http://www.oecd.org/dataoecd/48/33/47115635.pdf> (Article 3 states that the agreement applies to all taxes in Argentina and China except tariff taxes).

79. See Agreement Between the Government of The United States of America and the Government of the Republic of Panama for Tax Cooperation and the Exchange Of Information Relating to Taxes, U.S.-Pan., art. 3(1)(a)-(b), Nov. 30, 2010, <http://www.oecd.org/dataoecd/28/49/46569716.pdf> (Article 3 states that the agreement applies to Panama’s national taxes and U.S. federal income taxes).

80. Model TIEA, *supra* note 67, art. 5.

81. The requested party refers to the corresponding administration of the country who is asked to provide the taxpayer information by the administration of the other country.

82. Model TIEA, *supra* note 67, art. 5.

83. The applicant party refers to the corresponding administration of the country who requests the taxpayer information from the administration of the other country.

84. Model TIEA, *supra* note 67, art. 5(2).

measures" to provide the requested information, even if the requested party does not need the information for its own tax purposes.⁸⁵ Each party to the TIEA must ensure that its competent authority has the authority to obtain and provide the requested information including information held by banks and other financial institutions.⁸⁶

However, to obtain such information, the requested party must provide information to the requested Party to demonstrate the foreseeable relevance of the information.⁸⁷ To demonstrate the requested information's relevance to the request, the applicant party must provide the identity of the taxpayer under investigation, the purpose of this information, and the grounds for believing that the information requested is held in the requested country.⁸⁸

VI. Tax Information Exchange Agreements Overrides Bank Secrecy

One key innovative feature of the TIEA is that it overrides a contracting country's domestic bank secrecy laws. Article 5, paragraph 4 of the model TIEA makes it clear that a requesting party cannot avoid disclosure because of domestic bank secrecy laws or secrecy rules due to fiduciary duties.⁸⁹ It must provide for the disclosure of requested information regardless of local bank secrecy laws that may prohibit such disclosure.⁹⁰

If a TIEA is signed by the U.S. and China, the agreement would provide tax administrations with the capability to overcome each other's domestic bank secrecy laws.⁹¹ If the information is requested by either U.S. or Chinese tax authorities, neither country can use domestic bank secrecy laws to refuse to provide the requested information regarding a taxpayer's account. This would likely open

85. *Id.*

86. *Id.* art. 5(4)(a).

87. *Id.* art. 5.

88. *Id.* arts. 5(5)(a)-(e) (arts. (f) and (g) omitted).

89. *Id.* art. 5(4); *see also* McIntyre, *supra* note 65, at 706.

90. Testimony of Treasury Acting International Tax Counsel John Harrington Before the Senate Finance Committee on Offshore Tax Evasion, U.S. Dep't of Treasury, H.P. 385 (May 3, 2007), <http://www.treasury.gov/press-center/press-releases/Pages/hp385.aspx>.

91. The current U.S.-China treaty does not override local laws such as bank secrecy laws. *See* China-U.S. Treaty, *supra* note 37, art. 25.

the doors for tax authorities from both countries to track down concealed offshore accounts in each country and collect taxes on previously undisclosed income.

VII. Would the United States or China Give Up on Bank Secrecy and Enter into a TIEA for Greater Information Exchange?

The answer is very unlikely. Neither the U.S. nor the Chinese government would likely to give up their bank secrecy and commit to a TIEA. The reason is that both countries' domestic interests would be adversely affected by sharing information with each other, as explained below.

A. The U.S. Perspective

From the U.S. perspective, lifting *de facto* bank secrecy laws would put U.S. banks at a competitive disadvantage among global financial institutions.⁹² The likely reason that Congress allowed *de facto* bank secrecy exist in the first place was that the U.S. financial system needs the capital.⁹³ As explained earlier, bank secrecy laws attract foreign investments and promote the growth of the financial industry.

Agreeing to a TIEA would likely hurt the U.S. financial sector, as foreign tax evaders would inevitably move their funds to other countries that have tighter bank secrecy laws.⁹⁴ The U.S. banking sector would experience an enormous amount of revenue loss as a result of the withdrawals from nonresident aliens.

It is estimated that Chinese investments in the U.S. amounted to over \$1.6 trillion since June 2010.⁹⁵ That is a phenomenal figure compared to the estimated \$100 billion loss from offshore accounts around the world. It would undoubtedly be detrimental to the U.S. financial institutions if Chinese residents were to start withdrawing their deposits from U.S. banks.

For example, Florida banks alone fear that they would lose from \$4.4 billion to \$8.36 billion each year in operating revenue if

92. See generally Goulder, *supra* note 16.

93. *Id.* at 739.

94. See Ken Stier, *Foreign Tax Cheats Find U.S. Banks a Safe Haven*, TIME (Oct. 29, 2009), <http://www.time.com/time/business/article/0,8599,1933288,00.html>.

95. See *Chinese investment in US: \$2 trln and counting*, *supra* note 17.

foreign residents were to withdraw their deposits from their bank.⁹⁶ These unintended consequences would damage the U.S. financial sector and economy as a whole. As financial capital dries up, banks would be forced to lend less money to American businesses. Many industries would suffer and continue to suffer, such as the real estate and the construction industries. In addition to the huge loss in revenue among U.S. banks, many jobs in the financial sector would be lost.

Despite these detrimental effects, the Treasury Department attempted to loosen bank secrecy to correspond with other countries' requests by proposing two regulations in 2001 and 2002.⁹⁷ The first proposed regulation was to extend information reporting requirements to bank deposit interest paid to "nonresident alien individuals who are residents of other countries."⁹⁸ The second proposed regulation narrowed the scope of the reporting requirements to interest paid to residents of fourteen specific foreign countries.⁹⁹

Even with Treasury Department's good intentions to cooperate with global tax information transparency, both regulations never became effective. Banks and financial organizations around the country have furiously lobbied against regulations¹⁰⁰ in order to protect the secrecy of their foreign customer information and in fear of potentially losing these valued customers. Banks eagerly met with various tax policymakers to express concerns that the regulation would cause foreign investors to withdraw their deposits from U.S. banks.¹⁰¹

In light of the cost-benefit analysis, it may not be worthwhile for the U.S. government to endure the firestorm of bank oppositions, bank revenue loss, and financial sector job loss in exchange for the collections of additional tax revenues in China. Given the current

96. Goulder, *supra* note 16, at 743.

97. *Id.*

98. Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens, 66 Fed. Reg. 3925, 3926 (Jan. 17, 2001) (to be codified at 26 C.F.R. pt. 1 & 31), available at <http://www.irs.gov/pub/irs-regs/12610000.pdf>.

99. Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens, 67 Fed. Reg. 50386, 50386 (Aug. 2, 2002) (to be codified at 26 C.F.R. pt. 1 & 31).

100. Goulder, *supra* note 16, at 743.

101. *Id.* at 744 ("Simply stated, international investors surely will move their funds – potentially more than \$100 billion – to banks in London, Zurich, Hong Kong, and elsewhere if the regulation is finalized.").

economic downturn and the staggering figures of potential bank revenue loss, lifting bank secrecy laws would place the U.S. banks at a huge competitive disadvantage globally.

B. China's Perspective

It should not be surprising that China has a similar objective in attracting foreign capital domestically. José Manuel Barroso, the president of the European Commission, believes that China is a major international power blocking a global solution to the offshore bank and secrecy problem.¹⁰² It is doing so to protect its own secrecy jurisdiction, Hong Kong.¹⁰³

As indicated in the earlier section, offshore banks that have operated out of Switzerland and other traditional offshore financial centers are now targeting Hong Kong.¹⁰⁴ Amid a growing crackdown on banking in Switzerland,¹⁰⁵ wealthy people are flocking to Hong Kong, where it offers some of the world's most attractive bank secrecy accounts.¹⁰⁶

China, and mainly Hong Kong, have benefited enormously by enacting stringent bank secrecy laws that help wealthy foreigners transfer their assets to its banks.¹⁰⁷ Tax haven countries receive extensive foreign investment, and, largely as a result, have enjoyed very rapid economic growth over the past twenty-five years.¹⁰⁸ China is a perfect example. The explosion of China's financial industry has now made the country the second largest economy by GDP and China has been very successful at maintaining the high rate of growth for over two decades.

102. Lucy Komisar, *China blocks international crackdown on offshore, says European Commission President Barroso*, THE KOMISAR SCOOP (Sept. 27, 2010), <http://thekomisarscoop.com/2010/09/china-blocks-international-crackdown-on-offshore-says-european-commission-president-barroso> (last visited Apr. 4, 2012).

103. *Id.*

104. *Id.*

105. Browning, *supra* note 9. ("In 2007, the Justice Department began a criminal investigation into UBS and, later, other Swiss banks for selling private banking services to wealthy Americans that allowed them to evade taxes. Last year, UBS paid \$780 million to settle the case. It later agreed to lift the veil of Swiss bank secrecy and disclose the names of 4,450 American clients to the Internal Revenue Service.")

106. *Id.*

107. Jek Aun Long et al., *The Growth of Private Wealth Management Industry in Singapore and Hong Kong*, 6 CAP. MKT. L. J., 104, 117-18 (2011).

108. Dharmapala, *supra* note 32, at 1.

With nonexistent tax capital gains and deposit interest, banks in Hong Kong have benefited largely from the deposits its banks received from wealthy American investors.¹⁰⁹ Hong Kong is making a concerted effort to replace Switzerland as the global center for private banking.¹¹⁰ UBS, the largest bank in Switzerland, has lost about \$200 billion in assets from private banking clients over the last two years in Switzerland.¹¹¹ But in Asia, it has won more new money than it has lost.¹¹² The bank plans to hire an additional 400 "client advisers," or private bankers, for its Asia-Pacific region,¹¹³ including Hong Kong. Hong Kong has become the Swiss bank's "second home," and the bank plans to double its assets in Hong Kong to twenty-five percent of its total within five years.¹¹⁴

Given the current golden opportunity with the failures of offshore banks in Switzerland, it would be in Hong Kong's best interest to continue attracting more investment around the world and lend capital to global entities, including mainland Chinese companies who need cash to grow their businesses.¹¹⁵ Chinese entities flourish from Hong Kong's bank secrecy since they can easily borrow a large sum of capital from banks in Hong Kong to fund their businesses.

To exchange phenomenal capital growth in the financial sector and economic development for wider information sharing with the U.S. would seem illogical to the Chinese government. China's primary goal should be to promote continued exponential growth and development in Hong Kong and mainland China by encouraging more foreign deposits and attracting more foreign customers in the domestic banks.

109. See generally Browning, *supra* note 9.

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. Lipsher, *supra* note 42, at 645.

VIII. Tax Information Exchange Agreement Viewed Ineffective

It has also been widely viewed and criticized that TIEAs are highly ineffective in the actual facilitation of information exchange.¹¹⁶ This is mainly due to Article 5 of the TIEA, which requires that the requesting country must first identify the name of the taxpayer before requesting any relevant tax information from the other party.¹¹⁷ This is inherently very difficult to achieve. Without granting tax authorities access to all financial records necessary to determine if any of their citizens are concealing income, such evidence is usually unavailable and nearly impossible to obtain.¹¹⁸ Therefore, even if bank secrecy laws of a particular country, e.g., China, were to be lifted, the U.S. government still may not be able to obtain bank information if the IRS cannot first identify which U.S. resident is hiding bank accounts in China.

Given the ineffectiveness and the insignificant role TIEAs potentially play in information exchange, the U.S. and China would be even less likely to enter into a TIEA. It would not be in the U.S.'s or China's best interest to hastily sign into an ineffective tax agreement that is seemingly effective to the public and potentially provoke anxiety among their respective financial institutions foreign residents with domestic bank accounts. It would be even less desirable for both countries to risk massive losses of financial sector revenue and jobs, which in turn would slow down the growth of each country's economy for a fruitless tax information exchange agreement.

IX. Conclusion

Tax information exchange is hindered because the U.S. and China may rely on bank secrecy to improve the flow of foreign capital into financial markets. While it would be ideal if there was a universal, global effort to eliminate tax havens altogether, both the U.S. and China still seem reluctant to crack down on tax evasion because of the risk of endangering capital inflow. In the end, these

116. Addison, *supra* note 68, at 717–18; see also McIntyre, *supra* note 65, at 697 (discussing the ineffectiveness of the “fishing expedition” of the Switzerland treaty, which is essentially the same as the Model TIEA).

117. Model TIEA, *supra* note 67, art. 5(5)(a).

118. Addison, *supra* note 68, at 717–18.

two countries will always have their own best interests in mind when negotiating an exchange agreement. In the current situation state, entering into a TIEA appears to be both impractical and disadvantageous.

Effective information sharing will likely require domestic sacrifice and a mutual willingness to provide information, which has not been seen thus far. Additional innovative and collective actions must be invented and fostered to provide economic incentives for both countries to relinquish their bank secrecy laws and to enact and enforce effective TIEAs. Although the road to transparent tax information exchange between the two countries remains winding and uncertain, tax authorities will soon realize that TIEA's are not the answers to offshore tax evasion but mutual cooperation and reciprocity might be.