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## Turnabout is Fair Play: The U.S. Response to Mexico's Request for Bank Account Information

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# TURNABOUT IS FAIR PLAY: THE U.S. RESPONSE TO MEXICO'S REQUEST FOR BANK ACCOUNT INFORMATION

KEVIN PRESLAN\*

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## ABSTRACT

This Note argues that the United States needs to come to a compromise with Mexico over Mexico's request for information concerning interest paid by U.S. banks to residents of Mexico. The United States could ignore Mexico's request, but that may create animosity between the two nations. Alternatively, the United States could fully comply with Mexico's request; however, that may lead to strong opposition from the banking sector. It is in the best interest of the United States to model its compromise on the recent compromise between the United States and Switzerland. While there are issues with this compromise that would need to be resolved first, a similar compromise would be a good initial step for two countries that would have a lot to lose if this interest information request cannot be resolved.

## I. INTRODUCTION

All the Mexican Ministry of Finance wants from the United States (U.S.) and the Internal Revenue Service (IRS) is information related to interest paid by U.S. banks

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to Mexican residents.<sup>1</sup> This information would help the Mexican government identify and prevent tax evasion, money laundering, drug trafficking, and organized crime.<sup>2</sup> This information would also allow the Mexican Ministry of Finance to tax any funds that were never reported to the Ministry of Finance by its own residents in the first place as well as the interest earned on these funds from U.S. banks. It is the same information that the United States wanted and received from Switzerland and UBS, a global financial services company headquartered in Switzerland, in a recent August 2009 compromise.<sup>3</sup> It is the same information that the United States has exchanged with Canada on a regular basis since 1997.<sup>4</sup> So, why is the United States not willing to comply with this request?

In addition to having paid a \$780 million fine to the United States in February of 2009<sup>5</sup>, UBS agreed in August 2009 to disclose the names and details of approximately 4,450 accounts held by U.S. citizens in Switzerland to the Swiss government, which, in turn, agreed to hand the information over to the IRS.<sup>6</sup> The IRS requested this information from UBS so that it could tax the interest accrued by U.S. taxpayers because it was going untaxed by both Switzerland and the United States.<sup>7</sup> Does this fact pattern not sound familiar to Mexico's request described above? Why, then, is the United States willing to allow other countries to lose tax dollars when it is not willing to do the same?

Despite these recent events, the United States has yet to respond to a request made by Mexico Secretary of Finance Agustin Carstens, dating back to February of 2009.<sup>8</sup> Carstens made this request to the IRS because of Mexico's recent victories against the country's drug cartels and organized crime.<sup>9</sup> Mexico has determined that it wants to take advantage of its crackdown on crime and start benefitting from it

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<sup>1</sup> See *Mexican Finance Minister Seeks Exchange of Certain Bank Information with United States*, 2009 TAX NOTES TODAY 50-12 (Mar. 18, 2009) [hereinafter *Mexican Finance Minister*].

<sup>2</sup> *Id.*

<sup>3</sup> See Agreement between the United States of America and the Swiss Confederation on the Request for Information from the Internal Revenue Service of the United States of America Regarding UBS AG, a Corporation Established under the Laws of the Swiss Confederation, U.S.-Switz., Aug. 19, 2009, available at [http://www.irs.ustreas.gov/pub/irs-drop/us-swiss\\_government\\_agreement.pdf](http://www.irs.ustreas.gov/pub/irs-drop/us-swiss_government_agreement.pdf) [hereinafter *UBS Agreement*].

<sup>4</sup> See *Final Regs Require Reporting of Bank Deposit Interest Paid to NRAs Who Are Residents of Canada*, 1996 TAX NOTES TODAY 84-13 (Apr. 22, 1996) [hereinafter *Final Regs*].

<sup>5</sup> Kevin McCoy, *UBS Must Release Data on 4,500 Suspected Tax Cheats*, USA TODAY, Aug. 20, 2009, at 1B, available at [http://www.usatoday.com/money/perfi/taxes/2009-08-19-ubs-tax-irs\\_N.htm](http://www.usatoday.com/money/perfi/taxes/2009-08-19-ubs-tax-irs_N.htm).

<sup>6</sup> Evan Perez & Carrick Mollenkamp, *Swiss Bank to Give Up Depositors' Names to Prosecutors*, WALL ST. J., Feb. 19, 2009, at A1.

<sup>7</sup> See McCoy, *supra* note 5.

<sup>8</sup> Robert Goulder, *How the U.S. is a Tax Haven for Mexico's Wealthy*, 2009 TAX NOTES TODAY 161-3 (Aug. 24, 2009).

<sup>9</sup> See *id.*

financially, as well.<sup>10</sup> The start of this process began with Mexico's initial crackdown on crime. With that element already set in place, the Mexican government now hopes to find suspicious bank accounts in foreign countries, such as the United States.<sup>11</sup> With this bank account information in hand, Mexico's Ministry of Finance could then determine whether the money in these bank accounts came from legitimate sources of reported income or from illegal sources of unreported income, such as drug trafficking and organized crime.<sup>12</sup> Mexico believes that a majority of these Mexican accounts in foreign banks come from illegal sources and are unreported to the Ministry of Finance.<sup>13</sup> Requesting this interest information from U.S. banks is the next step in one large plan already set in motion by the Mexican government to bring in much needed tax revenue and to crack down on crime.

Even Switzerland, a country known worldwide for its bank secrecy laws regarding the exchange of similar information, was willing to compromise with the United States and come to an amicable resolution.<sup>14</sup> However, those within the Swiss government believe that "the agreement fully complies with Swiss law and doesn't violate banking secrecy, which . . . isn't meant to protect criminal behavior."<sup>15</sup> While the Swiss government originally believed that there would be no long-term effects on their banking secrecy laws as a whole, it appears that may not be the case.<sup>16</sup> To avoid further problems with other countries, the Swiss government signed new tax agreements with at least twelve nations, ending a decades-old practice by agreeing to exchange confidential information regarding some of its bank clients.<sup>17</sup> It remains to be seen whether this is the beginning of the end for Swiss bank secrecy laws.

In light of this recent compromise between the United States, Switzerland, and UBS, it is in the United States' best interest to comply with Mexico's request, as well. However, full compliance is not as simple as it may appear. No matter what the United States ultimately decides on this issue, some group or faction will be disappointed with the end result. Full compliance would harm an already-hurting U.S. banking sector. Non-compliance would aggravate an important neighboring

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<sup>10</sup> *See id.*

<sup>11</sup> *See* Ken Stier, *Foreign Tax Cheats Find U.S. Banks a Safe Haven*, TIME, Oct. 29, 2009, available at <http://www.time.com/time/business/article/0,8599,1933288,00.html>.

<sup>12</sup> "Carstens doesn't say it in his letter, but that information exchange would also allow Mexican tax authorities to identify doctors, dentists, and business executives who knowingly shelter money tax free in U.S. banks." *See* Goulder, *supra* note 8.

<sup>13</sup> *See Mexican Finance Minister, supra* note 1.

<sup>14</sup> *See* Ashby Jones, *In UBS Deal, Is the U.S. Hoping To Use Secrecy to Its Advantage?*, WALL ST. J., Aug. 19, 2009, available at <http://blogs.wsj.com/law/2009/08/19/in-ubs-deal-is-the-us-hoping-to-use-secrecy-to-its-advantage>.

<sup>15</sup> *Id.*

<sup>16</sup> Manuel Ammann told the AFP that "[t]he time when tax evaders could take advantage of Swiss financial services and feel safe about it is certainly over." *See* Peter Capella, *Swiss Bank Secrecy Emerges from 2009 with Holes*, AGENCE FRANCE PRESSE, Dec. 26, 2009, available at [http://www.google.com/hostednews/afp/article/ALeqM5gKT\\_Cz-IckohkgtiiSV2qTGghMCg](http://www.google.com/hostednews/afp/article/ALeqM5gKT_Cz-IckohkgtiiSV2qTGghMCg).

<sup>17</sup> *Id.*

country in Mexico. That is something that the United States does not want to do. Given these potential reactions, the U.S. government must now perform a difficult balancing act between what is best for the United States and what is best for Mexico, one of its biggest allies, and the world as a whole.

Part II of this Note discusses the history and background of the last two years of the UBS and Switzerland situation in depth. Part II also explores Mexico's current request to the United States. What exactly does Mexico want from the United States and why? Part III further analyzes Mexico's request and the issues that the United States will face. What issues will arise due to the recent UBS Agreement that has eerily similar facts to the Mexico situation?

Part IV explores the costs and benefits of possible solutions to the United States' dilemma. Should the United States fully comply with Mexico, or should it sit back and do nothing? Should the United States use the UBS Agreement as a model for future negotiations with Mexico? Why or why not? Part V concludes this Note and discusses the most appropriate solution in these circumstances. While there appears to be no perfect solution to this dilemma, there is a right way to deal with Mexico's request in order to satisfy both countries. Both countries need to receive a significant benefit from any potential resolution to be reached.

## II. THE PAST AND PRESENT OF THE UNITED STATES: A FURTHER LOOK INTO SWITZERLAND AND MEXICO

### A. *The Involvement of UBS with U.S. Taxpayers*

In the spring of 2007, Bradley Birkenfeld, a U.S. citizen who worked for UBS in Switzerland from 2001 to 2006,<sup>18</sup> came forward to the U.S. Justice Department with information implicating UBS in helping American clients defraud the U.S. Treasury.<sup>19</sup> In divulging this information to the United States, Birkenfeld admitted that UBS private bankers, including himself, were helping American clients invest, spend, and move their money without submitting the required disclosures to the United States.<sup>20</sup> One example of moving a client's money involved Birkenfeld removing funds from a client's account, buying diamonds with these funds, and then transporting the diamonds into the United States.<sup>21</sup> Even though the diamonds were transported in a toothpaste tube, Birkenfeld claims that since the diamonds were worth less than \$10,000 they did not need to be declared at customs.<sup>22</sup>

Transactions like this one are done because UBS's American clients want to evade U.S. taxes on their investment returns. American clients are able to evade taxes through UBS because of Swiss bank secrecy laws.<sup>23</sup> Under Swiss law, only the

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<sup>18</sup> Janet Novack, *Banker Charged with Helping Billionaire Dodge Taxes*, FORBES, May 13, 2008, available at [http://www.forbes.com/2008/05/13/taxes-ubs-olenicoff-biz-beltway-cz\\_jn\\_0513taxes.html](http://www.forbes.com/2008/05/13/taxes-ubs-olenicoff-biz-beltway-cz_jn_0513taxes.html).

<sup>19</sup> *Banking: A Crack in the Swiss Vault*, CBS NEWS, Jan. 3, 2010, available at <http://www.cbsnews.com/stories/2009/12/30/60minutes/main6038169.shtml>.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *See id*

individual client and the client's bank have the right to the bank account information of an individual.<sup>24</sup> Swiss banks were sworn to this secrecy in 1934 due to then-Nazi Germany pursuing this information from Germans who were believed to be Jews or political opponents.<sup>25</sup> While similar circumstances are not occurring today, Swiss bank secrecy law still exists more than 75 years later.

Eventually, on May 13, 2008, the United States charged Bradley Birkenfeld with defrauding the United States by helping other U.S. citizens evade paying taxes on their investment returns in bank accounts held in Switzerland.<sup>26</sup> Birkenfeld ultimately pleaded guilty and agreed to cooperate with the United States.<sup>27</sup> In agreeing to help, Birkenfeld admitted that UBS banks in Switzerland held approximately \$20 billion in the undeclared accounts of approximately 20,000 U.S. citizens.<sup>28</sup> Because these large sums of money were going untaxed by the IRS, the United States then served "John Doe" summons on UBS on July 1, 2008.<sup>29</sup> A "John Doe" summons is "a summons made out to an unidentified defendant who is referred to in the summons as John Doe."<sup>30</sup> This was done because the United States did not know the identities of those residents who had undeclared deposits held in these UBS bank accounts.<sup>31</sup> Switzerland has "long been known as a place to put your money if you don't like taxes or you commit crimes for a living."<sup>32</sup>

However, the issuance of the "John Doe" summons did not resolve much due to the structure of the tax treaties the United States has with other countries, including Switzerland.<sup>33</sup> Every U.S. tax treaty contains an article that pertains to the exchange

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<sup>24</sup> See C. Todd Jones, *Compulsion Over Comity: The United States' Assault on Foreign Bank Secrecy*, 12 NW. J. INT'L L. & BUS. 454, 462 (1992).

<sup>25</sup> Peter Capella, *History Comes Full Circle as Swiss Bank Secrecy Shudders*, AGENCE FRANCE PRESSE, Feb. 7, 2010, available at <http://business.inquirer.net/money/breakingnews/view/20100207-251776/History-comes-full-circle-as-Swiss-bank-secrecy-shudders>.

<sup>26</sup> Birkenfeld was not the only person charged by the United States in connection with the UBS scandal. Igor Olenicoff, a U.S. real estate investor whom Birkenfeld helped hide \$200 million in offshore assets, pleaded guilty to federal tax charges in 2007 and agreed to pay the IRS more than \$52 million in overdue taxes, penalties, and interest. Others, involved as current and former employees of UBS, have been charged, but are believed to be in Switzerland at this time. Novack, *supra* note 18; see also McCoy, *supra* note 5.

<sup>27</sup> Janet Novack, *UBS Cheats Can Still Come Clean*, FORBES, July 9, 2008, available at [http://www.forbes.com/2008/07/08/irs-ubs-taxes-biz-beltway-cz\\_jn\\_0709beltway.html](http://www.forbes.com/2008/07/08/irs-ubs-taxes-biz-beltway-cz_jn_0709beltway.html).

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> Dictionary.com, <http://dictionary.reference.com/browse/John+Doe+summons> (last visited Apr. 4, 2011).

<sup>31</sup> See Carrick Mollenkamp, *IRS to Expand Use of 'John Doe' Tactic*, WALL ST. J., Apr. 29, 2009, at M12.

<sup>32</sup> Kate Pickert, *A Brief History of: Swiss Banks*, TIME, Feb. 26, 2009, available at <http://www.time.com/time/magazine/article/0,9171,1881977,00.html>.

<sup>33</sup> The United States has executed bilateral tax treaties with dozens of countries around the world. The chief aim of these treaties is to "reduce juridical double taxation, to prevent excessive taxation, and, increasingly, to help to police tax avoidance through exchange of information . . . . They resolve disparities in assertions of jurisdiction to tax by providing tie-

of information between the two contracting countries.<sup>34</sup> Article 26 of the United States-Switzerland Tax Treaty states that, “in cases of tax fraud, if specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of authenticated copies of unedited original records or documents.”<sup>35</sup> The United States-Switzerland Tax Treaty defines “tax fraud” as “fraudulent conduct that causes or is intended to cause an illegal and substantial reduction in the amount of the tax paid to a Contracting State.”<sup>36</sup> These provisions of the United States-Switzerland Tax Treaty are interpreted to mean that original documents and records will only be handed over to the United States if the IRS already knows who it is specifically looking for by name.<sup>37</sup> The problem with that interpretation is that knowing a particular person’s name is not typical.

At this point, Switzerland was hoping the United States would dismiss the “John Doe” summons against UBS in exchange for an amendment to the countries’ tax treaty.<sup>38</sup> However, the United States was able to secure another victory in February of 2009 when UBS agreed to a \$780 million deferred prosecution agreement for offering their services to wealthy Americans to evade paying taxes.<sup>39</sup> In accordance with the agreement, UBS also agreed to disclose account information on request from its American clients, as well as to stop providing services in the future that help American clients evade taxes.<sup>40</sup> This was a tough blow for UBS, as this practice accounted for between \$120 and \$140 million in revenues each year.<sup>41</sup>

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breaker rules in situations in which a taxpayer would be a resident of both contracting states under each state’s domestic law. Once residence is resolved, treaties set up a system of default allocation rules, under which either the residence state or the source state is assigned an exclusive or primary right to tax income based on its classification, and the other state either cedes its right to tax entirely or retains a residual right to tax.” Ruth Mason, *U.S. Tax Treaty Policy and the European Court of Justice*, 59 TAX L. REV. 65, 69-71 (2005).

<sup>34</sup> See Goulder, *supra* note 8.

<sup>35</sup> Convention for the Avoidance of Double Taxation with Respect to Taxes on Income, U.S.-Switz., Oct. 2, 1996, available at <http://www.irs.gov/pub/irs-trty/swiss.pdf>.

<sup>36</sup> *Id.*

<sup>37</sup> See Goulder, *supra* note 8.

<sup>38</sup> See Perez & Mollenkamp, *supra* note 6.

<sup>39</sup> Lynnley Browning, *UBS to Pay \$780 Million Fine over Offshore Services*, N.Y. TIMES, Feb. 19, 2009, available at <http://www.nytimes.com/2009/02/18/business/worldbusiness/18iht-UBS.20289166.html>.

<sup>40</sup> Press Release, Department of Justice, UBS Enters into Deferred Prosecution Agreement (Feb. 18, 2009), available at <http://www.justice.gov/opa/pr/2009/February/09-tax-136.html>.

<sup>41</sup> “From at least 1999 through 2008, UBS acted as an unregistered broker-dealer and investment advisor to thousands of U.S. persons and offshore entities with United States citizens as beneficial owners. UBS had at least 11,000 to 14,000 of such clients and held billions of dollars of assets for them.” John Churchill, *UBS Nailed with \$780 Million Fine, Admits to Aiding Tax Dodge Clients*, REGISTERED REP, Feb. 18, 2009, available at [http://registeredrep.com/advisorland/regulatory/ubs\\_ailed\\_admits\\_to\\_tax\\_dodge0218/](http://registeredrep.com/advisorland/regulatory/ubs_ailed_admits_to_tax_dodge0218/).

This conflict finally came to a resolution on August 19, 2009, when the United States and Switzerland came to terms on the UBS Agreement.<sup>42</sup> In return for the United States withdrawing its “John Doe” summons against UBS, Switzerland agreed to process the United States’ request for the outstanding account information that it had requested all along.<sup>43</sup> Both countries agreed that this request would involve approximately 4,450 accounts held by American clients of UBS in Switzerland.<sup>44</sup> Within 60 days of UBS receiving a request from the Swiss Federal Tax Administration (SFTA), UBS would submit the necessary information to the SFTA on the first 500 cases.<sup>45</sup> The remaining cases would be submitted by UBS to the SFTA within 270 days of the initial request by the United States.<sup>46</sup>

*B. The Beginning of Mexico’s Involvement*

The United States’ struggle with UBS and Switzerland had finally come to an end. The United States got what it wanted: A large fine paid by UBS, an amendment to their tax agreement with Switzerland, and, in time, the information that it requested in the first place. All appeared to be good on this front. At least that is what the United States thought. On February 9, 2009, while the United States was still in the middle of its struggle with Switzerland, Mexico Secretary of Finance Agustin Carstens requested that the United States and Mexico start sharing information related to interest paid by banks of one country to residents of the other.<sup>47</sup> This request is essentially the same request that the United States made to Switzerland and struggled with for more than two years. With history now on his side, Carstens made this request to the IRS because of its recent victories against Mexico’s drug cartels and organized crime.<sup>48</sup> Mexico had determined it wanted to take advantage of their crackdown on crime and start benefitting from it financially. Mexico Secretary of Finance Agustin Carstens believes this interest information is necessary from the United States in order to enforce Mexico’s tax regime more effectively and receive additional revenues from it.<sup>49</sup>

Mexico’s request involves a reciprocal agreement between the two countries. Mexico wants information related to interest paid by U.S. banks to residents of Mexico, and is willing to do the same for the United States.<sup>50</sup> This should not be a problem for the two countries, according to Carstens, because “Mexico and the United States [already] regularly exchange information, on a case-by-case basis, in accordance to our bilateral Tax Treaty. We also exchange bulk information on

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<sup>42</sup> *UBS Agreement*, *supra* note 3, at 6.

<sup>43</sup> *Id.* at 3.

<sup>44</sup> *Id.* at 2.

<sup>45</sup> *Id.* at 4.

<sup>46</sup> *Id.*

<sup>47</sup> *See Mexican Finance Minister*, *supra* note 1.

<sup>48</sup> *See id.*

<sup>49</sup> *See id.*

<sup>50</sup> *Id.*

interest payments (between corporations), dividends and royalties.”<sup>51</sup> Carstens compared a potential agreement with Mexico and the United States to the current situations between Canada and both the United States and Mexico because Canada already has mechanisms in place that exchange this interest information on a regular basis with both countries.<sup>52</sup>

The difference in treatment of the exchange of interest information by the United States is not found in the language of the U.S. tax treaties with Mexico and Canada. Rather, the distinction stems from Section 6049 of the Internal Revenue Code and the relevant regulations associated with that section.<sup>53</sup> Section 6049 states that “every person who makes payments of interest . . . aggregating \$10 or more to any other person during any calendar year . . . shall make a return . . . setting forth the aggregate amount of such payments and the name and address of the person to whom paid.”<sup>54</sup> Treasury Regulation § 1.6049-8 clarifies the meaning of Section 6049 by stating “the term interest means interest paid to a Canadian nonresident alien individual . . . where the interest is . . . maintained at an office within the United States . . . . A Canadian nonresident alien individual is an individual who resides in Canada and is not a United States citizen.”<sup>55</sup> There is no mention of Mexico in this or any other regulation on this matter.<sup>56</sup>

### C. Where the UBS Agreement went Wrong

On top of Mexico’s request, the UBS Agreement took a turn for the worse. On January 21, 2010, an American UBS client had her appeal granted by Switzerland’s Federal Administrative Court.<sup>57</sup> Her original case sought to prevent the Swiss government from disclosing her account information to the United States under the UBS Agreement.<sup>58</sup> Switzerland’s Federal Administrative Court held that “the settlement [from August 2009 between Switzerland and the United States] ignored aspects of Swiss banking secrecy rules, including safeguards that prevent the government from handing over files to foreign tax authorities except in cases of deliberate fraud.”<sup>59</sup> The court classified the UBS Agreement as “merely a mutual

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<sup>51</sup> *Id.*

<sup>52</sup> *Mexican Finance Minister, supra* note 1.

<sup>53</sup> 26 U.S.C. § 6049 (2008).

<sup>54</sup> *Id.* at (a)(2).

<sup>55</sup> Treas. Reg. § 1.6049-8(a) (2000).

<sup>56</sup> *Id.*

<sup>57</sup> Kristen A. Parillo, *Swiss Court Says Government Cannot Disclose UBS Data on U.S. Client*, 2010 TAX NOTES TODAY 15-1 (Jan. 25, 2010) (Switzerland’s Federal Administrative Court is similar to the United States Court of Appeals.).

<sup>58</sup> “The ruling, made public on January 22, reviewed one unnamed client’s appeal as a pilot case. Twenty-five similar cases are pending. The court reportedly ruled that the Swiss government may not disclose the client’s account information because her failure to file a Form W-9 did not constitute ‘tax fraud and the like,’ as required by the information exchange provisions of the Switzerland-U.S. income tax treaty.” *Id.*

<sup>59</sup> Matthew Saltmarsh, *Swiss to Submit Revised UBS Tax Deal to Parliament*, N.Y. TIMES, Feb. 24, 2010, available at <http://www.nytimes.com/2010/02/25/business/global/25tax.html>.

agreement that permitted no change to the terms that had been given binding definitions in the bilateral double taxation agreement.”<sup>60</sup>

The granting of this appeal came as a temporary blow to the United States because Switzerland could not transfer any additional information to the United States until the UBS Agreement had been approved by Parliament, unless authorized to do so by the consent of the UBS clients themselves.<sup>61</sup> Out of the approximately 4,450 accounts believed to fall under the UBS Agreement, only 250 of them involved fraud, while the remaining 4,200 involved cases of "continued or serious tax offense," which, under Swiss law, does not rise to the level of "fraud."<sup>62</sup> This is significant because the UBS Agreement defines the term "continued or serious tax offense" to include

[t]he failure of a U.S.-domiciled client to provide a Form W-9 for a three-year period, with at least one year occurring in the requested period, or the inability of a U.S. client to prove on request by the Swiss Federal Tax Administration that he has complied with U.S. reporting requirements, such as the filing of a foreign bank account report.<sup>63</sup>

Switzerland's Federal Administrative Court ultimately ruled in the January, 2010, case that the Swiss government cannot disclose a client's account information because the failure to file a Form W-9 did not constitute "tax fraud and the like" as required by the Switzerland-United States Income Tax Treaty.<sup>64</sup> This precedent will make it difficult for the United States to obtain any information concerning approximately 4,200 out of the 4,450 accounts believed to fall within the UBS Agreement because it "basically invalidates" the compromise.<sup>65</sup>

A recent development, however, has put the United States back in line to receive the bank account information that it has been seeking all along. On March 31, 2010, Switzerland's Federal Council approved an amendment to the UBS Agreement that "creates the necessary legal basis for the Swiss Federal Tax Administration (SFTA) to issue final decisions even in cases of continued and serious tax evasion, and permits Switzerland to fulfill the obligations under international law that it entered into with the original Agreement."<sup>66</sup> The amendment to the UBS Agreement raises it

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<sup>60</sup> *Swiss to Resume Talks with U.S. over UBS Accounts*, WEBBCPA, Jan. 29, 2010, available at <http://www.onwallstreet.com/news/UBS-Swiss-Accounts-2665632-1.html>.

<sup>61</sup> "[Swiss] Federal Council [could] put the UBS agreement to Parliament for approval, an approach that the [Federal Administrative Court] indicated in its ruling as a possible solution. If the agreement were approved by the Swiss Parliament, the Federal Administrative Court could not then regard the agreement as merely a mutual agreement in any future appeals. Instead, the agreement would stand as a treaty with the same status as the older and more general bilateral double taxation agreement and, according to general rules of interpretation, would take precedence over the latter." *Id.*

<sup>62</sup> Parillo, *supra* note 57.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *See id.*

<sup>66</sup> *Switzerland Announces Signing of Protocol to UBS Agreement with U.S.*, 2010 TAX NOTES TODAY 62-29 (Apr. 1, 2010).

to the same level as the bilateral double taxation convention.<sup>67</sup> This amendment will allow Switzerland to fulfill its obligation to the United States in turning over the necessary bank account information that had been disallowed by Switzerland's Federal Administrative Court.<sup>68</sup>

Now it is the United States' turn to make a move. Does it fully comply with Mexico's request? Or does it continue to do nothing, as it has for the last year? There are several issues that the United States will face in implementing a solution that will be further examined in Parts III and IV of this Note.

### III. MEXICO'S REQUEST AND THE ISSUES THAT WILL ARISE

#### A. *How Mexico got to this Point*

The history behind Mexico's request dates back to the year 2006. Felipe Calderon was narrowly elected as President of Mexico.<sup>69</sup> President Calderon's first major project was battling Mexico's illegal drug trade.<sup>70</sup> Battling Mexico's illegal drug trade was significant because it has been attempted many times in the past to no avail.<sup>71</sup> President Calderon's concentrated effort on illegal drug trafficking has led to much success thus far, but much success has come with much violence and death.<sup>72</sup> Mexico's drug cartels have as much power, money, and influence as any organization in the country. Because of this immense power, President Calderon has been forced to take extreme measures to keep everything under control. These efforts have included deploying the country's military in situations where it is believed that local drug cartels are having too much influence on the police in the area.<sup>73</sup> President Calderon has also partnered with countries globally, most importantly the United States, in order to obtain as much support as possible.<sup>74</sup> The United States is a logical ally in this fight against drugs because most of the drugs these cartels are selling and producing ultimately end up in the United States.<sup>75</sup>

President Calderon's partnership with the United States began in March of 2007 when President Calderon and former United States President George W. Bush began discussions that focused on U.S. financial support in Mexico's campaign against drugs.<sup>76</sup> In the end, the United States transferred \$400 million to Mexico in 2008 in what became known as the Merida Initiative.<sup>77</sup> These funds were intended for uses

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<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> Goulder, *supra* note 8.

<sup>70</sup> *See id.*

<sup>71</sup> *See id.*

<sup>72</sup> *See id.*

<sup>73</sup> *Id.*

<sup>74</sup> Goulder, *supra* note 8.

<sup>75</sup> *See id.*

<sup>76</sup> Stephanie Erin Brewer, *Rethinking the Merida Initiative: Why the U.S. Must Change Course in its Approach to Mexico's Drug War*, 16 HUM. RTS. BR. 9 (Spring 2009).

<sup>77</sup> *Id.*

such as “the purchase of airplanes and helicopters for the Mexican military for surveillance, counternarcotics, and counterterrorism operations; the purchase of scanners and armored vehicles; the establishment of law enforcement databases; training for specialized police units combating organized crime; and anti-corruption activities in the federal police.”<sup>78</sup> In 2009, Congress approved an additional \$300 million to be sent to Mexico in furtherance of the Merida Initiative.<sup>79</sup> In total, as much as \$1.4 billion will be sent to Mexico over a three-year period ending in 2010.<sup>80</sup>

Given the amount of money invested in Mexico’s fight against their drug cartels, it is in the best interest of the United States to continue these efforts and comply with Mexico’s bank interest information request. If Mexico wants this information in order to tax these drug cartels, among others, shouldn’t the United States simply comply to further their joint efforts against drugs and crime? In theory, the United States would love to cooperate. However, that may not be a feasible solution given the circumstances.

### B. The U.S. Banking Sector’s Opposition

Complying with Mexico’s request is not as easy as it may appear. The main obstacle that the United States would face in exchanging information related to interest earned by Mexican residents from U.S. banks is the strong opposition posed by the U.S. banking sector, which has opposed similar requests in the past. In January of 2001, the IRS issued a proposed regulation under Section 6049 entitled “Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens.”<sup>81</sup> The purpose of the proposed regulation was to extend the information reporting requirement of Treasury Regulation § 1.6049-8 to “bank deposit interest paid to nonresident alien individuals who are residents of other foreign countries.”<sup>82</sup> One of the reasons given by the IRS for attempting to make final such a regulation is that other foreign countries with which the United States has tax treaties with have requested this information in the past.<sup>83</sup>

Even with the Treasury Department’s arguably good intent to follow through with other foreign countries’ requests, the regulation never became effective. During the Treasury Department’s request for public comments, banks and organizations across the country wrote the Treasury Department displaying their strong opposition to the proposed regulation.<sup>84</sup> Eventually, the Treasury Department countered with a

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<sup>78</sup> *Id.*

<sup>79</sup> *Id.* (“This lower amount may signify a reduction in total Merida spending over the contemplated three-year period.”).

<sup>80</sup> *Id.*

<sup>81</sup> *Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens*, 66 Fed. Reg. 3925 (proposed Jan. 17, 2001), available at <http://www.irs.gov/pub/irs-regs/12610000.pdf>.

<sup>82</sup> *Id.* at 3926.

<sup>83</sup> See Cynthia Blum, *Sharing Bank Deposit Information with Other Countries: Should Tax Compliance or Privacy Claims Prevail?*, 6 FLA. TAX REV. 579, 581-83 (2004).

<sup>84</sup> Goulder, *supra* note 8 (“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.”).

second proposed regulation, Regulation 133254-02, which narrowed the scope of the reporting requirements.<sup>85</sup> Instead of banks reporting to the IRS information on interest paid to all nonresident aliens on an annual basis, the second proposed regulation would have narrowed the requirements to only apply to interest paid to residents of 16 specific foreign countries.<sup>86</sup> The list of countries whose residents would be subject to the second proposal did not include Mexico or any South American, Central American, and Caribbean countries.<sup>87</sup>

Despite the narrow scope of the Treasury Department's second proposed regulation, strong opposition from the banking sector continued to exist and the proposed regulation never became final.<sup>88</sup> The banking sector still believed that the proposed regulation would result in nonresident aliens moving their funds elsewhere, even if they were not residents of any of the countries affected by the second proposed regulation. Why would a wealthy investor keep his money in a country that is in the process of making it more difficult for foreign investors to avoid paying taxes to their home countries? For most taxpayers that goal, unfortunately, may be the point of placing money in another country's bank in the first place.

The banking sector has resisted this change in policy in the past and would do so again in the future because of the likelihood that foreign investors would move their business elsewhere. When similar regulations were proposed by the Treasury Department at the beginning of the decade, the Florida International Banking Association estimated that the regulation change could cause one-third to more than one-half of the roughly \$50 billion of foreign deposits held in its banks to move elsewhere.<sup>89</sup> The Association further estimated that between 41,000 and 78,000 jobs would be lost within fifteen years in the state of Florida alone if the regulation were adopted, while revenues would drop between \$4.4 billion and \$8.36 billion each year.<sup>90</sup> Those numbers are staggering given the context of the regulation's effect on Florida alone.

### C. Other Issues that may Arise

Mexico Secretary of Finance Agustin Carstens is well aware of the United States automatic exchange of interest information arrangement that has been in place with

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<sup>85</sup> See *Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens*, 67 Fed. Reg. 50386 (proposed Aug. 2, 2002).

<sup>86</sup> *Id.*; see also Blum, *supra* note 83.

<sup>87</sup> "The IRS and Treasury believe that limiting reporting to residents of these countries will facilitate the goals of improving compliance with U.S. tax laws and permitting appropriate information exchange without imposing an undue administrative burden on U.S. banks. Accordingly, the 2002 proposed regulations would modify the current regulations (which require reporting of U.S. bank deposit interest only if paid to Canadian residents) by requiring in addition reporting of U.S. bank deposit interest paid to residents of Australia, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, and the United Kingdom." *Guidance on Reporting of Deposit Interest Paid to Nonresident Aliens*, *supra* note 85; see also Goulder, *supra* note 8.

<sup>88</sup> See Goulder, *supra* note 8.

<sup>89</sup> Stier, *supra* note 11.

<sup>90</sup> *Id.*

Canada since 1997.<sup>91</sup> This arrangement requires the reporting of interest paid on deposits maintained at a bank's office in the United States to an individual who is a nonresident alien of the United States and a resident of Canada.<sup>92</sup> This is exactly what Mexico is requesting from the United States. If the United States has the same automatic exchange of information agreement with Canada, a bordering country to the north, then why does the United States not have that same agreement with Mexico, a bordering country to the south?

Once again, while it may appear that the logical thing for the United States to do would be to fully comply with Mexico's request, there are issues with that argument, as well. The United States has little to gain from exchanging this information on a regular basis.<sup>93</sup> While Mexico is willing to offer reciprocity to the United States, this offer has minimal appeal. U.S. taxpayers are not depositing their money in Mexican banks.<sup>94</sup> These U.S. taxpayers can find safer and more secure banks than Mexican banks that have stricter bank secrecy laws because those looking to evade taxes on these funds want their money to stay safe and away from taxes. History, until recently, has shown that Switzerland is an example of such a safe location. While Switzerland was willing to give in to the United State's request for bank account information, it does not appear that the United States is ready to do the same for Mexico.

The United States also has to worry about other countries making the same request that Mexico has made from it. While most regard Canada to be the exception to the rule due to the two countries' close relationship, if the United States complies with Mexico as well, countries across the world will begin to inquire too.<sup>95</sup> Compliance would cause severe consequences for the U.S. banking sector, as explained above.<sup>96</sup> So what will the United States do? While that remains to be seen, there are several possible routes the United States can go. Even though all of these possible solutions have significant consequences, the United States must find a solution that is beneficial to sectors in both countries.

#### IV. COST-BENEFIT ANALYSIS OF POSSIBLE SOLUTIONS

##### A. *Issues with Full Compliance and Non-Compliance*

The United States has the option of fully complying with Mexico's request. This would result in banks and financial institutions across the country annually reporting interest paid to nonresident aliens of the United States and residents of Mexico to the IRS, which would forward that information to Mexico. Banks and financial institutions already know which accounts this reporting mechanism would affect.

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<sup>91</sup> See Goulder, *supra* note 8.

<sup>92</sup> See *Final Regs*, *supra* note 4.

<sup>93</sup> See Goulder, *supra* note 8.

<sup>94</sup> "Maybe the Cayman Islands, but certainly not Mexico. The reciprocity that Mexico will offer Treasury has little appeal. This particular subset of the offshore sector is a decidedly one-way street." *Id.*

<sup>95</sup> See *id.*

<sup>96</sup> See *id.*

Banks would determine whether a client is a Mexican resident based on the address in the country of permanent residence required to be provided on the Form W-8.<sup>97</sup> Is this effort worth it to the United States and the IRS, or is the benefit one-sided?

As discussed earlier in this Note, the main issue that the United States would face in complying with Mexico's request is the strong opposition from the banking sector and the effects on this already struggling industry. There are also additional issues that would need to be overcome before full compliance becomes a viable option. Full compliance would create negative precedent in matters concerning interest earned by nonresident aliens. If the United States complied with Mexico's request, would it not have to do the same for all other ally countries? A good example of negative precedent is that, since September 2009, Canada has been requesting from UBS the same information the United States received from the financial institution in the UBS Agreement.<sup>98</sup> While nothing has come from it yet, Canada is threatening a lawsuit against UBS, much like the United States lawsuit, if UBS is not willing to comply.<sup>99</sup> In addition, while the United States was willing to compromise with Canada, full compliance with Mexico would show that Canada was not just the exception to the rule. Full compliance with Mexico would also not be a sufficient long-term solution to the big-picture problem. This problem will be discussed in more detail later in this Note.

In contrast, noncompliance would be the simplest solution for the United States. Noncompliance results in expending the least amount of resources possible. The banking sector would not lose out on any revenue from services provided to nonresident aliens. Everything would stay as-is. There is a strong possibility, however, that Mexico would not react well to noncompliance.

The main issue with failing to comply with Mexico's request is a breakdown of the two countries' relationship in other areas. The United States and Mexico have a strong trading relationship. An important element of this trading relationship is the North American Free Trade Agreement (NAFTA). NAFTA created the world's largest free trade bloc, "which now links 444 million people producing \$17 trillion worth of goods and services."<sup>100</sup> In terms of total trade, Mexico is the United States' third largest trading partner, while the United States ranks first among Mexico's trading partners.<sup>101</sup> In terms of U.S. imports, Mexico ranks third among United States trading partners, after China and Canada.<sup>102</sup> In 2008, the United States imported \$399.5 billion worth of goods from Canada and \$215.9 billion from Mexico.<sup>103</sup>

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<sup>97</sup> *Final Regs*, *supra* note 4.

<sup>98</sup> See David Ljunggren, *Canada Says Could Sue UBS Over List of Clients*, REUTERS, Dec. 2, 2009, available at <http://www.reuters.com/article/BROKER/idUSN024814020091202>.

<sup>99</sup> *Id.*

<sup>100</sup> Office of the United States Trade Representative, North American Free Trade Agreement (NAFTA), <http://www.ustr.gov/trade-agreements/free-trade-agreements/north-american-free-trade-agreement-nafta>.

<sup>101</sup> M. Angeles Villarreal, *U.S.-Mexico Economic Relations: Trends, Issues, and Implications*, CONGRESSIONAL RESEARCH SERVICE, Apr. 3, 2009, available at <http://www.fas.org/sgp/crs/row/RL32934.pdf>.

<sup>102</sup> *Id.*

<sup>103</sup> See Office of the United States Trade Representative, *supra* note 100.

Imported goods from Canada and Mexico totaled \$555.4 billion in 2008, which was up 5.2% from 2007, and up 268% since the year before the enactment of NAFTA in 1993.<sup>104</sup> In terms of U.S. exports, Mexico ranks second, after Canada.<sup>105</sup> In 2008, total U.S. exports purchased by Mexico were \$151.2 billion, while Canada purchased \$261.2 billion of U.S. exports.<sup>106</sup> These numbers are up 7.2% since the year before, 2007, and 190% since 1993.<sup>107</sup> U.S. exports to Canada and Mexico accounted for 32% of overall U.S. exports in 2008.<sup>108</sup> U.S. foreign direct investment in Canada and Mexico was \$348.7 billion in 2007, up 11.3% from 2006.<sup>109</sup> Foreign direct investment is “any form of investment that earns interest in enterprises which function outside of the domestic territory of the investor.”<sup>110</sup> U.S. direct investment in Canada and Mexico is typically in the manufacturing, finance, nonbank holding companies, and mining sectors.<sup>111</sup> Canadian and Mexican foreign direct investment in the United States was \$219.2 billion in 2007, up 21.4% from 2006.<sup>112</sup> Canadian and Mexican direct investment in the U.S. is typically in the finance, manufacturing, and banking sectors.<sup>113</sup> Given these figures, the United States and Mexico need each other in terms of importing and exporting goods.

The United States and Mexico have had problems in the past over NAFTA. For example, under NAFTA, Mexican commercial trucks were supposed to be given full access to four border states by 1995 and full access throughout the United States by 2000 in order to bring imported goods into the country.<sup>114</sup> The United States cited safety concerns as its reasoning for not allowing full implementation.<sup>115</sup> While a pilot program was put in place in September of 2007 to eventually initiate a full access truck program, Congress enacted the Omnibus Appropriations Act in 2009, which terminated the pilot program that allowed Mexican-registered trucks to operate beyond the 25-mile border commercial zone inside the United States.<sup>116</sup> In response, Mexico increased the duties on ninety U.S. products, which increased the duties on

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<sup>104</sup> *Id.*

<sup>105</sup> *See id.*; *see also* Villarreal, *supra* note 101, at summary.

<sup>106</sup> *See* Office of the United States Trade Representative, *supra* note 100.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Foreign Direct Investment (FDI)*, ECONOMYWATCH, <http://www.economywatch.com/foreign-direct-investment/> (last visited May 8, 2010).

<sup>111</sup> *See* Office of the United States Trade Representative, *supra* note 100.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> *See* Villarreal, *supra* note 101.

<sup>115</sup> *Id.*

<sup>116</sup> *See id.* at 25.

these imports by \$2.4 billion, effective March 19, 2009.<sup>117</sup> As of early 2009, both countries were still attempting to resolve this issue.<sup>118</sup>

Another disagreement within NAFTA has been a trade dispute over sugar and high fructose corn syrup. Mexico believed that it could send its excess sugar to the United States duty-free, while the United States argued that there was a limitation to the amount of sugar that could be imported on a duty-free basis.<sup>119</sup> In response to the United States not allowing Mexico's excess sugar into the country duty-free, the Mexican government imposed a twenty percent tax on soft drinks made within the United States with high fructose corn syrup.<sup>120</sup> This tax was implemented to help Mexico's domestic sugar industry deal with its problem of producing too much sugar.<sup>121</sup> Eventually, both countries came to a resolution that set a limit on the amount of sugar shipped to the other country.<sup>122</sup> Mexico also repealed the twenty percent tax effective January 1, 2007, more than five years after the tax was initially enacted.<sup>123</sup>

There are also growing concerns about the amount of corn and beans entering United States.<sup>124</sup> Mexican President Felipe Calderon is facing pressure within Mexico to reinstall tariffs put on corn and beans that Mexico collected from the United States before the enactment of NAFTA.<sup>125</sup> While NAFTA has been in effect since 1993, the United States was facing tariffs on corn and beans from Mexico until January 1, 2008.<sup>126</sup> Since then, the opposition claims that the corn and beans entering Mexico from the United States are hurting the local farmers in Mexico.<sup>127</sup> In defense of NAFTA, U.S. Commerce Secretary Carlos Gutierrez is reassuring Mexican farmers that "the corn being imported to Mexico is not the white corn that the Mexicans grow to produce their tortillas, but rather the yellow corn that is used to feed livestock."<sup>128</sup> According to government estimates, there are about 3.5 million corn farmers in Mexico that need this yellow corn because they use donkeys or mules rather than machines.<sup>129</sup>

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<sup>117</sup> *Id.* at 22.

<sup>118</sup> *See id.* at 22-23.

<sup>119</sup> *See* Villarreal, *supra* note 101, at 23.

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

<sup>123</sup> *See id.*

<sup>124</sup> Melissa Long, *Recent Developments in NAFTA*, 14 *LAW & BUS. REV. AM.* 875, 877 (2008).

<sup>125</sup> *Id.*

<sup>126</sup> *See* Missy Ryan & Mica Rosenberg, *U.S., Mexico Trumpet NAFTA Changes but Farmers Balk*, *REUTERS*, Jan. 11, 2008, available at <http://www.reuters.com/article/idUSN1159484020080111>.

<sup>127</sup> *See* Long, *supra* note 124, at 877.

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

Besides potential issues over NAFTA, the United States and Mexico could encounter issues over Mexico's fight with its country's drug lords. One of Mexican President Felipe Calderon's anti-drug strategies has been to send 45,000 troops to various locations throughout Mexico, including 7,000 to Juarez, a city well-known as the world's murder capital.<sup>130</sup> These efforts have not come without great heartache, as there have been over 18,000 drug-related murders, including 5,349 in Juarez itself, since President Calderon took power in December of 2006.<sup>131</sup> The reason for the large concentration of murders in Juarez is that there is currently a war going on between two of Mexico's drug gangs over control of the smuggling rights to the large U.S. market.<sup>132</sup> These murders have included numerous Americans.<sup>133</sup> Because of the quantity of illegal drugs entering the United States from Mexico and the numerous murders of American citizens occurring throughout Mexico, the United States has a large stake in Mexico's fight against its drug cartels. Besides pledging over \$400 million a year to Mexico's anti-drug efforts, the U.S. government has offered assistance in helping Mexico investigate the recent killings of Americans.<sup>134</sup> There is much at stake for Mexico, as well as the United States, in controlling Mexico's drug lords and cartels.

The United States and Mexico could potentially encounter significant issues in the area of immigration, as well. In the early 1990s, the United States was allowing over a half-million legal admissions to the United States from Mexico each year, reaching its peak in 1991 of almost one million people.<sup>135</sup> However, since 1993, the number of legal admissions to the United States from Mexico has not exceeded 200,000 people.<sup>136</sup> Even at approximately 175,000 legal admissions from Mexico in 2004, that number is approximately 18.5% of all new U.S. legal permanent residents.<sup>137</sup> Canada accounts for only approximately 1.6% of the total legal admissions for any given year.<sup>138</sup> In comparison, the United States gives temporary visas to less than five thousand Mexican residents annually, while giving temporary visas to over sixty thousand Canadian residents per year.<sup>139</sup>

Given these figures, there has been tension between the two countries concerning this issue. With unemployment continuing to rise, politicians are concerned with the

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<sup>130</sup> David Luhnnow & Nicholas Casey, *Killings Cast Pall on Mexico Drug Plan*, WALL ST. J., Mar. 18, 2010, available at <http://online.wsj.com/article/SB10001424052748704059004575128023316087594.html>.

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *See id.*

<sup>134</sup> *Id.*

<sup>135</sup> *See United States-Canada-Mexico Fact Sheet on Trade and Migration*, MIGRATION POLICY INSTITUTE, Oct. 2005, available at [http://www.migrationpolicy.org/pubs/US\\_Canada\\_Mexico\\_1005.pdf](http://www.migrationpolicy.org/pubs/US_Canada_Mexico_1005.pdf).

<sup>136</sup> *See id.*

<sup>137</sup> *See id.*

<sup>138</sup> *Id.*

<sup>139</sup> *See id.*

fact that there are over twelve million illegal immigrants currently residing in the United States.<sup>140</sup> While some lawmakers are willing to allow those already in the country to be granted citizenship if in good standing, others are willing to fight this battle because they believe that Americans should be given the first opportunity to jobs within the United States.<sup>141</sup> This animosity over immigration reform, coupled with the potential animosity if the United States continues to ignore Mexico's request for bank account information, could result in significant deterioration of relations between the two countries. While a deterioration of relations is just mere speculation at this point, matters have certainly worsened between the United States and Mexico given the current tough economies for both countries.

In addition to the relationship between the two countries, the United States also has to be concerned with its "tax haven" status with the rest of the world. At the center of the international tax world is hope that all countries will join together and defeat tax evasion and fraud completely. This effort has been headed by the Organization for Economic Cooperation and Development (OECD). The OECD defines a tax haven as "a jurisdiction characterized by lack of transparency and lack of effective exchange of information . . . . The key factor . . . is not so much that a country is a low-tax jurisdiction, but that there is excessive secrecy."<sup>142</sup> Jeffrey Owens, director of the center for tax policy and administration at the OECD, says, "the OECD's objectives regarding tax havens include improved transparency, improved exchange of information, and a cooperative approach between tax authorities. What the OECD does not seek to do is harmonize tax rates or impinge on national fiscal sovereignty."<sup>143</sup> Based on the OECD's definition of a tax haven and the organization's main objectives regarding tax havens, the United States would directly conflict with those objectives and strengthen its status as a tax haven if it did not comply. In fact, a recent study done by the Tax Justice Network (TJN) has already stated that the United States is a tax haven. On November 1, 2009, the TJN released its rankings of global tax havens.<sup>144</sup> The rankings listed the United States as the number one tax haven in the world, with Switzerland only third in the rankings.<sup>145</sup> Among the twelve factors considered in these rankings that are relevant for this discussion are formal banking secrecy, automatic information exchange, bilateral treaties, and effective access to banking information, among others.<sup>146</sup>

With this recent information coming to light, the United States might be inclined to remove itself from the top of the TJN's rankings. Given the efforts that the United

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<sup>140</sup> See Jared Allen, *Proponents Alter Immigration Legislation in the Face of Tough Economic Climate*, THE HILL, Nov. 23, 2009, available at <http://thehill.com/homenews/house/69059-dems-alter-immigration-bill-in-face-of-tough-economic-climate>.

<sup>141</sup> *See id.*

<sup>142</sup> Lisa M. Nadal, *OECD'S Owens Addresses Economic Effects of Tax Havens*, 2006 TAX NOTES TODAY 238-5 (Dec. 11, 2006).

<sup>143</sup> *Id.*

<sup>144</sup> Charles Gnaedinger, *U.S. at Top of Tax Justice Network's Financial Secrecy Index*, 2009 TAX NOTES TODAY 210-4 (Nov. 2, 2009).

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

States has already put forth in complying with OECD standards, such as implementing the OECD's internationally agreed tax standard, ignoring Mexico's request for an exchange of interest information would make these efforts less meaningful.<sup>147</sup> Among these efforts was President Obama's proposal to "crack down on illegal overseas tax evasion, close loopholes, and make it more profitable for companies to create jobs here in the United States."<sup>148</sup> Within his proposal, President Obama plans on getting tough with overseas tax havens.<sup>149</sup> This includes "eliminating loopholes for 'disappearing' offshore subsidiaries," "cracking down on the abuse of tax havens by individuals," and "devoting new resources for IRS enforcement to help close the international tax gap."<sup>150</sup>

The proposal also calls for

[m]easures [that] would let the IRS know how much income Americans are generating in overseas accounts by requiring overseas banks to provide 1099s for their American clients, just like Americans have to do for their bank accounts here in this country. If financial institutions won't cooperate with us, we will assume that they are sheltering money in tax havens, and act accordingly.<sup>151</sup>

While President Obama's proposals are mainly aimed at protecting the tax base of the United States, they also have the effect of the United States cracking down on foreign countries' tax havens in order to enforce its tax code. Noncompliance would seem hypocritical due to the recent efforts of the United States on tax evasion abroad.

#### *B. Benefits of Full Compliance and Non-Compliance*

While much has been said about the problems with both full compliance and noncompliance, both potential solutions do have their benefits. The benefits of complying with Mexico's request are straightforward. If the United States shares the interest information that Mexico is seeking, this disclosure will help the United States lose some of its "tax haven" status with the rest of the world. Whether the IRS and Congress like it or not, the United States offers *de facto* banking secrecy to all nonresident aliens that place their money in U.S. banks. The United States fails to provide other foreign countries with the necessary information so that those foreign countries can tax or not tax the bank interest as they see fit. Complying with Mexico's request is the first step in the process of stopping this practice. Another benefit of fully complying with Mexico's request is keeping the relationship between the United States and Mexico productive and friendly. Given the proximity and the

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<sup>147</sup> See generally James K. Jackson, *CRS Examines OECD Tax Haven Initiative*, 2009 TAX NOTES TODAY 152-24 (July 24, 2009).

<sup>148</sup> *Id.*

<sup>149</sup> *See id.*

<sup>150</sup> *Id.*

<sup>151</sup> Press Release, Office of the Press Secretary, Remarks by the President on International Tax Policy Reform (May 4, 2009), available at [http://www.whitehouse.gov/the\\_press\\_office/Remarks-By-The-President-On-International-Tax-Policy-Reform](http://www.whitehouse.gov/the_press_office/Remarks-By-The-President-On-International-Tax-Policy-Reform).

amount of importing and exporting done between the two countries, it is in the best interest of the United States to keep its relationship with Mexico intact.

There would also be several advantages to the United States in not complying with Mexico. Failing to comply with Mexico's request would on the surface cost the country nothing. Banks would not have to expend any additional resources to comply with potential legislation. The bureaucracy would also not have to expend time and resources in an additional project to develop and oversee. Failing to comply would also be financially beneficial to the banking sector. If Florida would stand to lose \$4.4 billion to \$8.36 billion each year from potential legislation, how much would the rest of the nation lose as well? The entire sum lost due to investors moving their funds elsewhere would hurt the industry as a whole. Another benefit to the United States in not complying with Mexico is that it would set positive precedent for other countries wanting to make the same request. While the United States was willing to compromise with Canada, noncompliance would show that Canada truly was the exception to the rule.

### C. Where the UBS Agreement Fits In

Due to the significant concerns with full compliance and noncompliance, the United States must be more creative and flexible with its solution to Mexico's request. However, a lot of groundwork may have already been done in connection with the UBS Agreement. The United States and Mexico already have a basic framework to use. In November of 2009, the IRS disclosed the criteria used in determining which UBS accounts would be turned over to the United States and the IRS.<sup>152</sup> If an American client had an account with UBS that contained more than \$248,200 in it, then that account information was provided to the IRS.<sup>153</sup> Accounts that received more than \$99,280 each year in annual revenue also had account information turned over to the IRS.<sup>154</sup> The annex to the UBS Agreement additionally required the disclosure of most undisclosed bank accounts that had assets exceeding approximately \$990,000 at any time between 2001 and 2008.<sup>155</sup> The annex also called for disclosures when a U.S. person, regardless of domicile, "beneficially owned 'offshore company accounts'" in use at any time between 2001 and 2008 if there is suspicion of "tax fraud or the like."<sup>156</sup> In a separate measure, the IRS initiated a voluntary disclosure program that allowed account holders with UBS and all other foreign financial institutions around the world to voluntarily come forward and admit that they were evading taxation.<sup>157</sup> If the taxpayer voluntarily disclosed their account

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<sup>152</sup> David S. Hilzenrath, *Swiss No Longer Shielding Biggest U.S. Tax Dodgers*, WASHINGTON POST, Nov. 18, 2009, available at <http://www.washingtonpost.com/wp-dyn/content/article/2009/11/17/AR2009111701240.html>.

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

<sup>155</sup> David D. Stewart, *IRS Releases UBS Agreement Criteria, Results of Voluntary Disclosure Initiative*, 2009 TAX NOTES TODAY 220-1 (Nov. 18, 2009).

<sup>156</sup> *Id.*

<sup>157</sup> Brian Wingfield, *IRS Sees Success in Anti-Evasion Campaign*, FORBES, Nov. 17, 2009, available at <http://www.forbes.com/2009/11/17/irs-amnesty-offshore-business-washington-tax.html>.

information before an investigation had already been started by the IRS, the taxpayer would still have to pay hefty fines, penalties, and back taxes, but jail time would most likely be avoided.<sup>158</sup>

Even though only approximately 4,450 accounts will be handed over by Switzerland in the near future under the UBS Agreement, the voluntary disclosure program had great success. While typically only 100 offshore account holders voluntarily disclose their account information through similar programs each year, more than 14,700 taxpayers with bank accounts in seventy countries voluntarily disclosed their account information by the program's October 15, 2009 deadline.<sup>159</sup> IRS Commissioner Douglas Shulman was quoted as saying, "We are talking about billions of dollars coming into the U.S. Treasury."<sup>160</sup> The UBS Agreement also allowed both countries to get what each wanted. The United States and the Treasury were able to increase its tax revenue immediately, while Switzerland was still able to keep most of its banking secrecy intact.<sup>161</sup> This compromise appears to be a good model for a potential compromise between the United States and Mexico in the near future.

Once again, however, this compromise is not as beneficial to both countries as may be anticipated. While this basic framework is a good start for the United States and Mexico, there are still some major issues that would need to be worked out. The criteria used to determine which accounts would be handed over to the IRS by UBS and the Swiss government should have never been released. While these criteria would not control in any potential resolution between the United States and Mexico, it would probably be the starting ground for the criteria used to determine which accounts would be handed over to the Mexican government by the United States. Now that the Swiss criteria particulars have been made public, wealthy Mexican residents with bank accounts in the United States have a general basis to determine how to structure their bank accounts going forward. Because of this criteria disclosure, a different formula will need to be used to determine which accounts would be handed over to the Mexican government. This leads to another problem with the UBS Agreement. After the dust settles from the UBS Agreement, U.S. account holders in Swiss banks with funds that exceed \$248,200 or annual revenues that exceed \$99,280 will move their funds elsewhere in fear of a similar request being made by the United States in the future. Even if Switzerland will no longer assist its banks' customers in evading taxes, some other country will. Mexico would run into the same problem of its residents moving their funds elsewhere if a resolution is reached with the United States.

The criteria used for the UBS Agreement also limited the number of potential accounts turned over to approximately 4,450 when the IRS initially sought

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<sup>158</sup> *Id.*

<sup>159</sup> Curt Anderson, *IRS settles with 14,700 over Foreign Accounts*, BREITBART, Nov. 17, 2009, available at [http://www.breitbart.com/article.php?id=D9C1BVAO0&show\\_article=1&catnum=0](http://www.breitbart.com/article.php?id=D9C1BVAO0&show_article=1&catnum=0).

<sup>160</sup> Hilzenrath, *supra* note 152.

<sup>161</sup> See generally Sami Hartsfield, *What are the Criteria by which UBS will Disclose Information on its U.S. Customers to the IRS?*, EXAMINER, Nov. 30, 2009, available at <http://www.examiner.com/tax-law-in-national/what-are-the-criteria-by-which-ubs-will-disclose-information-on-its-us-customers-to-the-irs>.

information from approximately 52,000 accounts held by U.S. residents in UBS financial institutions.<sup>162</sup> Criteria that limits the account information turnover rate to less than 10% of the number of potential tax evaders (4,450 / 52,000) is only a temporary solution to the problem. According to Senator Carl Levin of Michigan, “the tortured wording and the many limitations in [the compromise] shows the Swiss Government trying to preserve as much bank secrecy as it can for the future, while pushing to conceal the names of tens of thousands of suspected U.S. tax cheats.”<sup>163</sup> I imagine a compromise similar to the UBS Agreement would be equally disappointing for the Mexican government as they would be settling for whatever the United States would be willing to relinquish.

A perfect solution allows the Mexican government to increase its tax revenue, while not negatively affecting the U.S. banking sector. However, this perfect solution is probably not possible. The remainder of this Note will attempt to craft a solution that is beneficial to both the United States and Mexico.

#### V. THE ANSWER TO A UNITED STATES-MEXICO COMPROMISE

It is in the best interest of the United States to take positive steps towards complying with Mexico’s request to some extent. Given the extensive history between the two countries, the United States does not appear to have much choice. Ignore Mexico, and a dysfunctional relationship is sure to follow. However, the United States may not be able to avoid the strong opposition of its banking sector. Like it or not, the U.S. banking sector will have a strong influence on how the United States compromises with Mexico in the near future.

The first element that needs to be considered in crafting a viable solution is immediacy. The solution to this problem needs to have immediate effects for Mexico. Despite some minor setbacks caused by Switzerland’s Federal Administrative Court, the UBS Agreement was quite effective on this element. As mentioned earlier, over 14,700 taxpayers with bank accounts in 70 countries voluntarily disclosed their accounts during 2009 through the IRS’s voluntary disclosure program.<sup>164</sup> The number of voluntary disclosures through voluntary disclosure programs for noncompliant taxpayers was up significantly from the usual 100 taxpayers who disclose their foreign account information through the program on a yearly basis.<sup>165</sup> In conjunction with the additional billions of dollars that should be brought in as tax revenue, the IRS has now also been made aware of “a wide range of tax evaders and evasion methods”<sup>166</sup> due to these voluntary disclosures. “The program reached out to lots of different taxpayers with lots of different circumstances all around the globe,”<sup>167</sup> IRS Commissioner Douglas Shulman said. An increase in voluntary disclosures through a voluntary disclosure program and the

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<sup>162</sup> John R. Crook, *United States and Switzerland Agree on Access to Swiss Bank Information*, 103 AM. J. INT’L L. 748, 748 (2009).

<sup>163</sup> Hartsfield, *supra* note 161.

<sup>164</sup> Anderson, *supra* note 159.

<sup>165</sup> *See id.*

<sup>166</sup> Stewart, *supra* note 155.

<sup>167</sup> *Id.*

awareness of tax evaders and their methods of tax evasion is extremely beneficial in Mexico's continued effort against drugs and tax evasion.

The United States was also able to negotiate an accelerated time frame for requests to be honored by the Swiss government. Within sixty days of UBS receiving a request from the Swiss Federal Tax Administration (SFTA), UBS submitted the necessary account information to the SFTA on the first 500 cases submitted by the United States. The remaining cases will be submitted by UBS to the SFTA within 270 days of the initial request by the United States. While the January 2010 Swiss ruling has slowed down the accelerated time frame, this process is an effective manner to structure a compromise between the United States and Mexico around. A similar exchange of information mechanism, together with an initiative started by the Mexican government for voluntary disclosures through voluntary disclosure programs and any additional information obtained from the voluntary disclosures of the tax evaders themselves, are a sufficient starting ground for Mexico and its crackdown on drugs and tax evasion.

The second element that needs to be considered is the long-term effects of the potential compromise. While the UBS Agreement was a good short-term solution to the problem, minimal safeguards were put in place to deter future tax evasion by U.S. taxpayers in the future. According to the United States Department of Justice, "UBS has . . . agreed to expeditiously exit the business of providing banking services to United States clients with undeclared accounts."<sup>168</sup> While this is a victory for the United States, the long-term effects of the UBS Agreement end there.

Under Article I of the Agreement between the United States and the Swiss Confederation, the approximate number of accounts expected to fall under the United States's request is 4,450.<sup>169</sup> Even if, for argument's sake, this was believed to be sufficient account information being turned over to the United States, what about the rest of the estimated 52,000 accounts where account information is not being handed over? If UBS account holders were willing to take a risk by not voluntarily disclosing their account information and, on top of that, do not have their account information turned over to the U.S. government at all, the remaining thousands of undisclosed accounts appear to walk away clear of any harm for the time being. Also, there are thousands of other financial institutions all over the world. The account holders in these banks, who are evading taxes as well, do not suffer any consequences for their blatant tax evasion. While the threat of 4,450 account holders having their account information being handed over to the United States may have scared some into voluntarily disclosing their account information, those accounts make up only a small fraction of the bank account holders evading taxes on the national, or even global, level. More needs to be done in a compromise between the United States and Mexico to turn this one time request by Mexico into a regular exchange of information between the two neighboring countries. Until then, tax evasion will always be an ongoing issue between the United States and Mexico. While the United States and Mexico cannot end tax evasion entirely by themselves, a sound compromise between the two countries could go a long way in developing other similar compromises between countries all over the world.

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<sup>168</sup> Press Release, *supra* note 40.

<sup>169</sup> Crook, *supra* note 162.

On this front, one step that the United States has taken in the past is allowing the U.S. Treasury to take action against financial institutions or jurisdictions that pose tax evasion concerns, including preventing U.S. financial institutions from doing business with the offending bank or jurisdiction and essentially locking the offending bank or jurisdiction out of the U.S. financial system.<sup>170</sup> Similar action needs to be taken with any potential compromise with Mexico. Governments across the world need to band together against rogue banks that refuse to cooperate with the tax laws of the countries they are operating in.

Another possible long-term solution to Mexico's crackdown on tax evasion would be to amend the United States' tax treaty with Mexico. The U.S. and OECD Model Treaties do not allow either country involved to go "phishing" for information held by the other country.<sup>171</sup> The language in both model treaties requires a country to know who or what it is looking for in advance when requesting information.<sup>172</sup> This language obviously presents some problems. Amending this process, allowing for an automatic exchange of interest and bank account information, would be a more beneficial way of monitoring and preventing tax evasion on a long-term basis. Specific names would not be needed by the requesting governments, and information could automatically flow between the two countries based on criteria established during negotiations. A good example of this practice is the agreement already in place between the United States and Canada.<sup>173</sup>

The third element that needs to be considered in developing a solution to Mexico's request is the potential effect on the United States and Mexico in terms of trade. As mentioned before, the United States, Mexico, and Canada have an important trade agreement in place that affects approximately \$17 trillion in goods and services among the three countries.<sup>174</sup> Given the importance of this agreement, it would be in the best interest of the United States to reach an amicable agreement with Mexico, if only to protect the trade relationship of the United States with Mexico. The United States was able to negotiate with Switzerland to surrender similar information to the United States simply because of the importance of the United States to Switzerland and its economy. Switzerland had nothing else to gain from surrendering bank account information to the United States. If anything, Switzerland stands to lose significant tax revenue by divulging this information because clients are moving their funds outside of the country. The United States must be willing to do the same for Mexico, if only to protect itself and its trade relations.

## VI. CONCLUSION

In light of the UBS Agreement, it is in the best interest of the United States to comply with Mexico's request for information in a similar fashion. In the end, all countries involved will only have the interests of their citizens in mind when

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<sup>170</sup> Carl Levin, *Levin Urges Continued Fight Against Tax Havens*, 2009 TAX NOTES TODAY 179-45 (Sept. 16, 2009).

<sup>171</sup> See Goulder, *supra* note 8.

<sup>172</sup> *Id.*

<sup>173</sup> See *Final Regs.*, *supra* note 4.

<sup>174</sup> See Office of the United States Trade Representative, *supra* note 100.

negotiating a compromise. While it would be great if the entire world came together and unite as one to put an end to tax havens altogether, that is just not possible due to the amount of money involved. Mexico would benefit the most if the United States were to fully comply. This would give the Mexican government the information necessary to find and tax those who are evading taxes, especially those involved with drug cartels. However, full compliance would hurt the U.S. financial sector, as foreign investors would be likely to move their funds elsewhere. The United States would benefit the most if it were to ignore Mexico's request completely. United States banks and financial institutions would not have to fear investments and revenue leaving its system. The United States government would not have to expend the resources to initiate a new system of reporting this information to the IRS, and eventually, Mexico. However, non-compliance would be a last resort for the United States as it would have an extremely negative impact on its relationship with Mexico.

Therefore, the United States and Mexico need to reach a compromise that will benefit both countries. The United States will have to budge and give up some interest information through an exchange of information agreement, similar to the one reached between the United States and Switzerland. At the same time, Mexico cannot expect full compliance. There is no benefit for the United States in doing such. Like the United States did with Switzerland, Mexico needs to request full compliance but be content with whatever the United States is willing to share. However, there must be more of a long-term impact on the prevention of tax evasion between the United States and Mexico. A one-time exchange of information may be financially beneficial to both the United States and Mexico, but it does not solve the problem of tax evasion. Permanent automatic exchange of information is just one of the steps the United States needs to take if it hopes to continue its efforts on the worldwide fight against tax evasion.

In the end, the only benefits the United States may receive from any sort of compromise with Mexico is the concept of not disrupting its trade relationship with Mexico and starting the process of removing its "tax haven" status with the world. However, removing its "tax haven" status may not be as important as the negative financial implications that would occur in the end. It remains to be seen what the U.S. Treasury and Congress will do, but it is safe to say that full-compliance and non-compliance are not viable options for the United States going forward.