

MORE THAN JUST THE NUMBERS: THE LEGAL DILEMMAS AND ECONOMIC REPERCUSSIONS OF THE FATCA

BRIAN A. MOTTL*

I. Introduction.....	260
II. The Negative Effects FATCA Will Have on Circular Flow in the US Economy.....	262
III. Unemployment, deflation, and recession: The effects of implementing FATCA.....	263
IV. It Costs More To Implement FATCA Than the Estimated Revenue it Will Generate.....	265
V. Why the U.S. Federal Government is Willing to Implement FATCA: Businesses All Over the World Paying Most of the Costs.....	267
VI. FATCA Must Be Repealed Due to the Legal Implications it Brings.....	268
VII. FATCA Violates the Sovereignty of Other States.....	269
VIII. Strained Foreign Relations Will Be the Result of FATCA.....	271
IX. The Solution to the FATCA Dilemma.....	273
X. Conclusion.....	275

I. INTRODUCTION

David R. Kamerschen, Professor of Economics at the University of Georgia, wrote an article in an attempt to imitate the American tax system and the disproportionality of the tax bracket tiers. This depiction, known as Bar Stool Economics, tells the story of ten men that walk into a bar, and accumulate a tab of \$100.¹ The amount each person pays represents the percentage of taxes that a certain amount of the American population would pay. One hundred dollars represents all taxes paid, and each person equates to ten percent of the population. Four out of the ten men in the bar would pay nothing, \$0.00.² The fifth person would pay a whopping \$1.00.³ The sixth person would pay \$3.00 and the seventh would pay \$7.00.⁴ The eighth person would pay \$12.00 and the ninth \$18.00.⁵ That leaves the rest for the tenth person, the richest, who would have to cover the tab of \$59.00. These figures, while not exact due to the small amount of people used to make the analogy, are still accurate. The richest people will end up paying the majority of the nation's taxes, which drives them to acquire income from other places, thus creating foreign assets. In order to not have to pay another \$59.00 at another bar outing, these Americans maintain their money abroad. The combination of Americans taking their assets abroad and the \$100 budget not being enough to cover government expenses, results in the birth of the Foreign Account Tax Compliance Act (FATCA).

¹ See David R. Kamerschen, *Bar Stool Economics*, CAT-V, http://doc.cat-v.org/economics/bar_stool_economics (last visited Apr. 9, 2016).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

As the country was seeking to recover from a period of recession, the federal government naturally decided to seek new methods of increasing revenue, and this was one of them. In response to the 2008 Recession, Congress passed the Foreign Account Tax Compliance Act.⁶ The new law requires Foreign Financial Institutions (FFI) to report the foreign assets of American citizens, within after a certain dollar amount of income.⁷ FATCA requires US citizens who have foreign financial assets in excess of \$50,000 for bona fide residents overseas; \$200,000 for single filers and \$400,000 for joint filers, to report those assets every year on a new Form 8938 to be filed with the 1040 tax return Form.⁸ The Act also requires all FFIs to report all American assets to the IRS.⁹ Failure to report, empowers these institutions to charge up to thirty percent withholding penalty on their US investments.¹⁰ So far, approximately 77,000 foreign financial institutions have complied with the requirements of the Act, ensuring the US financial policing of American assets overseas.¹¹

However, this new piece of legislation has led to a parasitic relationship between the United States and foreign institutions, where the US benefits from the assets reported, and the foreign financial institutions are bullied into coping with the costs and burden of identifying American assets. Many financial institutions have stopped doing business with American citizens to avoid the hassle, and the number of renounced US citizenships has quadrupled since FATCA was enacted. This frustrating experience will produce considerable capital flight from United States, as evidenced by foreign companies unwilling to do business with Americans. Although some may say that FATCA is a positive law that will generate revenue, nevertheless, it should be repealed and replaced with a more cost effective auditing system, because of the effects on circular flow of money, cost outweighing benefit, and legal complications.

This work will analyze the repercussions of FATCA on circular flow of money in the economy, highlighting externalities such as unemployment, deflation, and recession. Then the cost-benefit analysis of implementing this law will be broken down. And lastly, this comment will analyze the legal implications associated with implementing FATCA, including the violation of sovereignty of states and strained foreign relations.

⁶ See I.R.C. §§ 1471-74 (2006 & Supp. V 2011).

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ See *Taxing America's Diaspora: FATCA's Flaws*, THE ECONOMIST (Jun. 28, 2014), <http://www.economist.com/news/leaders/21605907-americas-new-law-tax-compliance-heavy-handed-inequitable-and-hypocritical-fatcas-flaws>.

¹¹ *Id.*

II. THE NEGATIVE EFFECTS FATCA WILL HAVE ON CIRCULAR FLOW IN THE US ECONOMY

FATCA will negatively affect circular flow of money, and will pose repercussions related to unemployment, deflation, and recession. Circular flow of money in the economy details the interaction of liquid money between three types of entities: households, firms, and the government. As depicted in Figure 1 below, money flows in all directions, and not just in a circular manner. The term circular is a general description of how the money flows, but is not exact.¹²

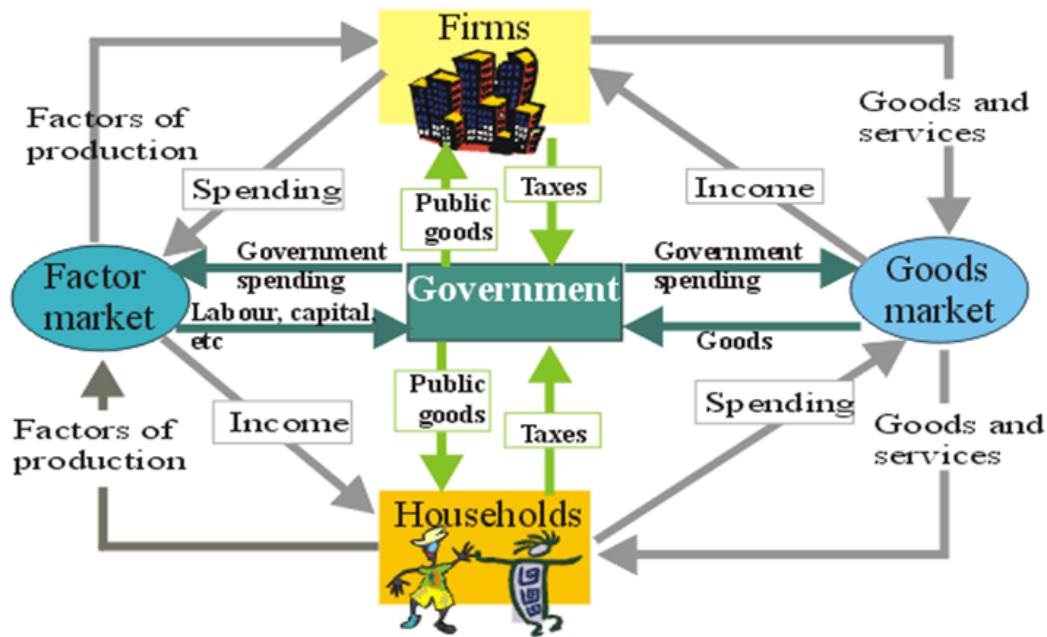


Figure 1

First, Figure 1 present households, which have money flowing in two directions, to businesses and to the government. Next, the government takes its share through taxes. The leftover monies are the households' net wages, or disposable income. The disposable income is then spent by the households on a variety of goods and services, from shampoo and soap, to obtaining an oil change for their vehicle. This is how money flows from households to firms.¹³

Firms or businesses, obtain money in form of revenue from what households spend in the market. They dish this money out to two entities, the government in the form of corporate taxes and back to the individuals, in the form of income or wages for their work in a firm as an employee.¹⁴ Lastly there is the government, who in the chart, is in the middle, the self-imposed player if you will. The government takes taxes from both households and firms, to provide public goods in exchange.¹⁵

¹² See *Knowledge Granules for Economics*, UNIVERSITY OF SOUTH AFRICA http://www.econom.co.za/econres/kn_ecs2602/c.html (last visited on Apr. 9, 2016).

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

In applying FATCA to the circular flow model, notice that all the arrows are currently approximately the same widths. FATCA would essentially engorge the arrows of money flowing from firms and households to the federal government. Since money does not appear out of thin air (unless the government wants to print it and cause hyperinflation), the money must be taken from the gross income and revenue that firms and households have, thus leaving less disposable income, which is what makes circular flow and economic well-being possible. If before the government was taking \$30 out of every \$100; now they are taking \$40, leaving \$10 less in disposable income than before.

III. UNEMPLOYMENT, DEFLATION, AND RECESSION: THE EFFECTS OF IMPLEMENTING FATCA.

FATCA has and will cause unemployment to rise in the future. This is where the real problems begin to sink in, taking the circular flow model and analyzing what this means for day to day Americans. Between 2006 and 2008, unemployment fluctuation started at 4.7% and ended at 7.3% in 2008.¹⁶ By the time FATCA was passed in 2010, the unemployment rate was at 9.9% at the peak, with a steady incline in the following year as well.¹⁷

Although the full implementation of the law did not take place until 2014, the mere expectation of it began to cause effects. The importance of expectations is due to their often substantial impact on the current choices of business and households, and hence on current prices and the overall level of economic activity.¹⁸ Despite the unemployment rate quelling during 2014, we can expect another rise in the decades to come because of FATCA full effects. Less disposable income means households will have less money to spend on goods and services, meaning shrinkage in the goods market (imagine if that blue bubble shrunk in half). This leads to the arrow of money or income going to firms to thin, drastically.

The effects on unemployment lead to a down spiral cycle of negative economic effects. Less money going to business means that firms will have less money to spend into the factor market. The factor market is partially composed of employees. Now since firm A is only receiving 90% of what it is used to, it has to cut spending. This is done by cutting the number of employees it hires, and thus, ensuring the skyrocketing of unemployment; reflecting that tax policies can affect the inflows to the duration of unemployment spells.¹⁹ This is what FATCA will contribute to, in a time where adding to the unemployment rate is the last thing anyone would want to do. It leads to a down spiral trend of unemployed people without money to put in the goods market, and firms receiving even less money. Meanwhile the unemployed are seeking more public goods, when the

¹⁶ See United States Department of Labor, *Labor Force Statistics from the Current Population Survey* (Apr. 9, 2016), <http://data.bls.gov/timeseries/LNS14000000>.

¹⁷ *Id.*

¹⁸ See *Economics of Expectations*, UNIVERSITY OF OREGON, at 5060 (last visited on Apr. 9, 2016) <http://pages.uoregon.edu/gevans/isb304053.pdf>.

¹⁹ See Richard Disney, *The Impact of Tax and Welfare Policies on Employment and Unemployment in OECD Countries*, INTERNATIONAL MONETARY FUND, at 5 (2000).

government will eventually, if not already, begin to receive less money since people are unemployed.²⁰ When there is less to tax, there is less revenue.

The government in response takes initiatives such as FATCA, to attempt to combat this trend. However, FATCA does the opposite. Veronique De Rugy of the Mercatus Center at George Mason University testified before the Senate stating that fiscal adjustments and economic growth are not incompatible.²¹ While fiscal adjustments may not always trigger immediate economic growth, spending-based adjustments are much less costly in terms of output than tax-based ones.²² In fact, when governments try to reduce their debt by raising taxes, the policy is more likely to result in deep and pronounced recessions, possibly making the fiscal adjustment counterproductive.²³

Another negative externality from FATCA is deflation, which is a contributing factor to the down spiral effect on circular flow. Picture Figure 1, with needle thin arrows and penny sized bubbles. Monetarists claim that a decrease in the money supply or in the velocity of circulation causes deflation.²⁴ The smaller arrows represent this decrease in the money supply. The decrease occurs at the point where the government takes more money in taxes from individuals, businesses or both. FATCA will cause this not just from a taxing perspective, but from the penalty of freezing 30 % of FFIs' US investments.²⁵ In essence, it will forcefully decrease the money supply as punishment for non-compliance with FATCA. This is a direct cause of deflation, which means that there will be a decrease in the price of goods. This equates to a shortage of goods for sale, since they are cheaper now. Demand increases without supply increasing as well.

Through the above effects, FATCA is likely to end in causing a recession. The most famous example of the results of a vicious deflation cycle is the Great Depression.²⁶ The globalization of emerging economies in conjunction with innovation in information technology and transportation is the major underlying force that is affecting world economic events today.²⁷ Technology and globalization have allowed for a far reaching law like FATCA to develop, which affects the economy negatively. This is how the US will keep FFIs accountable for reporting US foreign assets, and thus being able to hold and freeze thirty percent of US investments. In holding these investments, undoubtedly it will have a direct effect on the US activities of these companies. A cause of the most recent

²⁰ See Bernhard Heitger, *The Impact of Taxation on Unemployment in OECD Countries*, 22.2 CATO JOURNAL 333, 342 (2002).

²¹ *The Effect of Tax Increases and Budget Cuts on Economic Growth: Testimony Before the Senate Budget Comm*, 113th Cong. 2 (2013) (testimony of Veronique De Rugy, Senior Research Fellow, Mercatus Center, George Mason University).

²² *Id.*

²³ *Id.*

²⁴ See Tejvan Pettinger, *Causes of Deflation*, ECONOMICSHELP, (2013). <http://www.economicshelp.org/blog/8968/uncategorized/cause-deflation/>.

²⁵ See I.R.C. §§ 1471-74 (2006 & Supp. V 2011).

²⁶ See *Effects of Deflation*, ECONOMYWATCH, (2010). <http://www.economywatch.com/inflation/deflation/effects.html>.

²⁷ See Ravi Jagannathan, Mudit Kapoor, et. al., *Causes of the Great Recession of 2007-9: The Financial Crisis is the Symptom Not the Disease*, National Bureau of Economic Research, at 3 (2009).

2008 Recession was an increase in unemployment and a distortion in the labor supply.²⁸ Coupled with deflation and other contributing factors, the recession that the United States is finally beginning to recover from came about. Distortions to the labor market are responsible for 100% of the rise in the unemployment rate since 2007.²⁹ As described above, in Figure 1, FATCA will further distort the labor market due to it impacting the factors market. This could very much lead to another recession within the next decade. The previous 2001 Recession showed the highest distortions to the labor market along with the 2008 Recession.³⁰ If this pattern continues, there is a great potential for a Recession of 2015 to develop. There was a seven year gap between the first two recession of the 21st century, and next year will be seven years from the greatest economic downturn since the Great Depression. FATCA poses a negative effect on circular flow of money in the U.S. with an increase in unemployment, deflation, and the likelihood of recession as negative externalities of this.

IV. IT COSTS MORE TO IMPLEMENT FATCA THAN THE ESTIMATED REVENUE IT WILL GENERATE

FATCA should be repealed because it does not pass a cost-benefit analysis. Cost-benefit analysis is a useful tool in decision making when it comes to implementing a new government programs.³¹ The formula is to calculate the net benefit you have after incurring costs.³² In order to do this, you take in the total benefit and subtract the total costs of the program (FATCA in this instance), to see how effective the program will be.³³ If you receive a negative number, than it is costing you more to implement the program than the benefit received, and thus a waste of resources and time. Negative impacts of a program are treated as costs and added to actual budgetary outlays in assessing the overall costs of a program, whereas positive impacts are counted as benefits.³⁴ This means that the effects analyzed in the first part of the argument above would be added on to the monetary costs of implementing the law. However, that will not be necessary. As analyzed below, the numbers alone do not lie, and prove that FATCA is a waste of government resources.

The Association of Certified Financial Crime Specialists estimate FATCA will bring in approximately \$800 million in revenue per year.³⁵ IRS estimates have predicted a steady yearly intake and have stretched this estimate to stay the

²⁸ See Casey Mulligan, *What Cause the Recession of 2008? Hints from Labor Productivity*, NATIONAL BUREAU OF ECONOMIC RESEARCH, at 7 (2009).

²⁹ *Id.* at 8.

³⁰ *Id.* at 7.

³¹ See Stephanie Riegg Cellini & James Edwin Kee, *Cost-Effectiveness and Cost-Benefit Analysis*, HANDBOOK OF PRACTICAL PROGRAM EVALUATION, at 493 (2010).

³² *Id.* at 494.

³³ *Id.*

³⁴ *Id.* at 494.

³⁵ See Brian Kindle, *FATCA May Identify Tax Cheats, But Its Dragnet For Financial Criminals May Produce an Even Bigger Yield*, ASSOCIATION OF CERTIFIED FINANCIAL CRIME SPECIALISTS, (2012). <http://www.acfcs.org/fatca-may-identify-tax-cheats-but-its-drag-net-for-financial-criminals-may-produce-an-even-bigger-yield>.

same for the next ten years, totaling \$8 billion for the next decade.³⁶ Therefore, if we were doing a purely budgetary cost-benefit analysis on FATCA over the next ten years, we would say that the total benefit (revenue generated) will be \$8 billion.

FFIs may face steep costs for FATCA compliance.³⁷ It is estimated that as many as 200,000 foreign institutions would fall under FATCA's purview, including banks, broker-dealers, and investment firms.³⁸ Estimates of costs are mainly due to compliance, through analyzing and sifting through huge amounts of customer data, and creating new systems to handle pass-through payments. Costs start at hundreds of millions of dollars, going up to \$10 billion.³⁹

The European Commission estimates it will cost European banks alone \$100 million in order to comply with FATCA.⁴⁰ Pending final IRS rules remain unchanged, KPMG estimates the cost of compliance for foreign institutions will far outweigh any tax revenue the IRS may collect.⁴¹ The Congressional Research Services estimates that FATCA will bring \$8.7 billion in revenue over the next decade.⁴² This revenue is low compared to a total cost of \$40 billion in offshore tax evasion.⁴³

This places the highest estimate of revenue at \$8.7 billion over the next decade with the highest cost of implementation at more than four times that amount. In order to get the most accurate estimate, the average should be used to run the cost-benefit analysis for FATCA. The results in an average revenue of \$8.9 billion and the average figure for cost of implementation at \$10 billion. Using the formula, *Net Benefit* equal to *Total Benefit* minus *Total Cost*,⁴⁴ FATCA has -\$1.1 billion in Net Benefit. This is not taking into account other projected effects such as capital flight, which is a different cost on its own.

The American equity and bond markets are the largest in the world.⁴⁵ Most foreign fund managers have to automatically register with the IRS to report assets that FATCA requires.⁴⁶ This means that managers could ask clients to keep certain assets in different shares for compliance purposes.⁴⁷ However, it could lead many fund managers to avoid Americans investments completely.⁴⁸ They are frightened of even accidentally not complying with FATCA and facing a holding of a hefty 30% of American investments. This is another incurred cost that goes beyond budgetary cost-benefit analysis that impacts the economy on detrimental levels.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² See Jane G. Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, CONGRESSIONAL RESEARCH SERVICE, at 36 (2013).

⁴³ *Id.*

⁴⁴ Cellini & Kee, *supra* note 34, at 494.

⁴⁵ See *Scratched by the FATCA*, THE ECONOMIST (2011), <http://www.economist.com/node/215402>

70.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

V. **WHY THE U.S. FEDERAL GOVERNMENT IS WILLING TO IMPLEMENT FATCA:
BUSINESSES ALL OVER THE WORLD PAYING MOST OF THE COSTS**

The reason the U.S. government is adamant in implementing FATCA is because the brunt of the monetary costs will be paid by financial institutions. Compliance by financial institutions alone is estimated to be \$8 billion per year.⁴⁹ This is more than ten times the projected revenue to be brought by FATCA.⁵⁰ Even with the most realistic estimates, at the very least it will be \$100 million per institution.⁵¹ And if this is not enough, even the lowest estimates predict that at the very least it will cost FFIs the same amount of money to implement FATCA as the amount of money it will bring in.⁵² In the UK, it is estimated that for the first five years alone the costs of implementing FATCA will be £1.1 billion to £2 billion,⁵³ or \$1.7 billion to \$3.16 billion. After those years, there will be an annual cost of £50 million to £90 million,⁵⁴ or \$79 million to \$142.2 million.

The Financial Post labels FATCA as electronic spying.⁵⁵ In Canada, for example, supposedly one of our biggest allies, it seems that FATCA has cost Scotia Bank of Canada \$100 million alone, before the full implementation has taken place.⁵⁶ Just seeing how much FATCA has cost businesses in countries before the full implementation is astounding. This is multiplied by the majority of States in the world, since there are American assets everywhere. So far, approximately 77,000 financial institutions have registered with the IRS to report American assets.⁵⁷ Most reports seem to approximate the initial cost per financial institution to be \$100 million, as noted in the example of Scotia Bank of Canada.⁵⁸ Multiplying this number by \$100 million will result in more money than FATCA will bring in for the next century. That would equal \$3.8 trillion in costs. This is why the U.S. government is willing to go along with FATCA, since the majority of the costs will not come from the government, but rather the private sector, and because the U.S. government is the only entity gaining profit. There is not much data out on how much the IRS will put into implementing FATCA, however it will not cost more than the amount the private sector will pay, as seen in the above examples.

The next section will explore the legal controversies involving FATCA. This encompasses a variety of effects on international law and foreign relations.

⁴⁹ See Robert Wood, *FATCA Carries Fat Price Tag*, FORBES, (2011). <http://www.forbes.com/sites/robertwood/2011/11/30/fatca-carries-fat-price-tag/>.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ Herbert Smith Freehills, *The Cost of Complying with FATCA – Similar Initiatives to Follow?* LEXOLOGY, (2013). <http://www.lexology.com/library/detail.aspx?g=a74e2969-7fe3-4931-999b-7caaf60c5588>.

⁵⁴ *Id.*

⁵⁵ John Greenwood, *Electronic Spying 'A Big Issue' For Banks*, FINANCIALPOST, (2013). <http://business.financialpost.com/2013/10/23/electronic-spying-a-big-issue-for-banks-scotia-ceo-waugh-says/>

⁵⁶ *Id.*

⁵⁷ *FATCA's Flaws*, *supra* note 10.

⁵⁸ Greenwood, *supra* note 55.

VI. FATCA MUST BE REPEALED DUE TO THE LEGAL IMPLICATIONS IT BRINGS

FATCA must be repealed because it violates international law. Article 2 of the United Nations Charter states that, “Member [states] shall refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any state.”⁵⁹ Clearly this says force, and not only military force.⁶⁰ Members are also required to abide by these principles in order to maintain international peace.⁶¹

In this instance, the force that is being threatened is through the use of soft power.⁶² This refers to power and leverage that is used that non-military, such as resources, and in this case, money. Hard power refers to military strength. The world is turning into using soft as opposed to hard power,⁶³ because it is cheaper, and instead of requiring physical action, usually means engaging in inaction, such as a trade embargo. World politics in the modern age has been undergoing changes that have elevated the importance of soft power relative to hard power.⁶⁴ This new global environment and modern technology have paved the way for this trend.⁶⁵ Nations are increasingly seeking to maximize their soft power.⁶⁶ This term can be used to describe their ability to achieve their international objectives through attraction and co-option rather than coercion,⁶⁷ in an effort to promote cultural understanding and avoid cultural misunderstanding.⁶⁸ This has also led to increased difficulty in successfully using hard power against nations and non-state actors.⁶⁹

Conveniently so, the Foreign Financial Institutions that FATCA is attempting to force to comply with reporting fall under this group of non-state actors. The international community as seen above in the UN Charter condemns the use of force.⁷⁰ A more efficient method of bypassing this and accomplishing the same end is through using soft power. FATCA’s soft power lies in the 30% withholding of US assets on FFIs if they fail to comply with reporting requirements to the IRS.⁷¹ Even though it affects only FFIs and not countries directly, the overreaching power of FATCA is so strong that States have begun to express their dissatisfaction towards FATCA, and this has strained foreign relations for the United States and will continue to do so.

⁵⁹ U.N. Charter art. 2.4.; see also Charter of the United Nations, UNITED NATIONS., <http://www.un.org/en/documents/charter/chapter1.html> (last visited Oct. 9, 2014).

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² See Giulio M. Gallarotti, *Soft Power: What it is, Why it's Important, and the Conditions Under Which it Can Be Effectively Used*, 4 J. POL. POWER 25, 30 (2011), available at http://works.bepress.com/giulio_gallarotti/3.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ See British Council, *Influence and Attraction Culture and the Race for Soft Power in the 21st Century*, BRITISH COUNCIL, (2010), <http://www.britishcouncil.org/sites/britishcouncil.uk2/files/influence-and-attraction-report.pdf>.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ Gallarotti, *supra* note 62.

⁷⁰ U.N. Charter, *supra* note 59.

⁷¹ *FATCA's Flaws*, *supra* note 10.

VII. FATCA VIOLATES THE SOVEREIGNTY OF OTHER STATES

The overreaching powers of FATCA affect other States' financial systems to the extent that their sovereignty is violated. So far 77,000 FFIs have complied with FATCA.⁷² There are 195 sovereign states in the world.⁷³ If the 77,000 registered FFIs were split evenly, that would result in an average of 394 institutions per state. At this rate and with the costs of compliance so high, \$100 million per institution,⁷⁴ the average cost to a state is \$39 billion. This is the point where the non-state actors being affected begin to affect the State itself. The same effects on U.S. circular flow will be mimicked at this rate in other countries. It may not seem so, however, other countries' economies are not as massive as the one of the United States. This cost would rock an economy such as The Bahamas, (a big destination for U.S. foreign assets) which has an \$8.4 billion economy.⁷⁵ Another country that is an even bigger destination for American foreign assets is Switzerland, with a \$650 billion economy.⁷⁶ Even a modern country such as Switzerland could not ignore such a high fraction of its economy dominated by FATCA. And this is where the violation of a state's sovereignty begins, when there is either a physical or economic invasion, which FATCA brings.

Political sovereignty is the ultimate overseer or authority in decision-making within the state.⁷⁷ Often traditionally, this also deals with the person responsible for maintenance of order.⁷⁸ This traditional definition over time has been correlated to also signify independence.⁷⁹ That is, a state having the ultimate say within its clearly defined border. By the end of World War II, the principle of popular sovereignty was firmly rooted as a fundamental postulate.⁸⁰ It also signified political legitimacy.⁸¹ The United Nations Charter tells of developing friendly relations between States based on respect for equal right and self-determination of peoples.⁸² The manner in which FATCA invades the foreign economic systems of various States, as exemplified above, threatens this notion of sovereignty. Not only because it interferes with the operation of firms, but also because it forces these States to be negatively impacted by FATCA, a statute which was voted in to law in the United States Congress.⁸³ Given this modern day definition of sovereignty, it is permissible to conclude that altering a fraction

⁷² *Id.*

⁷³ See Bureau Of Intelligence and Research, *Independent States in the World*, U.S. DEPARTMENT OF STATE, (2014), <http://www.state.gov/s/inr/fls/4250.htm>.

⁷⁴ Wood, *supra* note 49.

⁷⁵ *Report for Selected Countries and Subjects*, INTERNATIONAL MONETARY FUND (2013), <http://www.imf.org/external/pubs/ft/weo/2014/02/weodata/weorept.aspx?sy=2013&ey=2013&scsm=1&ssd=1&sort=country>.

⁷⁶ *Id.*

⁷⁷ See *Sovereignty* in ENCYCLOPEDIA BRITANNICA, <http://www.britannica.com/EBchecked/topic/557065/sovereignty> (last visited on Mar. 3, 2016).

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ See W. Michael Reisman, *Sovereignty and Human Rights in Contemporary International Law*, 84 AM. J. INT'L L. 866, 867 (1990).

⁸¹ *Id.*

⁸² *Id.*

⁸³ See I.R.C. §§ 1471-74 (2006 & Supp. V 2011).

of a nation's economy, especially in the financial sector itself, is a clear violation of the political sovereignty of a State.

Most examples where soft power is used effectively are when it is used to help people, as in the majority of modern day examples. These do not constitute violations because they are a desired assistance with a positive effect on the state's populous. One example of successful soft power is the ability of the European Union (EU) to attract new members.⁸⁴ The EU's success generates among non-member states the desire to participate in the project of European integration.⁸⁵ This desire to join the EU fosters peace and safety among European states.⁸⁶ It will lead to the enlargement of the EU and a strengthening of its position on a global level.⁸⁷ The soft power is derived in this instance from the EU's readiness to offer a seat at the decision making table.⁸⁸ In other words, demand to join the EU is high, which makes this a positive and successful use of soft power, and not a violation of sovereignty.

A negative example of soft power and one more in line with what FATCA imposes is the Chinese manipulation of the Yuan. In early 2014, it was reported that the Central Bank of China had engineered the depreciation of the Yuan,⁸⁹ in order to prepare the currency for wider trading.⁹⁰ This action shows financial reforms that include a more-freely-traded currency.⁹¹ The goal is for the Yuan to one day rival the US Dollar as the de facto global currency.⁹² A market driven Yuan would make China less dependent on investment and exports and more reliant on domestic consumption. Additionally, a freer Yuan could give Chinese consumers flexibility in terms of spending and investments.⁹³

Members of Congress have accused China of currency manipulation and have stated that it causes a strain on U.S. exports and a loss of American jobs.⁹⁴ China manipulates its currency to whatever is most convenient at the time. Maintaining a currency artificially low allows for an increase in a country's exports. This is due to this causing other currencies to appreciate relative to the yuan, in this instance. When other currencies appreciate, goods in China are much cheaper, and therefore an increase in exports is the result. Now that the world economy is improving, some are resuming a call for China to allow the yuan to gain strength,⁹⁵ making Chinese exports more expensive, allowing for other nations to better compete.⁹⁶ This would occur if China were to stop

⁸⁴ See Jan-Philipp N. E. Wagner, *The Effectiveness of Soft & Hard Power in Contemporary International Relations, E-International Relations* (2014), <http://www.e-ir.info/2014/05/14/the-effectiveness-of-soft-hard-power-in-contemporary-international-relations/>.

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ See Lingling Wei, *China Intervenes to Lower Yuan*, THE WALL STREET JOURNAL, (2014), <http://online.wsj.com/news/articles/SB10001424052702304071004579406810684766716>.

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ See Forbes, *The Costs of China's Currency Policy*, FORBES, (2010), <http://www.forbes.com/2010/01/21/china-currency-policy-entrepreneurs-finance-wharton.html>.

⁹⁶ *Id.*

depreciating their currency on purpose, and allow the international market to act freely. As long as it is generating the profit it seeks however, this action will most likely never stop.

Generally, when an economy weakens its currency tends to weaken as well.⁹⁷ That makes for cheaper goods for foreigners, stimulating exports and allowing for recovery.⁹⁸ As an economy strengthens, the currency tends to get stronger, helping to prevent overheating.⁹⁹ What China has done however, is once it's economy became strong, it maintained the Yuan at a level lower than it should be, keeping Chinese exports high. These actions are a blatant disregard of the effects to other countries, such as the United States. This also takes away from exports that may need to be carried out by weak economies. It will slow down their recovery process.

Similarly, FATCA seeks to interfere with large fractions of states' economies with a blatant disregard to costs, as long as the IRS can generate more revenue. Compared to the two examples above, FATCA is much more like the Chinese manipulation of the Yuan, than the EU. This is a law that will affect circular flow and affect the different sectors of the economy in the majority of countries in the world. The same costs are applied in all states affected. There is one international market, and all economies may not function the same way, but they do react the same way. Just like the depreciation of the yuan costs American jobs and interferes with exports,¹⁰⁰ FATCA deeply interferes with other states' economies and presents a clear violation of international laws of popular sovereignty, per modern day definitions of ultimate overseer¹⁰¹ and of self-determination.¹⁰² The United States government cannot negatively affect other countries in the way that China has affected it. It is hypocritical and in violation of international laws of sovereignty.

Over 100 submissions has been presented by organizations, businesses, and political entities worldwide condemning FATCA.¹⁰³ There is a recurring theme in these submissions,¹⁰⁴ disenchantment and disagreement with this attempt to unilaterally impose extraterritorial observance and enforcement of U.S. laws.¹⁰⁵ This seems to closely parallel U.S. reactions to the artificial depreciation of the Yuan.

VIII. STRAINED FOREIGN RELATIONS WILL BE THE RESULT OF FATCA

FATCA will result in strained foreign relations for the United States because of the legal implications discussed above. The Canadian government stated

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ Wei, *supra* note 89.

¹⁰¹ ENCYCLOPEDIA BRITANNICA, *supra* note 80.

¹⁰² Reisman, *supra* note 80, at 867.

¹⁰³ See ACA, *Why FATCA Is Bad for America and Why It Should Be Repealed*, AMERICAN CITIZENS ABROAD. <http://americansabroad.org/issues/fatca/fatca-is-bad-for-america-why-it-should-be-repealed> (last visited Sept. 15, 2014).

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

FATCA's far reach and extraterritoriality.¹⁰⁶ The government said that this would make Canadian banks extensions of the IRS and jeopardize Canadians' privacy rights.¹⁰⁷ If one of our closest allies is feeling violated, then one cannot help but think of what other countries around the world must have to say about FATCA costing them not only millions of dollars, but their sovereignty and freedom to engage in business freely. It is not just the position of this article that this law is overreaching. The Economist labeled FATCA "Stunning, even by Washington's standards."¹⁰⁸ The word *even* is evidence that the United States is known for overreaching it's boundaries. Canada and many other countries would have to change their privacy laws in order to comply with FATCA.¹⁰⁹ This is a source of bad will for the United States.¹¹⁰ The Canadian Bankers Association's president even stated that FATCA takes an end-run around the Canada Revenue Agency.¹¹¹ He also stated that it coerces financial institutions into reporting to the IRS.¹¹² Just as there is ill will towards China about their currency manipulation, there will be negative reactions towards the U.S. due to FATCA. This is similar to what occurred in Canada. Unfortunately what makes this worse is that Canada is our biggest trading partner.¹¹³ The United States sends \$292.9 billion in exports.¹¹⁴ The United States receives and even greater sum of imports from Canada, totaling to \$324.2 billion.¹¹⁵ This is a total of \$616.7 billion, almost \$100 billion more than the second biggest trading partner, China.¹¹⁶

China and other pacific countries have negatively reacted towards FATCA as well. China is our second largest trading partner.¹¹⁷ The United States exports a total of \$110.6 billion,¹¹⁸ and receive a total of \$425 billion.¹¹⁹ Although we receive more imports from China, the total trade is only at \$536 billion.¹²⁰ This is further evidence that there is currency manipulation, since their total number of exports is so high. Another contributing factor is their cheap labor market, which is an externality of currency manipulation. However, our second biggest trading link is also reacting negatively to FATCA. The U.S. government will never get every nation to join FATCA.¹²¹ Speaking of the Asia-Pacific countries, they are all heavily influence by Beijing.¹²² Currently none of the Asian-Pacific countries

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ See *FATCA's Flaws*, *supra* note 10.

¹⁰⁹ *ACA*, *supra* note 106.

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ See U.S. Census Bureau, *Top Trading Partners*, CENSUS, (2012), <http://www.census.gov/foreign-trade/statistics/highlights/top/top1212yr.html#2012>.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ See U.S. Census Bureau, *Top Trading Partners*, CENSUS, (2012), <http://www.census.gov/foreign-trade/statistics/highlights/top/top1212yr.html#2012>.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ See Jon Matonis, *FATCA is Far from a Done Deal*, AMERICANBANKER.COM, (2013), <http://www.americanbanker.com/bankthink/fatca-is-far-from-a-done-deal-1057947-1.html>.

¹²² *Id.*

are signed up.¹²³ Japan will most likely be the first.¹²⁴ However, without countries such as Singapore, China, Hong Kong, and Macau, FATCA faces real challenges.¹²⁵ These countries are not on the list of countries that the U.S. Treasury claims to be in negotiations with concerning FATCA.¹²⁶ There will be so few U.S. citizens and residents holding bank accounts in China, that the cost will far outweigh the benefit in China.¹²⁷ In short, no Asian country has registered to comply with FATCA, and the U.S. wants a country that manipulates its currency to sign up to comply with a law that costs them more to implement than any benefit it will receive. The chances of any Asian country other than Japan signing up, are very slim. It will be interesting to see if anything changes, however, given that no one has signed up, the most probably outcome is that these states will most likely continue to ignore FATCA. This interferes with U.S. legitimacy, if states are not willing to listen to the United States. However, when one does not play their power cards right, especially in this clear attempt to coerce through soft power, this can be the result.

This law not only poses economic implications around the world and fails to meet a basic budgetary cost-benefit analysis, but it also is a violation of international law, causing a strain in foreign relations. This one law has and will continue to pose these negative effects, unless it is repealed completely. The next part of this piece will focus on proposed solutions for FATCA, as well as what the author of this analysis poses as the most appropriate solution.

IX. THE SOLUTION TO THE FATCA DILEMMA

There are many different angles through which FATCA has been analyzed, with different solutions proposed. This comment poses the following as potential solutions, with the first being the preferred one:

1. A full repealing of the Foreign Account Tax Compliance Act. There are too many negative externalities of the law to offer a potential amendment to fix the issues analyzed above.
2. A replacement of FATCA with a randomized auditing system where the IRS picks out potential individuals who may be off shoring assets for purposes of tax evasion.

The first proposal is the best one in order to correct all the wrongs that FATCA has brought. The second proposal would work as well since it would help avoid tax evasion, and also meet the requirements of cost-benefit analysis. This would not include a reporting requirement for FFIs.

Some scholars such as Antoine Thibault from Columbia University claim that FATCA will cause the United States to return to its imperialist nature.¹²⁸ He focuses on the historical aspect of political power and believes the U.S. would

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ See Matonis, *supra* note 123.

¹²⁸ See Antoine de Thibault, *FATCA or How a US Initiative Will Transform the World*, 3 COLUM. J. TAX LAW 27 (2012).

regress into the era prior to the twentieth century.¹²⁹ This comment however focuses on the economic and legal implications, and believes the historical context is not as vital in considering FATCA. This is because this is an unprecedented law never seen before imperialism America is something prior to modern technology and globalization. Others state that certain elements of the law and need fixing.¹³⁰ These elements are connected to capital market transactions.¹³¹ While this is an important element to focus on, the effects on capital market transactions come after the effects on circular flow and other aspects discusses above. This is an after effect, and due to the other negative economic effects discusses above, the entire law needs to be repealed.

One scholar focuses on FATCA being the solution to the problem of efficiently reporting tax evasion.¹³² They state that FATCA allows for information to be shared automatically.¹³³ This is opposed to having to share information upon requests.¹³⁴ This article focuses more on the enforcement and efficiency aspect of gathering information.¹³⁵ However, an automatic sharing of information does not outweigh all of the economic and legal consequences of FATCA. Clearly this focus was on maximizing efficiency in data reporting. Another legal journal proposes either an international U.S. tax based system, or a residence tax based system.¹³⁶ An international U.S. tax system would push the effects of FATCA even further. Reporting would still have to be required, and strains on economies of the world would still be an issue. This article also tells of citizenship incentives,¹³⁷ which as noted above, are at record breaking numbers since prior to 2008.¹³⁸

The Columbia Business Journal focuses on data retrieval methods by the U.S. government.¹³⁹ The U.S. government is using Tax Information Exchange Agreements (TIEAs) in order to attain information on U.S. assets.¹⁴⁰ The article concludes by stating that data gathering is not only difficult, but likely to be inaccurate.¹⁴¹ This will make executing FATCA difficult.¹⁴² Another argument states that yes there is a problem of tax evasion.¹⁴³ There are some issue with

¹²⁹ *Id.*

¹³⁰ See Noam Noked, *Impact of the FATCA Proposed Regulations on Capital Markets Transactions*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE AND FINANCIAL REGULATION, (2012). <http://blogs.law.harvard.edu/corpgov/tag/fatca/>.

¹³¹ *Id.*

¹³² See Joshua Blank & Ruth Mason, *Exporting FATCA* (2014). NEW YORK UNIVERSITY LAW AND ECONOMICS WORKING PAPERS, Paper 370.

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ See Richard Harvey, Jr., *Worldwide Taxation of United States Citizens Living Abroad - Impact of FATCA and Two Proposals*, 4 GEO. MASON J. INT'L COM. L. 319 (2013).

¹³⁷ *Id.*

¹³⁸ Bachmann, *supra* note 2.

¹³⁹ See Olga Basko, *FATCA: Taxes Just Got More Complicated*, 2014 COLUMBIA BUS. L. REV., (2014).

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ See Frederic Behrens, *Using a Sledgehammer to Crack a Nut: Why FATCA Will Not Stand*, 2013 WIS. L. REV. 205 (2013).

corporate tax payers.¹⁴⁴ However, FATCA is too big a solution for such a small problem.¹⁴⁵ It is taking a “sledgehammer” when one is not needed.¹⁴⁶

Another publication *focuses* on the burden to tax payers overseas.¹⁴⁷ The complications of FATCA will deter FFIs from doing business with American citizens.¹⁴⁸ There are issues addresses by this work that tell of the complications with self-reporting and third party reporting.¹⁴⁹ If a third party reporter’s numbers are different than the self-reported figures, then how does one determine which one is accurate? This article focuses a lot on the problems with enforcement of the Act.¹⁵⁰ Itai Grinberg from Georgetown Law writes that there is a difficulty in constraining residents from evading tax liability.¹⁵¹ And that it does not matter for these purposes whether the earned income was domestic or abroad.¹⁵² However, the author is of the idea that a remedy would be a uniform multilateral information exchange system.¹⁵³ This would improve the ability to tax offshore accounts.¹⁵⁴

The majority of these articles are focusing on improving the efficiency of implementing FATCA. Few, however focus on the damages that FATCA will cause, and that is why my propositions are best. I am not looking to repeal parts of the law or amend the execution of it, but rather propose a repeal of FATCA because it will cause to much damage. The law in its entirety causes so much damage that there is no hope in salvaging it. This is why at the very least the U.S. government should replace it with a randomized simple auditing system, in order to enforce tax liability but not increase compliance costs.

X. CONCLUSION

FATCA must be repealed or at least replaced with a more cost effective system, such as a randomized auditing process for offshore assets. This law is set to target the top 1% of Americans, who pay one third of the nation’s taxes.¹⁵⁵ The top 5% pay half.¹⁵⁶ Due to the minimum dollar amount required to be reported, \$50,000, it is clear that FATCA is meant to target the wealthier American population, who pay the majority of the U.S. income taxes.¹⁵⁷ This drain on the wealthiest Americans will cause the number of renounced citizenships to skyrocket, as discussed above. This trend will continue, and will be added on top of the negative effects of FATCA, such as deterring American investments

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ See Joanna Heiberg, *FATCA: Toward a Multilateral Automatic Information Reporting Regime*, 69 WASH. LEE L. REV. (2012).

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ See Itai Grinberg, *Taxing Capital Income in Emerging Countries: Will FATCA Open the Door?* 5 GEO. WORLD TAX J. 325 (2013).

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Supra* note 1.

¹⁵⁶ *Id.*

¹⁵⁷ See I.R.C. §§ 1471-74 (2006 & Supp. V 2011).

overseas.¹⁵⁸ Despite the argument that FATCA generates revenue for the U.S. in a time of need, due to the economic, cost-effective, and legal implications, FATCA requires repealing. There is more than just the numbers to look at, and this is shown by all the impact this law has cause before it's full implementation.

¹⁵⁸ Heiberg, *supra* note 149.