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THE CURE CAUSES NEW SYMPTOMS: CAPITAL CONTROL EFFECTS OF TAX ENFORCEMENT, GOLD REGULATION, AND RETIREMENT REFORM

*Beckett G. Cantley**

INTRODUCTION

For the last five years, the United States government has devoted significant attention and resources to how U.S. taxpayers are investing their money with special focus on offshore investments, gold, and retirement savings. In 2006, Congress held hearings and issued a report¹ on the offshore banking activities of U.S. taxpayers that led U.S. Senator Carl Levin to state that the “universe of offshore tax cheating has become so large that no one, not even the United States government, could go after all of it.”² The hearings and report began a flurry of activity by the United States government intended to crack down on the use of offshore bank accounts by U.S. citizens. This included forcing a major Swiss bank to break Swiss law by breaching the confidentiality of its clients by providing information to U.S.

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¹ STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY (Subcomm. Print Aug. 1, 2006) (prepared by Chairman Norm Coleman & Ranking Minority Member Carl Levin), <http://levin.senate.gov/newsroom/supporting/2006/PSI.taxhavenabuses.080106.pdf>; see also Press Release from Carl Levin, U.S. Sen., *Permanent Subcommittee on Investigations Issues Report On Offshore Tax Haven Abuses That Cost U.S. Taxpayers Over \$40 Billion Each Year* (August 1, 2006), <http://levin.senate.gov/newsroom/release.cfm?id=260030> (publicizing the purpose of the upcoming Senate Permanent Subcommittee on Investigations hearing).

² David Cay Johnston, *Tax Cheats Called Out of Control*, N.Y. TIMES, Aug. 1, 2006, <http://www.nytimes.com/2006/08/01/business/01tax.html>.

authorities.³ In addition to cracking down on offshore tax cheats, Congress passed the Hiring Incentives to Restore Employment (HIRE) Act,⁴ which created a tougher regulatory environment for foreign financial institutions with bank or investment accounts for U.S. taxpayers.⁵ The HIRE Act regime may result in foreign banking institutions collecting taxes directly from their U.S. clients and remitting them to the U.S. Treasury.⁶ Increased attention, regulation, and high profile criminal prosecution activity⁷ provides a huge deterrent to U.S. taxpayers with investments outside the United States to maintain their foreign investments offshore. Increased pressure and regulation is also making offshore financial institutions question their business relationships with U.S. taxpayers and weigh the risk and rewards of continuing these relationships.

In addition to these offshore measures, in 2008, Congress broadened its focus on U.S. investors to include their domestic

³ See I.R.S. News Release IR-2009-75, *IRS to Receive Unprecedented Amount of Information in UBS Agreement* (Aug 19, 2009), available at <http://www.irs.gov/newsroom/article/0,,id=212124,00.html>; David Voreacos and Carlyn Kolker, *U.S. Wants UBS to Break Swiss Law By Naming Clients, Bank Says*, BLOOMBERG (Feb. 21, 2009, 12:01 AM), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a46w1V8SdXG>
⁴ See also Barbara T. Kaplan, *Offshore Accounts: Too Late to Fess Up?*, FORBES.COM (Jan. 29, 2010, 4:55 PM), <http://www.forbes.com/2010/01/29/irs-ubs-swiss-offshore-amnesty-personal-finance-voluntary-disclosure.html>; Kevin McCoy, *IRS: Offshore Tax Crackdown Should Produce 'Billions,'* USA TODAY (Nov. 18, 2009, 12:42 AM), http://www.usatoday.com/money/perfi/taxes/2009-11-17-offshore-tax-evaders-irs_N.htm. See generally *U.S. v. UBS AG*, No. 09-20423-CIV, 2009 WL 2241122 (S.D. Fla. July 7, 2009) (denying UBS's motion to compel disclosure of the number of accounts targeted by a John Doe Summons, in which the U.S. seeks to compel production of records regarding taxpayers who had accounts managed by UBS from 2002 to 2007 for which UBS did not have Forms W-9 and did not file Forms 1099 naming such U.S. taxpayers and such payments made to those taxpayers).

⁴ Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010) (providing a tougher regulatory environment for foreign financial institutions by requiring such institutions to comply with numerous reporting and disclosure requirements).

⁵ See *id.* § 1472(a-d).

⁶ See *id.*

⁷ See generally *U.S. v. UBS AG*, No. 09-20423-CIV, 2009 WL 2241122 (S.D. Fla. July 7, 2009); U.S. Dep't of Justice News Release 09-136, *UBS Enters into Deferred Prosecution Agreement* (Feb. 18, 2009), available at www.usdoj.gov/opa/pr/2009/February/09-tax-136.html.

decisions as well.⁸ Congress enacted legislation which, in 2012, will require all businesses to issue an IRS Form 1099 to any individual or corporation from which they buy goods or services in excess of \$600 in a tax year.⁹ This change implicates gold companies, which are thus required to report extensive information to the IRS for each sale of gold in excess of 0.43 ounces based on prices as of December 1, 2010.¹⁰ In addition to the reporting requirement, Congress also recently passed legislation requiring gold companies to report if certain countries are the source of the gold they sell to U.S. citizens, whether onshore or offshore.¹¹ Further, the Dodd-Frank Act restricts U.S. gold dealers from contracting with certain countries that supply gold to the market.¹² These regulatory regimes will likely reduce the number of gold dealers and significantly increase the compliance costs for remaining gold dealers. These increased compliance costs will be passed on to gold investors and generally make it more expensive for U.S. taxpayers to invest in gold. Consequently, the net result is that increased gold regulation will likely result in an increased cost of investing in gold, and thus U.S. investors are more likely to avoid gold and seek alternative investments.

In 2008, Congress also began examining retirement investment vehicles. One proposal under consideration, the Guaranteed Retirement Account ("GRA"), calls for a "\$600 refundable tax credit, which takes the place of tax breaks for 401(k)s and similar individual accounts" as a way of paying for a partially government-funded, broad-based, government-managed retirement account system.¹³ The Social

⁸ See, e.g., Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9006, 124 Stat. 119, 855 (2010) ("[F]or purposes of this section the term 'person' includes any corporation that is not an organization exempt from tax under section 501(a).").

⁹ See § 9006, 124 Stat. at 855 (amending section 6041 of the Internal Revenue Code); see also Neil deMause, *Health Care Law's Massive, Hidden Tax Change*, CNNMONEY.COM (May 5, 2010, 11:00 PM), http://money.cnn.com/2010/05/05/smallbusiness/1099_health_care_tax_change/.

¹⁰ See, e.g., Matt Whittaker, *Gold Edges Up to \$1387.30*, WALL ST. J. (December 1, 2010, 4:54 PM), <http://online.wsj.com/article/SB10001424052748704594804575648412929325780.html>.

¹¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1502, 124 Stat. 1376, 2213 (2010).

¹² *Id.*

¹³ Teresa Ghilarducci, *Guaranteed Retirement Accounts: Toward Retirement Income Security*, ECON. POLICY INST. (Nov. 2007), http://www.law.harvard.edu/programs/lwp/Guaranteed_Retirement_Accountsnovember.pdf; see also *The*

Security Administration would administer the GRAs in addition to existing Social Security benefits.¹⁴ Without a tax incentive, 401(k) plans would likely cease to exist, making Social Security and GRAs the principal retirement investment vehicles for many Americans. However, Congressional borrowing from the Social Security Trust Fund for non-Social Security spending¹⁵ has resulted in a Treasury debt to the Trust Fund in excess of \$2.6 billion.¹⁶ Implementation of GRAs would provide the federal government with an entirely new source of capital to raid to meet current spending needs. In essence, taxpayers would be nudged out of Section 401(k) plans and into a government-held and government-managed retirement system that the Treasury could borrow against.

While each of the policies discussed above individually has a direct, laudable public protection purpose, the cumulative effect of these activities makes it more likely that U.S. investors are discouraged from investing in non-preferred locations, like offshore; asset classes, like gold; and vehicles, like Section 401(k) plans. Instead, these policies direct U.S. investors to preferred *domestic* locations; preferred asset classes, like U.S. Treasury bonds; and preferred investment vehicles, like GRAs. These measures comprise a network of capital controls that use regulation, incentives, taxes, and the threat of civil and/or criminal penalties to incentivize taxpayers into directing their investments where the U.S. government has more disclosure, control, and access to the capital. It is impossible to know whether the current

Impact of the Financial Crisis on Workers' Retirement Security: Hearing Before the Comm. on Educ. & Labor, 110th Cong. 38 (2008) [hereinafter *Hearing on Workers' Retirement Security*] (statement of Teresa Ghilarducci, Irene and Bernard L. Schwartz Professor of Econ. Policy Analysis, The New Sch. for Soc. Research, Dep't of Econ), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_house_hearings&docid=f:44713.pdf.

¹⁴ *Hearing on Workers' Retirement Security*, *supra* note 13, at 32.

¹⁵ According to the Social Security Administration, the government borrows current cash flows in place of special issue securities for future obligations. OFFICE OF THE CHIEF ACTUARY, SOC. SEC. ADMIN., TRUST FUND DATA: TRUST FUND FAQs (Aug. 5, 2010) [hereinafter TRUST FUND FAQs], <http://www.ssa.gov/OACT/ProgData/fundFAQ.html>; see also, Jeanne Sahadi, *Social Security Looms for Next President*, CNNMONEY.COM (Mar. 27, 2008 3:17 PM), http://money.cnn.com/2008/03/25/news/economy/socsec_candidates_trustees/.

¹⁶ OFFICE OF THE CHIEF ACTUARY, SOC. SEC. ADMIN., TRUST FUND DATA: INVESTMENT HOLDINGS (Feb. 13, 2011), <http://www.socialsecurity.gov/cgi-bin/investheld.cgi>.

U.S. budget and debt crises are driving these actions.¹⁷ However, it is possible that these policies are driven by the government's need of access to capital, particularly in light of the government's willingness to step on the toes of sovereign governments and historic allies, such as Switzerland.

Regardless of whether this capital control effect is intended, these policies make investing offshore more burdensome, make investing in gold more expensive and propose a radical shift in capital flow from private retirement accounts into a government-controlled retirement system at a time when the U.S. government is running a huge deficit. This paper discusses the concepts of international and domestic capital control, the current actions of the government referenced above, and the capital control effect of these government actions.

I. CAPITAL CONTROLS

A. DEFINING CAPITAL CONTROL

Capital controls are laws or regulations designed to impede the movement or exchange of capital (often in the form of currency) across national borders.¹⁸ Nations develop capital control regimes for several

¹⁷ Former senator Alan Simpson and former White House Chief of Staff Erskine Bowles were appointed to co-chair the National Commission on Fiscal Responsibility and Reform in February 2010. In commenting on the current fiscal state, Senator Simpson and Bowles respectively said, "[w]e find ourselves in a difficult fiscal situation that is unsustainable," and "[t]his debt is like a cancer." Press Release, White House Office of the Press Secretary, President Obama Establishes Bipartisan National Commission on Fiscal Responsibility and Reform (Feb. 18, 2010), <http://www.whitehouse.gov/the-press-office/president-obama-establishes-bipartisan-national-commission-fiscal-responsibility-an>; Balz, Dan, *Obama's Debt Commission Warns of Fiscal 'Cancer'*, WASH. POST (July 12, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/07/11/AR2010071101956.html>.

¹⁸ Currency control comes in a variety of forms, including restrictions on an individual's or business entity's ability to either possess foreign currency or have access to currency abroad. See Robert L. Maines, *The Interest Equalization Tax*, 17 STAN. L. REV. 711, 721-22 (1965) (discussing the interest equalization tax's ability to equalize "the cost of foreign borrowing in the United States with costs in foreign capital markets"); James Cooper, *Spirits in the Material World: A Post-Modern Approach to United States Trade Policy*, 14 AM. U. INT'L. L. REV. 957, 1021-23 (1999) ("It is well known that erecting

different reasons, including the protection of domestic investment in its economy.¹⁹ Governments engage in currency control through regulation of capitalization requirements, limitation of the amount of foreign exchange, or taxation of certain cash flows.²⁰ Governments do this primarily to protect the local balance of payments or promote exports of businesses that cannot otherwise compete on the international market.²¹ Capital constantly moves from country to country, converting from one country's currency to another.²² These movements consist of capital entering a country, "inflows," and leaving a country, "outflows."²³ This paper is specifically focused on capital outflow controls.

B. CONTROLLING INTERNATIONAL CAPITAL OUTFLOW

In the international context, the term "capital outflow" refers to the net amount of capital that flows out of a country.²⁴ The net amount is determined by subtracting the amount of foreign assets purchased with domestic capital from the amount of domestic assets purchased

barriers to the free flow of goods and services across national borders undermines the division of labor and standards of living by impeding the adjustment of the capital stock to its most productive uses.").

¹⁹ See Daniel Griswold, *Protectionism No Fix for China's Currency*, CATO INST. (Jun. 25, 2005), http://www.cato.org/pub_display.php?pub_id=3946.

²⁰ See Mary E. Footer, *GATT and the Multilateral Regulation of Banking Services*, 27 INT'L LAW. 343, 362-63 (1993); Raj Bhala, *Virtues, Chinese Yuan, and the American Empire*, 38 HONG KONG L.J. 183, 203 (2008); Am. Bar Ass'n, *International Legal Developments in Review: 2007, Regional and Comparative Law: Russia and Ukraine*, 42 INT'L LAW. 1083, 1090 (2008).

²¹ See Chantal Thomas, *Balance-of-Payment Crises in the Developing World: Balancing Trade, Finance and Development in the New Economic Order*, 15 AM. U. INT'L L. REV. 1249 (2000); Chris Brown, *China's GATT Bid: Why All the Fuss About Currency Controls?*, 3 PAC. RIM L. & POL'Y J. 57, 63 (1994).

²² At the heart of currency control is the regulation of a currency's convertibility. Since the flow of capital is often a taxable event, the existence of external convertibility is an important consideration for foreign firms intending to invest in a local economy in order to repatriate profits. See Stephen J. McGarry, *Pathfinder for Doing Business Abroad*, 522 INT'L LAW. 483, 506 (1988).

²³ James Oliver, *What are Capital Controls?*, THE UNIV. OF IOWA CTR. FOR INT'L FIN. & DEV., http://www.uiowa.edu/iframebook/faq/faq_docs/capital_controls.shtml.

²⁴ N. GREGORY MANKIW, *PRINCIPLES OF ECONOMICS* 696 (1st ed. 1997).

with foreign capital.²⁵ The difference is the capital outflow.²⁶ Capital outflows are “negative” when the foreign purchasing of domestic assets is higher than the domestic purchase of foreign assets.²⁷ Capital outflows are “positive” when the domestic purchasing of foreign assets is higher than the foreign purchase of domestic assets.²⁸

There are several ways that a country can prevent positive capital outflow. Capital control methodologies vary in degree of severity. Some methods involve strict rules about capital movement, including but not limited to: placing severe regulations on financial institutions to limit capital outflow from domestic institutions to offshore institutions, limiting the types of transactions where capital can be removed from the country, or devaluing currencies in order to limit capital flight and promote exports.²⁹ Governments adopting strict rules aspire to limit transactions in order to prohibit positive capital outflow. For example, China has employed strict capital controls allegedly in order to manipulate its currency and create negative capital outflow.³⁰ Less

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ See Carlos F. Liard-Muriente, *Capital Controls: Theory and Practice*, 1 J. BUS. & PUB. AFF. (2007), available at <http://www.scientificjournals.org/journals2007/articles/1011.htm>; see also, Mamiko Yokoi-Arai, *Regional Financial Institutionalization and the Creation of a Zone of Law: The Context of Financial Stability/Regulation in East Asia*, 35 INT'L LAW. 1627, 1644 (2001).

³⁰ China's manipulation of the exchange rate for its currency, the Renminbi (“RMB”), limits the transfer of RMB out of China. See, e.g., Belinda Cao, *China Will Expand Cross-Border Yuan Settlement, Offshore Usage*, PBOC Says, BLOOMBERG (Sep. 17, 2010, 12:34 AM), <http://www.bloomberg.com/news/2010-09-17/china-will-expand-cross-border-yuan-settlement-offshore-usage-pboc-says.html>; Andrew Batson, *China Says It Will Increase Yuan's Flexibility*, WALL ST. J. (Jun. 20, 2010, 1:19 AM), <http://online.wsj.com/article/SB10001424052748704365204575316382930451658.html>. The RMB of China, is not freely traded, but is instead subject to a managed floating exchange-rate regime. See UPDATE: PBOC Yi: Current FX Regime ‘Best Choice’ for China – State Media, WALL ST. J. (Feb. 13, 2011, 7:34 PM), <http://online.wsj.com/article/BT-CO-20110213-704194.html>. Only members of the foreign exchange market may trade the RMB and membership is limited to a select number of authorized foreign exchange banks and financial institutions. The member banks must trade the RMB within a small band around the announced exchange rates. See Bryan Mercurio & Celine Sze Ning Leung, *Is China a ‘Currency Manipulator’?: The Legitimacy of China's*

strict capital outflow controls can take the form of inducements or penalties that encourage investors to keep their capital in country.

1. INDUCEMENTS

Inducements may include more advantageous tax or regulatory treatment for domestic investments. For example, the United States offers tax credits to investors investing in domestic alternative energy enterprises. Since tax credits reduce the actual amount of taxes paid, a tax credit for domestic research is a very valuable incentive for U.S. taxpayers to fund domestic alternative energy investments.

Additionally, the U.S. currently offers several inducements to incentivize and encourage home ownership. First, a federal deduction for interest paid on loans secured by a qualified home.³¹ This valuable deduction has been available to homeowners since Congress enacted federal income tax in 1913 and is allowable on first homes, second homes, or equity loans or lines of credit used to substantially improve your home.³² The home mortgage interest deduction has effectively operated as a valuable inducement since the home mortgage deduction was saved in 1986 when the U.S. eliminated personal interest

Exchange Regime under the Current International Legal Framework, 43 INT'L LAW. 1257, 1262-3 (2009). In addition to exchange rate controls, China strictly regulates the ability all individuals and businesses within China to price or settle accounts in a foreign currency, except in Hong Kong and Macao. China also regulates foreign exchange earnings by mandating any income from a China-based organization be remitted back into China and deposited in an authorized foreign exchange bank. These authorized foreign exchange banks also are prohibited from making unauthorized deposits of foreign exchange outside Chinese territory. See Regulations of the People's Republic of China on Foreign Exchange Control (promulgated by Order No. 211, 1997 of the State Council, effective Jan. 14, 1997), http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=73096 (China); Chris Brown, *China's GATT Bid: Why All the Fuss About Currency Controls*, 3 PAC. RIM L. & POL'Y J. 57, 61-62 (1994).

³¹ A qualified home under IRS regulation is a house, cooperative, condominium, mobile home, boat, house trailer or similar property, which has sleeping, cooking, and toilet facilities. I.R.S., Dept. of the Treasury, Publication 936, *Home Mortgage Interest Deduction* (Nov. 10, 2010), available at <http://www.irs.gov/pub/irs-pdf/p936.pdf>.

³² U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-769, HOME MORTGAGE INTEREST DEDUCTION: DESPITE CHALLENGES PRESENTED BY COMPLEX TAX RULES, IRS COULD ENHANCE ENFORCEMENT AND GUIDANCE (JULY 2009), available at <http://www.gao.gov/new.items/d09769.pdf>.

deductions.³³ Secondly, the federal government offered an \$8,000 homebuyer tax credit for first time home purchasers under the American Recovery and Reinvestment Act of 2009.³⁴ Historically, the use of tax deductions and credits has been an effective means for the federal government to use fiscal policy to induce Americans into the types of investments the government values.

2. PENALTIES

Penalties can include higher costs or taxes imposed on foreign investments.³⁵ For example, taxing domestic taxpayers who invest in foreign assets deters the taxpayer from making the investment unless the investment's profit, less the taxes, exceeds the expected return of an investment not subject to the same capital control tax regime. The Federal Transfer Tax is an example of this type of capital control penalty. The Federal Excise Tax is often triggered by sending capital into an offshore insurance policy.³⁶ However, a transfer of the same capital to a domestic insurance policy would not trigger any Federal Excise Tax.³⁷ This government-created tax acts as a penalty and discourages the company from sending the capital outside the United States.

Additionally, the recently enacted³⁸ Hiring Incentives to Restore Employment (HIRE) Act is funded in part by its incorporation of the Foreign Account Tax Compliance Act ("FATCA") and the FATCA's

³³ *Id.*

³⁴ I.R.S., DEPT. OF THE TREASURY, THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009: INFORMATION CENTER (July 6, 2010), <http://www.irs.gov/newsroom/article/0,,id=204335,00.html>.

³⁵ One method of controlling capital outflow is by taxing the capital as it leaves the country ("Exit Tax"). For example, Malaysia and the Philippines impose "Departure Taxes" to individuals before being allowed to leave the country. See Yokoi-Aria, *supra*, note 29.

³⁶ I.R.S., DEPT. OF THE TREASURY, FOREIGN INSURANCE EXCISE TAX – AUDIT TECHNIQUE GUIDE (Jan. 28, 2011), <http://www.irs.gov/businesses/small/article/0,,id=186963,00.html> (discussing how tax rates are dependent on the structure of captive insurance policy).

³⁷ See generally Donald Arthur Winslow, *Tax Avoidance and the Definition of Insurance: The Continuing Examination of Captive Insurance Companies*, 40 CASE W. RES. L. REV. 79, 112 (1990).

³⁸ The Hire Act was signed into law on March 18, 2010. See CCH Tax Briefing: 2010 Hiring Incentives to Restore Employment Act, CCH (March 18, 2010), <http://tax.cchgroup.com/legislation/Hire-Act.pdf>.

series of reporting and disclosure requirements with significant penalties for non-compliance.³⁹ The FATCA mandates significant disclosures to the U.S. Treasury Department by foreign entities receiving U.S. taxpayers' investment funds.⁴⁰ The increased cost of the mandated disclosures will likely have one of two effects: (1) the foreign entity may enter into an agreement with the IRS to follow IRS procedures and guidelines that prohibit the foreign entity from maintaining any U.S. investment, or (2) the foreign entity may pass along the costs of the mandated disclosures to U.S. investors.⁴¹ Thus, the regulation is an example of a penalty that is directly intended to raise U.S. revenue and domestic investment because it adversely affects foreign investment through both a reduction in the available market of potential foreign investment (for those foreign entities who elect to enter into an agreement with the IRS as provided for in the FATCA) or an increase in the cost of foreign investment.

3. THE U.S. GOAL OF CAPITAL OUTFLOW CONTROL: INCREASING GOVERNMENT ACCESS TO DOMESTIC CAPITAL

The United States budget deficits and national debt are currently larger than anytime in history.⁴² In order to sustain current levels of government spending, the U.S. government must find additional sources of capital to borrow against. The United States may acquire the needed funds by increasing tax receipts (derived from income generated by U.S. taxpayers' investment of domestic capital) or by borrowing. Increasing tax receipts is done most easily by ensuring it is invested domestically where the IRS more easily monitor and collect taxes from its earnings. Borrowing against domestic capital is also a potential source of revenue. The U.S. Social Security Trust Fund has been a consistent source of revenue funding deficit spending.⁴³ Before

³⁹ Jeffrey R. Davine & Wayne R. Strasbaugh, *FATCA, HIRE Act Hold Ramifications for Foreign Investment in U.S.*, BNA TAX & ACCOUNTING (April 20, 2010), <http://www.bnatax.com/insightsdetail.aspx?id=2147484779>.

⁴⁰ FATCA requires disclosure of U.S. investment accounts that are prospectively valued at \$50,000 at any point during the year. *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴² See generally Andrew Woellner, *Spending on an Empty Wallet: A Critique of Tax Expenditures and the Current Fiscal Policy*, 7 HOUS. BUS. & TAX L.J. 201 (2006).

⁴³ According to the Social Security Administration, the government borrows current cash flows in place of special issues for future obligations. See OFFICE OF THE CHIEF ACTUARY, *supra* note 15; Sahadi, *supra* note 15.

the U.S. government can borrow against domestic capital, it must ensure that the U.S. economy in general has negative capital outflow relative to possible international investments.

C. U.S. INTERNAL DOMESTIC CAPITAL CONTROL

1. DEFINING INTERNAL DOMESTIC CAPITAL CONTROL

Once the government has implemented capital outflow controls to attempt to keep domestic capital in the country, the government may then make inducements, set up a penalty regime, or create restrictions that are likely to lead the domestic capital to be invested in a manner that provides increased government revenue opportunities.⁴⁴ In theory, the U.S. government has two normative approaches to choose from when adopting internal domestic capital controls: strict or less strict. The theoretical strict approach could include absolute bans on domestic investment overseas, mandatory currency conversion from the Dollar to foreign currencies, or both. The theoretical less-strict view incentivizes taxpayers away from private investment into government investment assets like Treasury bonds. This approach is also described as a “government asset preference” form of internal domestic capital control.

While the government asset preference form of capital control is potentially a preference between two domestic asset classes (private sector investments versus government issued debt and other government-preferred investments), it is very similar to an “outflow” capital control. This type of control substitutes the investment in government issued debt (and other government-preferred investments) for the term “domestic investment” and the non-preferred investment (foreign or domestic private sector investments) for the term “foreign investment.” The government is using its regulatory and taxing power to require and influence taxpayers to invest their capital in government-preferred destinations. If the government can make use of domestic tax resources by means of these devices, then it has shown a historical willingness to do so.⁴⁵

⁴⁴ Ethan Kaplan & Dani Rodrik, *Did the Malaysian Capital Controls Work?* 8 (NBER Working Paper No. W8142, 2001), available at <http://www.hks.harvard.edu/fs/drodrik/Research%20papers/Malaysia%20controls.PDF>.

⁴⁵ See, e.g., I.R.S., Dept. of the Treasury, Publication 15, (*Circular E*), *Employer's Tax Guide* (Dec. 29, 2010), available at <http://www.irs.gov/pub/>

2. THE U.S. GOAL: TURNING CAPITAL OUTFLOW INTO GOVERNMENT TAX RECEIPTS & BORROWING SOURCES

The large U.S. budget deficits⁴⁶ and national debt⁴⁷ requires the government to maximize access to capital and increase revenue opportunities targeting this capital or borrow from it as the government has done with Social Security.⁴⁸ The principal reason for using domestic capital controls to drive assets into government investments is to obtain access to U.S. taxpayer investments in order to sustain government solvency. The U.S. government clearly needs additional sources of capital in whatever form it can be obtained. However, to reach the goal of increasing government access to capital, the government must first keep U.S. domestic capital from going overseas—which is a likely byproduct of the deterrent effect on U.S. taxpayers created by the IRS attack on offshore accounts.

II. THE IRS OFFSHORE TAX ENFORCEMENT CRACKDOWN

A. THE OPENING SHOT: THE PSI HEARINGS

On August 1, 2006, the United States Senate's Permanent Subcommittee on Investigations (PSI)⁴⁹ began hearings on the depth

irs-pdf/p15.pdf; U.S. DEPT. OF THE TREASURY, RESOURCE CENTER: HISTORY OF THE U.S. TAX SYSTEM (Dec. 5, 2010), <http://www.treasury.gov/resource-center/faqs/Taxes/Pages/historyrooseveltmessage.aspx>.

⁴⁶ See CONG. BUDGET OFFICE, *Monthly Budget Review: Fiscal Year 2010* (November 5, 2010), available at <http://www.cbo.gov/ftpdocs/118xx/doc11873/NovemberMBR.pdf> (“The federal government recorded a total budget deficit of \$1.4 trillion in fiscal year 2010, \$122 billion less than the deficit incurred in 2009.”); Woellner, *supra* note 42, at 7.

⁴⁷ Michael D. Tanner, *The Deficit is a Symptom, Spending is the Disease*, NAT'L REVIEW ONLINE (Aug. 25, 2010, 4:00 AM), <http://www.nationalreview.com/articles/244616/deficit-symptom-spending-disease-michael-tanner> (projecting the U.S. national debt in excess of \$13.4 Trillion).

⁴⁸ The U.S. takes taxpayer dollars flowing into the Social Security Trust Fund and invests it into U.S. back securities (short and long term indebtedness known as “special issues” available only to the Social Security Trust Fund) and spends the borrowed cash. See OFFICE OF THE CHIEF ACTUARY, *supra* note 15; Sahadi, *supra* note 15.

⁴⁹ The PSI is a branch of the Committee on Homeland Security and Governmental Affairs. See SENATE COMMITTEE ON HOMELAND SECURITY &

and scope of Americans use of unreported foreign bank accounts. U.S. Senator Carl Levin (D-MI) brought the matter before the subcommittee.⁵⁰ The Subcommittee's report effectively fired the first shot in the coming U.S. attack on the use of unreported offshore accounts by U.S. citizens.

In conjunction with the hearings, PSI released a report on their findings ("2006 PSI Report").⁵¹ The 2006 PSI Report and a subsequent report entitled *Tax Haven Banks and U.S. Tax Compliance* ("2008 PSI Report")⁵² provided extensive information and statistics evidencing the magnitude of offshore banking by U.S. taxpayers.⁵³ The PSI reports described in detail several high-level tax schemes, where American taxpayers have used "billing schemes, management consultant agreements, and intermediary corporations . . . to distance themselves from the [offshore] entities and obscure the links between them."⁵⁴ The

GOVERNMENTAL AFFAIRS, <http://hsgac.senate.gov/public/index.cfm?FuseAction=Subcommittees.Home> (last visited Mar. 7, 2011).

⁵⁰ Press Release from Carl Levin, U.S. Sen., *Statement of Senator Carl Levin on Introducing the Stop Tax Haven Abuse Act, Part I* (Mar. 2, 2009), <http://levin.senate.gov/newsroom/release.cfm?id=308945> (publicizing the purpose of the Stop Tax Haven Abuse Act).

⁵¹ See STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY (Subcomm. Print Aug. 1, 2006) (prepared by Chairman Norm Coleman & Ranking Minority Member Carl Levin), <http://levin.senate.gov/newsroom/supporting/2006/PSI.taxhavenabuses.080106.pdf> (released in conjunction with the Permanent Subcommittee on Investigations Aug. 1, 2006 Hearing).

⁵² See STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE (Subcomm. Print July 17, 2008) (prepared by Chairman Carl Levin & Ranking Minority Member Norm Coleman), http://hsgac.senate.gov/public/_files/071708PSIReport.pdf (released in conjunction with Permanent Subcommittee on Investigations July 17, 2008 Hearing).

⁵³ STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY (Subcomm. Print Aug. 1, 2006) (prepared by Chairman Norm Coleman & Ranking Minority Member Carl Levin), <http://levin.senate.gov/newsroom/supporting/2006/PSI.taxhavenabuses.080106.pdf>; STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE (Subcomm. Print July 17, 2008) (prepared by Chairman Carl Levin & Ranking Minority Member Norm Coleman), http://hsgac.senate.gov/public/_files/071708PSIReport.pdf.

⁵⁴ STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY 29 (Subcomm. Print Aug. 1, 2006) (prepared by Chairman Norm Coleman &

2006 PSI Report concluded that the extent of the offshore tax fraud is so severe that law enforcement is unable to competently control it.⁵⁵ Switzerland and Lichtenstein were the primary offshore jurisdictions targeted by the PSI and the IRS in response to international tax scandals that revealed a large number of U.S. taxpayers taking advantage of the strict bank secrecy laws in those jurisdictions.⁵⁶

B. INCREASING U.S. TAX REVENUE BY HIGHER TAX COMPLIANCE

Historically, IRS found it difficult to uncover and prosecute offshore tax evasion because the criminal transactions are very complex particularly due to the multiplicity and sophistication of relationships between tax-shelter entities.⁵⁷ Additionally, these transactions take place in non-transparent offshore jurisdictions where the U.S. lacks authority to obtain necessary information.⁵⁸ The offshore schemes targeted by the PSI reduce tax revenue by as much as \$300 million.⁵⁹

Ranking Minority Member Carl Levin), <http://levin.senate.gov/newsroom/supporting/2006/PSI.taxhavenabuses.080106.pdf>.

⁵⁵ *Id.* at 11-16.

⁵⁶ STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 2 (Subcomm. Print July 17, 2008) (prepared by Chairman Carl Levin & Ranking Minority Member Norm Coleman), http://hsgac.senate.gov/public/_files/071708PSIReport.pdf.

⁵⁷ *Tax Compliance – Offshore Financial Activity Creates Enforcement Issues for the IRS: Hearing Before the S. Comm. on Fin.*, 111th Cong. (2009) [hereinafter *Hearings on Enforcement Issues*] (statement of Michael Brostek, Director of Strategic Issues Team), in U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-478T (Mar. 17, 2009), at 7, available at <http://www.gao.gov/new.items/d09478t.pdf>.

⁵⁸ Uncovering illegal activity is another reason for the U.S. government's crackdown on offshore tax havens. It is possible that strict offshore secrecy rules (like those in Switzerland) likely assist in shielding the proceeds of criminal activity from scrutiny by U.S. authorities. Bank secrecy laws allow offshore service providers to go to extraordinary lengths to protect clients' identities and financial information. These perks hinder tax and regulatory authorities so thoroughly that enforcement is nearly impossible. The removal of these bank secrecy laws would dramatically increase the U.S. government's ability to monitor its citizens' financial situations. See Press Release from Carl Levin, U.S. Sen., *Statement of Senator Carl Levin on Introducing the Stop Tax Haven Abuse Act, Part I* (Feb. 17, 2007), <http://levin.senate.gov/newsroom/release.cfm?id=269514> (discussing taxpayer abuse of offshore tax shelters and the need for enforcement of U.S. tax laws).

⁵⁹ See *id.*

Given the large budgetary problems the U.S. currently has, this lost tax revenue is a very important issue. Senator Levin said that offshore tax non-compliance is “undermining the integrity of the [American] tax system and renders the government unable to pay for critical needs, avoid going deeper into debt, and protect honest taxpayers.”⁶⁰ As the IRS began implementing the offshore crackdown to intimidate non-compliant taxpayers with foreign bank accounts, it also offered an escape for non-compliant taxpayers willing to voluntarily disclose, pay a penalty and resolved their balance with the IRS.⁶¹

1. THE VDI INCENTIVE

On March 23, 2009, the IRS announced the Voluntary Disclosure Initiative (VDI) to encourage taxpayers with unreported offshore bank accounts to report hidden assets.⁶² VDI participation significantly⁶³ reduces penalties for unpaid taxes for individuals and companies.⁶⁴ VDI was limited to a six-month window for applicants to become compliant under the program⁶⁵ and was available for taxpayers with a legal income source who are willing to make timely, accurate, and complete disclosures to the IRS and pay (or make arrangements to pay) the taxes due.⁶⁶ The IRS’s intent was two-fold: to provide an incentive to become compliant⁶⁷ and recover lost revenue.⁶⁸

⁶⁰ *Id.*

⁶¹ See generally Alan Winston Granwell et al., *IRS Issues New Voluntary Disclosure Guidance for Unreported Offshore Accounts and Entities*, INT’L TAX NEWSL. (DLA Piper), Mar. 31, 2009, at 2, available at <http://www.dlapiper.com/irs-issues-new-voluntary-disclosure-guidance-for-unreported-offshore-accounts-and-entities/> (“In anticipation of the April 2, 2009, G-20 Summit Meeting, . . . the United States, the United Kingdom, France and Germany have sought to pressure offshore financial centers to modify their bank secrecy laws.”).

⁶² Kristen A. Parillo, *IRS Streamlines Offshore Disclosure Process*, TAX NOTES TODAY, July 31, 2009, LEXIS, 2009 TNT 145-1.

⁶³ The IRS reported that 14,700 taxpayers disclosed the existence of or earnings from foreign financial accounts. See Kaplan, *supra* note 3.

⁶⁴ See Parillo, *supra* note 62.

⁶⁵ I.R.S., DEPT. OF THE TREASURY, ORIGINAL FREQUENTLY ASKED QUESTIONS (May 6, 2009), http://www.irs.gov/pub/irs-utl/faqs-revised_6_24.pdf.

⁶⁶ I.R.S. Internal Revenue Manual IRM 9.5.11.9, *Revised IRS Voluntary Disclosure Practice* (June 26, 2009), available at <http://www.irs.gov/newsroom/article/0,,id=104361,00.html>

While the program does not guarantee immunity from prosecution, it is the most effective way to avoid criminal penalties⁶⁹ and any non-compliant taxpayer who does not take advantage of the VDI is likely to be prosecuted.⁷⁰ The IRS is pleased with the response from VDI.⁷¹ Declining to give exact numbers, Bruce Friedland, a

("(3) A voluntary disclosure occurs when the communication is truthful, timely, complete, and when: (a) the taxpayer shows a willingness to cooperate with the IRS in determining his/her tax liability; and (b) the taxpayer makes good faith arrangements with the IRS to pay in full, the tax, the interest, and any penalties determined by the IRS to be applicable.

(4) A disclosure is timely if it received before: (a) the IRS has initiated a civil or criminal examination/investigation, or has notified taxpayer it intends to commence such; (b) IRS has received information from a 3rd party alerting the IRS to a taxpayer's noncompliance; (c) IRS has initiated a civil or criminal examination which is directly related to the specific liability of the taxpayer; or (d) the IRS has acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action.").

⁶⁷ IRS personnel may apply a new penalty framework to VDI requests regarding previously unreported offshore entities and accounts. Under VDI, the IRS assesses taxes and interest for the prior six-year period. Taxpayers are required to file or amend all returns for the applicable period, including filing the "Reports on Foreign Bank and Financial Accounts" (FBAR) form. Then IRS assesses either an accuracy penalty or a delinquency penalty based on the disclosure, unless the taxpayer can establish that a reasonable cause exception applies. In lieu of all other applicable penalties (including FBAR inaccuracy penalties, non-filing penalties, and other information return penalties), the IRS will assess a penalty of 20% of the assets held in foreign bank accounts in the year with the highest aggregate value. The penalty can be reduced to 5% for some inherited accounts. See I.R.S., DEPT. OF THE TREASURY, VOLUNTARY DISCLOSURE: QUESTIONS AND ANSWERS (Feb. 9, 2011), <http://www.irs.gov/newsroom/article/0,,id=210027,00.html>.

⁶⁸ Bringing tax avoiding and tax evading taxpayers into compliance will result in the collection of tax revenue otherwise lost due to the avoidance or evasion activity. See *id.* at Q2 ("The objective is to bring taxpayers that have used undisclosed foreign accounts and undisclosed foreign entities to avoid or evade tax into compliance with United States tax laws.").

⁶⁹ See *id.* at Q3.

⁷⁰ For cases involving unreported offshore income in which the taxpayer did not come in through the VDI, the IRS is "instructing [the] agents to fully develop these cases, pursuing both civil and criminal avenues, and consider all available penalties including the maximum penalty for the willful failure to file the FBAR [foreign bank account] report and the fraud penalty." I.R.S., DEPT. OF THE TREASURY, STATEMENT FROM IRS COMMISSIONER DOUG SHULMAN ON OFFSHORE INCOME (MAR. 26, 2009), <http://www.irs.gov/newsroom/article/0,,id=206014,00.html>.

⁷¹ See Parillo, *supra* note 62, at 3.

spokesman for the IRS, stated that during the week of July 20, 2009 alone, the IRS received more than four hundred requests to participate in the VDI.⁷² That number represents more than four times the total number of general pre-VDI voluntary disclosure requests received for all of 2008.⁷³ VDI succeeded in collecting numerous disclosures from non-compliant taxpayers⁷⁴ without the IRS or Department of Justice bringing civil or criminal charges. During the VDI period, the IRS also pressured offshore banks to disclose the names of American depositors. The first case was brought against large Swiss bank UBS AG.

2. THE UBS AG TAXPAYER DISCLOSURE CASE

UBS AG (UBS), headquartered in both Zurich and Basel, Switzerland, manages over \$2.3 trillion in assets and is among the world's largest financial institutions.⁷⁵ The 2008 PSI Report revealed that many of UBS's U.S. clients refused to be identified and to have U.S. taxes withheld.⁷⁶ Also in the report, UBS stated that many of their U.S. clients sold their U.S. assets after being required to report them under the existing disclosure agreement between the U.S. and UBS.⁷⁷ UBS bankers allegedly assisted U.S. taxpayers in concealing their identity as owners of assets in over nineteen thousand UBS accounts.⁷⁸ UBS created sham accounts in the names of offshore corporations, trusts, foundations, or other entities in various jurisdictions and claimed they were exempt from U.S.-UBS reporting requirements.⁷⁹ The 2008

⁷² *Id.*

⁷³ *Id.*

⁷⁴ Laura Saunders & Anita Greil, *Swiss Will Give Up the Names of U.S. Taxpayers*, WALL. ST. J., Nov. 18, 2009, <http://online.wsj.com/article/SB10001424052748704431804574541461590575636.html?KEYWORDS=Voluntary+disclosure+incentive>.

⁷⁵ UBS IN A FEW WORDS, <http://www.ubs.com/1/e/about/ourprofile.html> (last updated Dec. 10, 2010, 4:41 PM).

⁷⁶ STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 10 (Subcomm. Print July 17, 2008) (prepared by Chairman Carl Levin & Ranking Minority Member Norm Coleman), http://hsgac.senate.gov/public/_files/071708PSIRReport.pdf.

⁷⁷ *Id.*

⁷⁸ *Id.* at 11, 16.

⁷⁹ *See id.* at 11.

PSI Report alleges that UBS marketed and facilitated these tax-evasion schemes to wealthy Americans.⁸⁰

At the 2008 PSI hearing, UBS representative, Mark Branson, offered a number of concessions, including that UBS would no longer provide offshore banking services to U.S. customers.⁸¹ The following day, a Florida District Court granted the IRS permission to issue a John Doe summons⁸² to UBS for information regarding U.S. citizens who

⁸⁰ Bradley Birkenfeld, an American citizen and a UBS Geneva-based director of wealthy U.S. clients with offshore accounts from 2001-2005, was at the center of UBS's concealment services. Mr. Birkenfeld pled guilty to helping a U.S. billionaire evade millions of dollars in federal taxes. Birkenfeld testified that UBS bankers used a variety of ruses to entice U.S. clients to open up UBS offshore accounts and assist them in evading taxes. *See id.* at 83, 96

("[T]he private bankers from Switzerland who dealt with U.S. clients typically traveled to the United States four to six times per year, using their trips to search for new clients and provide financial services to existing clients. . . . Mr. Birkenfeld testified that UBS not only authorized and paid for the business trips to the United States, but also provided the Swiss bankers with tickets and funds to go to events attended by wealthy U.S. individuals, so that they could solicit new business for the bank in Switzerland.").

Birkenfeld stated that in his official position he served as a courier for UBS clients, getting checks out of the U.S. and depositing them in accounts in Denmark, Switzerland, and Liechtenstein. Birkenfeld testified that he was fully aware that what he was doing was illegal, but he did it anyway because of the "incentives" UBS offered him. Lynnley Browning, *Ex-UBS Banker Please Guilty in Tax Evasion*, N.Y. TIMES, June 20, 2008, <http://www.nytimes.com/2008/06/20/business/20tax.html>.

⁸¹ *See* Evan Perez, *UBS to shut down Swiss-based services for its US clients*, WALL ST. J., July 17, 2008, <http://www.efinancialnews.com/story/2008-07-17/ubs-to-shut-down-swiss-based-services-for-its-us-clients> (providing the statement of Mark Branson, CFO of UBS Global Wealth Management and Business Banking).

⁸² A "John Doe Summons" refers to "a summons from the [IRS] to a third party to provide information on an unnamed, unknown taxpayer with potential tax liability." *Black's Law Dictionary* (9th ed. 2009). *See* Press Release from Carl Levin, U.S. Sen., *Statement of Senator Carl Levin on Introducing the Stop Tax Haven Abuse Act, Part I* (Feb. 17, 2007), <http://levin.senate.gov/newsroom/release.cfm?id=269514> (explaining a John Doe summons is "tool used by the IRS in recent years to uncover taxpayers in offshore tax schemes. . . . [It] is an administrative IRS summons used to request information in cases where the identity of the taxpayer is unknown. . . . To obtain approval of the summons, [due to the IRS's inability to serve the taxpayer,] the IRS must show the court, in public filings to be resolved in open court, that: (1) the summons relates to a particular person or ascertainable class of persons, (2) there is a

were UBS offshore clients that may have failed to meet reporting or withholding obligations.⁸³ Raoul Weil, Chairman and CEO of UBS Global Wealth Management and Business Banking and a member of the UBS Group Executive Board, was subsequently indicted by a federal grand jury in connection with the ongoing Justice Department investigation of UBS.⁸⁴ He resigned his position at UBS.⁸⁵

UBS entered into a Deferred Prosecution Agreement (DPA) with the Department of Justice,⁸⁶ requiring UBS to pay \$780 million in fines, penalties, interest, and restitution for defrauding the U.S. government.⁸⁷ UBS waived indictment and consented to prosecution of one criminal count for conspiracy to defraud the U.S. under the agreement.⁸⁸ Provided UBS meets all obligations under the DPA, the Department of Justice will recommend dismissal of the charge.⁸⁹ The DPA requires UBS to provide the identities and account information of about two hundred and fifty non-compliant U.S. taxpayers.⁹⁰ Next, the

reasonable basis for concluding that there is a tax compliance issue involving that person or class of persons, and (3) the information sought is not readily available from other sources.”).

⁸³ In the Matter of the Tax Liabilities of John Does, et al., No. 08-21864-MC-Lenard/Garber (S.D. Fla., July 1, 2008) (explaining IRC § 7609(f) permits the IRS to serve a John Doe summons upon a proper showing to the court.).

⁸⁴ Indictment, United States v. Weil, No. 08-60322 (S.D. Fla., Nov. 12, 2008), 2008 WL 4898212. See also Carlyn Kolker & Ryan J. Donmoyer, *UBS Executive Weil Charged by U.S. in Tax Conspiracy (Update 3)*, BLOOMBERG (Nov. 12, 2008 4:44 PM), <http://www.bloomberg.com/apps/news?pid=20601208&sid=a9920BUoGuF4> (publicizing Weil’s indictment).

⁸⁵ *Statement on Indictment of UBS Executive*, UBS (Nov. 12, 2008 10:00 PM), http://www.ubs.com/1/e/media_overview/media_asiapacific/search1/search10?newsId=157836.

⁸⁶ See *Hearings on Enforcement Issues*, *supra* note 57 at 10; Dismissal of Criminal Information, U.S. v. UBS AG, No. 09-600333-CR-COHN (S.D. Fla., Oct. 22, 2010); Press Release, Office of Pub. Affairs, U.S. Dept. of Justice, UBS Enters into Deferred Prosecution Agreement (Feb. 18, 2009) [hereinafter DOJ DPA Announcement] <http://www.usdoj.gov/opa/pr/2009/February/09-tax-136.html>.

⁸⁷ See U.S. v. UBS AG, No. 09-20423-CIV, 2009 WL 2241122 (S.D. Fla. July 7, 2009).

⁸⁸ See Tax Compliance and Enforcement Issues with Respect to Offshore Accounts and Entities: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways & Means, 111th Cong. 32 (2009) (statement prepared by the Staff of the Joint Comm. on Taxation).

⁸⁹ *Id.*

⁹⁰ See DOJ DPA Announcement, *supra* note 86.

Department of Justice filed a civil suit against UBS to compel them to reveal the names of up to 52,000 U.S. clients.⁹¹ UBS, backed by the Swiss government, decided to withhold the names, reasoning that disclosure “would breach bilateral tax agreements and Swiss bank secrecy laws,”⁹² which make breaching client confidentiality a criminal offense.⁹³ The United States took the position that if the court were to enforce the John Doe summons, UBS subsequently failed to comply, and consequently the court held UBS in contempt for failure to comply, then UBS’s noncompliance may be a material breach of the DPA. A material breach of the DPA would have allowed the U.S. to proceed with criminal prosecution of UBS.⁹⁴ Eventually, UBS blinked and agreed to disclose the names of U.S. taxpayers with UBS accounts.⁹⁵

The UBS case serves as a deterrent to offshore banks from doing business with U.S. taxpayers and also deters U.S. taxpayers from investing offshore. Because of these disincentives, the UBS case has made it less likely that U.S. taxpayers will invest overseas and more likely they will invest domestically. As a result, the UBS case represents a control on capital outflow. If U.S. taxpayers believe there is a possibility that investing capital overseas may result in being ensnared in an IRS civil and/or Department of Justice criminal investigation, they are less likely to invest overseas. Even investors that intend to be compliant may still have reasonable fears of a mistake resulting in legal trouble. The cost of proving compliance is significant: requiring attorneys, accountants, and other professional

⁹¹ See *U.S. Sues UBS to Disclose Customer Names*, N.Y. TIMES: DEALBOOK (Feb. 19, 2009, 2:42 PM), <http://dealbook.blogs.nytimes.com/2009/02/19/us-sues-ubs-to-disclose-customer-names/>; David Voreacos & Carlyn Kolker, *U.S. Sues UBS Seeking Swiss Account Customer Names (Update 4)*, BLOOMBERG (Feb. 19, 2009, 5:44 PM), http://www.bloomberg.com/apps/news?pid=20601087&sid=axZmpp36b_OA&refer=home; Lynnley Browning, *UBS Pressed for 52,000 Names in 2nd Inquiry*, N.Y. TIMES (Feb. 19, 2009), <http://www.nytimes.com/2009/02/20/business/worldbusiness/20iht-20ubs.20329685.html>.

⁹² Pascal Fletcher & Lisa Jucca, *UBS, U.S. Settle Tax Evasion Case*, REUTERS (Aug. 12, 2009, 2:37 PM), <http://www.reuters.com/article/idUSTRE57B2CF20090812>.

⁹³ See Carolyn B. Lovejoy, *UBS Strikes a Deal: The Recent Impact of Weakened Bank Secrecy on Swiss Banking*, 14 N.C. BANKING INST. 435, 443, 446-47, (2010), available at <http://www.law.unc.edu/documents/journals/articles/33.pdf>.

⁹⁴ *Id.* at 449-51.

⁹⁵ See Tom Brown, *U.S., UBS Breakthrough Averts Tax Dispute Showdown*, REUTERS (July 31, 2009, 6:38 PM) at 2, <http://www.reuters.com/article/idUSTRE56U2ZY20090731>.

services. However, the U.S. was not content with merely implementing the VDI compliance incentive and creating a deterrent effect with its tax enforcement penalty regime; the U.S. Congress added to these capital control measures by passing new legislation to strengthen disclosure regulations.

3. THE HIRE ACT

In 2010, Congress passed the Hiring Incentives to Restore Employment Act (“HIRE”).⁹⁶ HIRE imposes significant new burdens on foreign financial institutions and other foreign investors that do business with U.S. citizens. HIRE provides that every foreign financial institution⁹⁷ that receives payments of U.S. source income must comply with new reporting requirements.⁹⁸ This includes annually providing the IRS with the name, address, taxpayer identification number, account number, balance, gross receipts, and gross account withdrawals.⁹⁹ Failure to comply with the new reporting requirements¹⁰⁰ subjects the foreign entity to a 30% withholding tax on any payment of U.S.-sourced investment income, including interest and

⁹⁶ Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

⁹⁷ The term “foreign financial institution” is defined broadly as “any foreign entity which (1) accepts deposits in the ordinary course of banking or a similar business, (2) holds financial assets for the account of others as a substantial portion of its business, or (3) is engaged primarily in the business of investing, reinvesting or trading securities, partnership interests, commodities or any interest on securities, partnership interests, and/or commodities.” Hiring Incentives to Restore Employment Act, I.R.C. § 1471(d)(5) (2010); Rory M. Cohen & Charles K. Kolstad, *HIRE ACT = Higher Withholding Tax for Foreign Entities*, VENABLE LLP (April, 2010), <http://www.venable.com/hire-act--higher-withholding-tax-for-foreign-entities-04-16-2010/>.

⁹⁸ “A number of foreign financial institutions may already be treated as Qualified Intermediaries (QI) for purposes of Section 1441 of the IRC; the rules discussed above are in addition to those QI rules and must be complied with separately.” Rory M. Cohen & Charles K. Kolstad, *HIRE ACT = Higher Withholding Tax for Foreign Entities*, VENABLE LLP (April, 2010), <http://www.venable.com/hire-act--higher-withholding-tax-for-foreign-entities-04-16-2010/>; Hiring Incentives to Restore Employment Act, I.R.C. § 1441 (2010) (§ 1441 provides that payment of services to non-U.S. citizens, for services performed in the U.S., are subject to tax withholding.)

⁹⁹ Hiring Incentives to Restore Employment Act, I.R.C. § 1471(c)(1) (2010).

¹⁰⁰ *Id.* at § 1471(b)(1).

dividends.¹⁰¹ The withholding tax provisions of HIRE effectively override existing provisions of U.S. income tax treaties, resulting in the imposition of the 30% withholding tax as the default method of compliance in many situations.¹⁰² HIRE also applies to U.S. taxpayers with more than \$50,000 in reportable foreign assets, requiring disclosure to the IRS of the maximum value of all foreign assets, including specific financial account and security information.¹⁰³ The penalty for failing to meet these new disclosure requirements begins at \$10,000, with an additional 40% tax underpayment penalty on underreported foreign assets.¹⁰⁴

HIRE disclosure and associated penalties provide an additional deterrent to U.S. investors maintaining assets offshore. The possibility of making a mistake in the disclosures required by HIRE has such negative financial consequences that many U.S. taxpayers may simply choose not to invest outside the United States. Because of the significant penalties for non-compliance placed upon foreign financial institutions, U.S. taxpayers will be forced to record, gather, and report an exorbitant amount of information that would not otherwise be required if the investments were made domestically. This will act as a sizable deterrent to enter into offshore transactions for both foreign financial institutions as well as domestic taxpayers. As such, the deterrent effect on U.S. financial institutions from this regulatory regime has the same capital outflow control effects as the deterrent effect created by the UBS case and the other offshore crackdown measures.

C. THE CAPITAL OUTFLOW CONTROL EFFECTS OF THE U.S. OFFSHORE CRACKDOWN

The United States has a strong interest in collecting all taxes due from its citizens, thus providing an understandable incentive for the government to deter its citizens and foreign banks from evading U.S. tax law. Congressional hearings and the resulting PSI reports; the VDI; the UBS case (and resulting increased focus on civil and criminal penalties); and new HIRE disclosure regulations are all efforts at increasing offshore tax compliance. This increased emphasis on tax

¹⁰¹ *Id.* at § 1473 (1)(A)(i).

¹⁰² Foreign entities may avoid this withholding tax and the new reporting requirements if they elect to report financial information as a U.S. financial institution or meet certain exemptions. *Id.* at § 1472.

¹⁰³ *Id.* at § 1474, Ch. 4, § 6038D(a).

¹⁰⁴ *Id.* at § 6038D(d)(1), (j)(3).

enforcement has also had the effect of making U.S. taxpayers think twice about compliant overseas investments. Whenever U.S. authorities spend significant time and resources focusing on a type of activity, the higher number of audits increases the chances that a compliant taxpayer will be subject to an expensive audit because the IRS has no system for ensuring that 100% of its audits are of non-compliant taxpayers. A compliant offshore investor attempting to prove they are in compliance will expend considerable time, energy, and money making compliance costs very high in the form of attorney and accounting costs. Even in the absence of an investigation, legal, accounting, and other professional services raise compliance costs for offshore investors. Even an innocent reporting error could lead to a high tax penalty.¹⁰⁵

Foreign banks may also limit access to U.S. investors in response to the U.S. crackdown. Offshore banks may fear being subjected to the scrutiny of the IRS or Department of Justice as a result of even unintentional non-compliance by their clients. This may pose too much of a burden for foreign banks to take the chance.¹⁰⁶ In particular, HIRE may result in significant unintended and detrimental consequences for U.S. investors. Accounting and reporting costs imposed on foreign financial institutions and the potential loss of U.S. taxpayers as clients are real added costs for these institutions. In the cost-benefit calculation of complying with HIRE and the other offshore crackdown measures, some foreign financial institutions may reduce or altogether stop accepting U.S. clients.

There are legitimate tax enforcement and collection reasons for all of the actions that the U.S. government has taken in the offshore crackdown. An additional result of these actions is more U.S. taxpayer capital remaining in or returning to domestic investments and accounts in order to avoid high compliance costs and other consequences. The VDI provided an opportunity for greater compliance at lower penalties for those taxpayers who had previously evaded tax laws. It also provided negative capital outflow pressure. HIRE, the UBS case, and the other civil and criminal consequences, are examples of penalties that theoretically may have dual tax enforcement and capital outflow consequences. These policies collectively will result in U.S. taxpayers,

¹⁰⁵ *Id.*

¹⁰⁶ Richard W. Rahn, *RAHN: Thoughtless Taxation*, WASH. TIMES (Nov. 22, 2010, 5:43 PM) <http://www.washingtontimes.com/news/2010/nov/22/thoughtless-taxation/>.

either by choice or by lack of access to offshore institutions, keeping their investments onshore, thus having the same effect as a control on net capital outflow.

III. GOLD REGULATION AS CAPITAL CONTROL

A. THE PATIENT PROTECTION AND AFFORDABLE CARE ACT OF 2010

The Patient Protection and Affordable Care Act of 2010 (ACA),¹⁰⁷ requires corporations to fill out a IRS Form 1099 reporting information about all consumers who buy or sell more than \$600 worth of goods or services.¹⁰⁸ One of the main industries burdened by this amendment to the Internal Revenue Code is the gold industry.¹⁰⁹ With a \$600 threshold, this requirement is likely to cover nearly all investments in gold made by U.S. investors because the current price of gold would require a separate report for each purchase and sale of 0.43 ounces.¹¹⁰ The ACA is the principal vehicle for President Obama's health care reform. In order to pay for the high government costs associated with expanding health care coverage, Congress added provisions to the ACA that would raise additional tax revenue,

¹⁰⁷ Patient Protection and Affordable Care Act, Pub. L. No. 111-148; 124 Stat. 119 (2010).

¹⁰⁸ See I.R.C. § 6041 (2010). See also Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9006, 124 Stat. 119, 855 (2010) (amending § 6041 so that the term "person" for the purpose of the reporting requirements now includes any corporation that is not otherwise exempt); *Report to Congress: Fiscal Year 2011 Objectives*, 2010 NAT'L TAXPAYER ADVOC. 10 ("[T]he new information reporting requirements are likely intended to detect unreported income or gross proceeds.").

¹⁰⁹ See Allen Sykora, *U.S. Coin Dealers Anxious for Resolution of New Form 1099 Rules*, COMMODITY ONLINE (Mar. 5, 2011, 6:45 AM), <http://www.commodityonline.com/news/US-Coin-dealers-anxious-for-resolution-of-new-Form-1099-rules-36966-3-1.html>. See generally *Coin and Precious Metal Disclosure Act: Hearing on H.R. 6149 Before the Subcomm. on Commerce, Trade, and Consumer Prot. of the H. Comm. on Energy & Commerce*, 111th Cong. 55-58 (2010) [hereinafter *Hearing on H.R. 6149*] (statement of Scott Carter, Exec. Vice President, Goldline Int'l) available at <http://democrats.energycommerce.house.gov/documents/20100923/ctcp/transcript.09.23.2010.ctcp.pdf> (discussing a concurrent legislative effort to increase mandatory disclosures required of dealers to protect consumers).

¹¹⁰ This is due to the fact that the current average price for gold is between \$1300 & \$1450 an ounce. See Whittaker, *supra* note 10.

including the Form 1099.¹¹¹ The requirement of filling out IRS Form 1099 creates a traceable sale so as to report the potential tax liability on behalf of the buyer. Since all sales of gold over \$600 are reported, the government will also have a complete record of the gold market; including who is participating in the market on both sides, how much they are purchasing, how frequently, and nearly all other aspects of gold sales in the U.S.

The ACA adds compliance costs to the purchase of gold by small investors. One significant gold coin dealer projected that it would file as many as 20,000 Form 1099s per year under the new ACA requirement.¹¹² Recent Congressional hearings that looked into the gold industry heard testimony that there are 5,000 serious gold dealers.¹¹³ If these estimates are correct, it is possible that the ACA could result in tens of millions of Form 1099s being filed by gold dealers. Even if the cost of filing a Form 1099 is only \$100, this could result in additional costs to the gold industry of between \$5 Billion and \$10 Billion. Disregarding these costs, on November 29, 2010, the U.S. Senate voted down two amendments that would have repealed the reporting requirements under the ACA because the Senate could not agree on a means to pay for the lost tax revenue generated by the reporting requirement.¹¹⁴ On the same day, a report was released by the U.S. House of Representatives Committee on the Budget. It stated that the new 1099 reporting requirements would raise around \$2.5 billion in tax revenue.¹¹⁵ As these costs are passed on to gold investors, the

¹¹¹ See Letter from Douglas W. Elmendorf, Dir., Cong. Budgetary Office, to Harry Reid, Senate Majority Leader (Nov. 18, 2009), *available at* http://www.cbo.gov/ftpdocs/107xx/doc10731/Reid_letter_11_18_09.pdf (“In total, CBO and JCT estimate that the legislation would . . . increase revenues by \$486 billion between 2010 and 2019 . . .”).

¹¹² Pat Heller, owner of Liberty Coin Service in Lansing, Michigan, deals with around 1,000 customers a week and projected that he will file between 10,000 and 20,000 1099s per year after the new tax law takes effect. Rich Blake, *Gold Coin Sellers Angered by New Tax Law*, ABC NEWS (June 21, 2010), <http://abcnews.go.com/Business/gold-coin-dealers-decry-tax-law/story?id=11211611>.

¹¹³ *Hearing on H.R. 6149, supra* note 109, at 55.

¹¹⁴ Eric Kroh, *Senate Votes Down Amendments to Repeal Expanded 1099 Reporting*, TAX NOTES TODAY, Nov. 30, LEXIS, 2010 TNT 229-1.

¹¹⁵ REPUBLICAN STAFF OF H. COMM. ON THE BUDGET, 111TH CONG., *THE SMALL BUSINESS JOBS AND CREDIT ACT: SMALL BUSINESSES STRUGGLE, WHILE CONGRESS SPENDS FREELY* (Comm. Print Sept. 22, 2010) (prepared by Dana T.

transaction costs necessarily must increase exponentially, reducing overall gold demand and nudging investors into other domestic investments.

B. THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT OF 2010

1. NEW REPORTING REQUIREMENTS

The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (DFRA),¹¹⁶ has certain investors concerned that the U.S. government is slowly implementing capital controls on gold by implementing new disclosure obligations.¹¹⁷ First, DFRA redefines “accredited investor,” as it relates to natural persons under the Securities Act of 1933, so that the definition excludes the value of a primary residence from an investor’s net worth.¹¹⁸ This change may substantially increase the net worth threshold to qualify as an accredited investor and allow the SEC to impose disclosure obligations on companies who offer securities to these wealthy investors.¹¹⁹ Second, DFRA requires buyers of gold and other minerals to report annually where they purchased the minerals from to ensure that they were not purchased in the Democratic Republic of Congo (DRC) or adjoining countries to the DRC.¹²⁰ The purpose of this DFRA provision is to reduce the capital available for the financing of wars.¹²¹ Third, § 742(a) of the DFRA prohibits any individual or

Wade, Budget Analyst for Financial Markets, Republican Caucus), <http://budget.house.gov/UploadedFiles/smallbusinessbill.pdf>.

¹¹⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 413, 124 Stat. 1376, 2213 (2010).

¹¹⁷ See, Ian MacGregor & Martin Fisher-Haydis, *So You Thought Dodd-Frank Was Just About Financial Industry Reform?*, LAW.COM: CORP. COUNS. (Sept. 13, 2010), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202471905864&So_You_Thought_DoddFrank_Was_Just_About_Financial_Industry_Reform.

¹¹⁸ DFRA § 413.

¹¹⁹ *U.S. Hedge Fund Reform: Investor Protection Provisions*, HEDGE.CO.NET (Aug. 3, 2010), <http://www.hedgeco.net/news/08/2010/u-s-hedge-fund-reform-investor-protection-provisions.html>.

¹²⁰ DFRA § 1502.

¹²¹ See, Brandon Prosansky, *Mining Gold in a Conflict Zone: The Context, Ramifications, and Lessons of AngloGold Ashanti's Activities in the Democratic Republic of the Congo*, 5 NW. U.J. INT'L. HUM. RTS. 236, 265-70 (2007).

company from offering or entering into a transaction involving any commodity, including precious metals like gold, with a person that is not an “eligible” counterparty.¹²² To be “eligible,” the counterparty must also be DFRA compliant.¹²³ Therefore, DFRA § 742(a) specifically limits the possible participants in the precious metal market.

2. REDUCING GOLD INDUSTRY COMPETITORS

The gold market may be further limited by additional regulations adopted pursuant to recent Congressional hearings. On September 23, 2010, the Subcommittee on Commerce, Trade and Consumer Protection held a hearing to discuss legislation that would further regulate gold dealers.¹²⁴ During the hearing, Rep. Steve Scalise (R-LA) asked a testifying witness if new disclosure requirements would reduce the number of market competitors.¹²⁵ The witness was concerned that the bill “might encourage unscrupulous marketers to collude and set prices.”¹²⁶ Furthermore, Rep. Scalise clarified that the language of the bill actually tolerates this collusion, which could ultimately cause a reduction in the number of market competitors to the detriment of the consumer.¹²⁷ With this theory, the consumer is likely to suffer increased cost from restricted market participation.¹²⁸ When competition is reduced to a smaller number of businesses in an industry, the remaining industry leaders are likely to raise prices.¹²⁹

¹²² DFRA § 742

¹²³ *Id.*

¹²⁴ *Hearing on H.R. 6149, supra* note 109 (discussing the Coin and Precious Metal Disclosure Act).

¹²⁵ *Id.* at 55 (statement of Scott Carter, Exec. Vice President, Goldline Int’l).

¹²⁶ *Id.* at 80.

¹²⁷ *Id.*

¹²⁸ Regulation can have the effect of limiting the number of market participants. For example, licensing requirements or other approval mechanisms may have this effect by increasing the barriers to being an approved market participant (i.e., the cost and burden of becoming licensed or approved). Fewer market participants reduce competition, which can result in increased prices. Additionally, the cost of compliance may be passed on to consumers.

¹²⁹ *See, e.g.,* David Sheppard & Joshua Schneyer, *World Oil Demand Growth to Outpace Supply in 2010: Poll*, REUTERS (Nov. 29, 2008, 8:09 AM), <http://www.reuters.com/article/idUSTRE5AN26920091124>.

3. COMPLIANCE COSTS

These reporting requirements and restrictions will cause U.S. gold dealers to incur substantial compliance costs.¹³⁰ Although the exact cost of DFRA compliance is unknown, there is evidence that the impact is likely to be high¹³¹ and the burden is likely to be felt disproportionately by small gold dealers.¹³² The government has historically substantially underestimated compliance costs associated with federal regulations.¹³³ DFRA § 742(a) requires gold dealers to incur the additional regulatory costs related to researching the source of the gold, the background of the seller, and how the law applies to both answers.¹³⁴

Since small gold dealers have fewer financial resources than larger gold dealers, smaller gold dealers are likely to be disproportionately impacted by these due diligence requirements. The number of small gold dealers will likely be substantially diminished as their marginal profits are squeezed by the cost of regulation.¹³⁵ Small dealers will pass increased costs onto investors,¹³⁶ which will disproportionately affect small investors who generally buy in the

¹³⁰ See generally MacGregor & Fisher-Haydis, *supra*, note 117.

¹³¹ *Id.*

¹³² In a 2005 Report for the Small Business Administration, W. Mark Crain of the Lafayette College in Pennsylvania concluded that the cost of tax compliance in small firms (with under 20 employees) is sixty-seven (67%) percent higher than in large firms (with 500 or more employees). W. Mark Crain, *The Impact of Regulatory Costs on Small Firms*, U.S. SMALL BUS. ADMIN., 2 (Sept. 2005), <http://www.sba.gov/advo/research/rs264tot.pdf>.

¹³³ The Office of Management and Budget is required to submit an accounting statement and report that includes estimates of the annual costs and benefits of federal rules, to the extent feasible. Act of Dec. 21, 2000, Pub. L. 106-554, § 624, 114 Stat. 2763, 27643A-161 (2000). The Office of Management and Budget reported to Congress the total costs of federal regulations to be between \$34 - \$39 billion (in 2001 dollars), as distinguished from the figures set forth by (1) the Small Business Administration and (2) Mark Crain and Thomas Hopkins who estimate the costs of regulation (for the same period with the same dollar base) to be between \$777 - \$876 billion. Crain, *supra* note 132, at 1-2.

¹³⁴ DFRA § 742(a).

¹³⁵ *Hearing on H.R. 6149, supra* note 109, at 55 (statement of Scott Carter, Exec. Vice President Goldline Int'l); see also Wade, *supra* note 115 (arguing that small business struggling with the filing requirements may find compliance to be financially burdensome and eliminate their business).

¹³⁶ Mankiw, *supra* note 24.

smaller amounts from small dealers.¹³⁷ Thus, the cost of regulation will likely reduce competition as small dealers and small investors are priced out of the gold market.

4. DOMESTIC CAPITAL OUTFLOW CONTROL

In short, increased regulations created by DFRA will result in fewer gold dealers and higher prices as the remaining dealers pass their regulatory costs to investors. These higher costs will deter potential investors, especially small investors, from investing domestic capital. Investors who otherwise may have invested in gold may decide that higher transaction costs reduce their potential profits in the investment and the risk that the gold is derived from a war zone raises other potential regulatory risks since such gold is illegal under the DFRA.¹³⁸ Additional regulation will likely deter gold investment, which may cause investors to look to other domestic investment opportunities, such as U.S. treasury bonds; this shift will diminish capital outflow.

IV. THE GUARANTEED RETIREMENT ACCOUNT PROPOSAL

A. GUARANTEED RETIREMENT ACCOUNTS

The Guaranteed Retirement Account (GRA) proposal would create a retirement account for every American who is not currently enrolled in a retirement saving vehicle like a 401(k) plan or IRA.¹³⁹ The GRA proposal requires taxpayers make a contribution to the GRA each year equal to 5% of the taxpayer's income up to the Social Security earnings cap.¹⁴⁰ The employer would pay 2.5% of the 5% contribution and the taxpayer would pay the other 2.5%.¹⁴¹ These

¹³⁷ See generally Larry Light, *Catching the Gold Bug*, WALL ST. J. (July 15, 2009, 11:57 PM), <http://online.wsj.com/article/SB10001424052970203577304574275953355412882.html?KEYWORDS=Catching+the+Gold+Bug#>.

¹³⁸ Generally, the longer an investor holds an investment the more volatility the investment may be subject to on the market. See *id.*

¹³⁹ Ghilarducci, *supra* note 13, at 2.

¹⁴⁰ See *id.* In 2010, the Social Security earnings cap is set at 6.2% of up to \$106,800 for each the employee and the employer or 12.4% for the self-employed. See SOC. SEC. ADMIN., SSA PUBLICATION NO. 05-10003 (2011), <http://www.ssa.gov/pubs/10003.html>.

¹⁴¹ Ghilarducci, *supra* note 13, at 2-3.

payments would be directly deducted from earnings in payroll taxes.¹⁴² As an incentive, the U.S. government will contribute \$600 toward every participating taxpayer's 2.5% contribution in the form of a refundable tax credit.¹⁴³ To pay for the credit, current tax benefits for 401(k) plans would be eliminated.¹⁴⁴ The Social Security Administration would administer the GRAs, and the funds would be managed by the Thrift Savings Plan or a similar body.¹⁴⁵ Under the plan, the government would guarantee a fixed return of three percent annually adjusted for inflation.¹⁴⁶ Much like Social Security and defined benefit retirement plans of the past, upon retirement the GRA would produce a fixed stream of income by converting contributions to a guaranteed lifetime annuity.¹⁴⁷ Additionally, in order to facilitate the significant transition from privately held Section 401(k) accounts to GRA accounts, which are more readily available for government use, a principal proponent of GRAs has testified in Congressional hearings that Congress should seek to shift private Section 401(k) investments into government-issued treasury securities.¹⁴⁸ Essentially, this would function as a "rollover"¹⁴⁹ of retirement accounts that are in existence at

¹⁴² *Id.* at 3.

¹⁴³ *Id.* at 3 (noting that the offset will be receivable in refundable tax credit).

¹⁴⁴ *Id.*

¹⁴⁵ Teresa Ghilarducci proposes the funds in GRAs be attached to identifiable individual accounts, but pooled together under the management of either the Social Security Administration or the Thrift Savings Plan, which is the public sector qualified plan under IRC regulations similar to those of 401(k) plans. *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 2-3; see also *Proposals for a New Retirement System*, RET. USA, (October 3, 2010), <http://www.retirement-usa.org/proposals-new-retirement-system>.

¹⁴⁸ Teresa Ghilarducci is a scholar who is frequently a witness on behalf of GRAs in Congressional hearings. Ms. Ghilarducci stated in her 2008 Congressional testimony that Congress should work to convert 401(k) plan assets into GRAs composed of government bonds. *Hearing on Workers' Retirement Security*, *supra* note 13, at 32 (statement of Teresa Ghilarducci, Irene and Bernard L. Schwartz Professor of Econ. Policy Analysis, The New Sch. for Soc. Research, Dep't of Econ).

¹⁴⁹ "Rollover" is a common financial services industry term. 401(k) savings are "rolled over" when an employee leaves a place of employment and is thus no longer eligible to participate in the firm 401(k) plan, or when the employee chooses to move retirement funds into a similarly qualified IRA.

the time of the initiation of GRA accounts. Staff for key members of Congress have made GRAs part of the retirement reform discussion.¹⁵⁰

B. THE GRA AS AN INTERNAL DOMESTIC CAPITAL CONTROL

When discussing GRAs, Congressional proponents list state-worker retirement security as the primary objective¹⁵¹ and propose GRAs as a compliment to Social Security.¹⁵² However, Congress has been borrowing capital from the Social Security Trust Fund for current non-Social Security spending for a very long time.¹⁵³ According to the Social Security Administration, tax income collected is deposited into the U.S. Treasury general fund, converted into “special issue” securities and is virtually indistinguishable from other cash in the general fund.¹⁵⁴ Currently it is estimated that the U.S. Treasury is over obligated (above expected tax revenues) to Social Security expenditures in excess of \$7.7 trillion over the next 75 years.¹⁵⁵ The implementation of GRAs would lead to the federal government having an entirely new piggy bank to raid for current spending needs.

To obtain access to this new capital, GRA-backers propose eliminating tax incentives for Section 401(k) plans to offset the costs of

¹⁵⁰ Mike DeCesare, Press Secretary for Rep. Jim McDermott (D-WA) of the U.S. Ways and Means Committee called Ms. Ghilarducci’s GRA plan “intriguing” and “is part of the discussion” when Congress discusses the restructuring of the current retirement system. Sara Hansard, *House Democrats Contemplate Abolishing 401(k) Tax Breaks*, INVESTMENT NEWS (Oct. 12, 2008, 6:01 AM), <http://www.investmentnews.com/article20081012/REG/310139971>.

¹⁵¹ *Hearing on Workers’ Retirement Security*, *supra* note 13, at 4-6 (opening statement of Hon. George Miller, Chairman, Comm. of Educ. and Labor).

¹⁵² *Id.*; see also, Joe Biden, *2009 Annual Report of the White House Task Force on the Middle Class*, WHITE HOUSE, at 28, (Feb. 2010), <http://www.whitehouse.gov/sites/default/files/microsites/100226-annual-report-middle-class.pdf>.

¹⁵³ Sahadi, *supra* note 15.

¹⁵⁴ “Special issue” is divided into two types of indebtedness, short-term certificates of indebtedness, which expire on the following June 30th; and bonds, which range from one to fifteen years and expire on the following June 30th, both of only available to the U.S.’s Old-Age and Survivor Insurance Fund and Disability Insurance Fund. TRUST FUND FAQs, *supra* note 15.

¹⁵⁵ Bruce Bartlett, *How Much Does the National Debt Matter?*, FORBES.COM (March 5, 2010, 12:01 AM), <http://www.forbes.com/2010/03/04/consumer-debt-deficit-budget-opinions-columnists-bruce-bartlett.html>.

funding the GRAs.¹⁵⁶ Section 401(k) plans would cease to be funded without these tax incentives because there would be no advantage to funding them. Without the tax incentives, Section 401(k) plans would just become an investment account with a great deal of restrictions on the accounts.¹⁵⁷ Private funds more traditionally directed to 401(k) and tax incentivized defined-contribution plans would instead be directed into required government-sponsored retirement accounts run like Social Security.¹⁵⁸ A transition from mixed global and domestic market portfolios, platforms traditionally found in 401(k) plans with stock market exposure, to U.S. treasury investments will not only suppress expected returns, but will also decrease foreign investment. There may be a decrease in expected returns since U.S. Treasury returns hover around 3 percent annually, while the stock market return is generally higher.¹⁵⁹

Consequently, implementing the GRA proposal would act as a large domestic capital outflow control as private investment retirement vehicles are shifted to government-managed investments, which provide the U.S. government with a source for borrowing capital in the future. A recent report by the Spectrem Group showed assets in defined-contribution plans such as Section 401(k) to be valued around \$4.5 trillion in 2009.¹⁶⁰ This movement of capital into government investments would only be accelerated if the GRAs were to be funded by U.S. Treasury bonds as the GRA sponsors propose.

¹⁵⁶ *Hearing on Workers' Retirement Security*, *supra* note 13, at 32 (statement of Teresa Ghilarducci, Irene and Bernard L. Schwartz Professor of Econ. Policy Analysis, The New Sch. for Soc. Research, Dep't of Econ).

¹⁵⁷ 401(k) accounts are retirement plans the IRS provides for in the Internal Revenue Code, where the IRS sets forth minimum standards for qualified plans. The IRS establishes: who is eligible for plan participation; when participants have a non-forfeitable right to their plan benefits; how much may be contributed to the plan by both the participant and the employer; and when and how distributions from the plan may be made. *See* I.R.S., DEPT. OF THE TREASURY, 401(K) RESOURCE GUIDE – PLAN SPONSORS – PLAN QUALIFICATION REQUIREMENTS (Oct. 29, 2010), <http://www.irs.gov/retirement/sponsor/article/0,,id=151924,00.html>.

¹⁵⁸ *Id.*

¹⁵⁹ TRUST FUND FAQs, *supra* note 15.

¹⁶⁰ Darrell A. Hughes, *Republicans Warn Against Change to 401(k) Policy*, WALL ST. J. (May 4, 2010, 5:29 PM), <http://online.wsj.com/articles/SB10001424052748703866704575224511840462980.html>.

V. CONCLUSION

The U.S. has spent several years using investigatory, taxing, prosecutorial, legislative, and regulatory powers to create inducements and penalties to direct U.S. investors to preferred investments. The government began with the 2006 PSI hearings¹⁶¹ and reports.¹⁶² Focus on offshore investments continued with the UBS¹⁶³ case and with the enactment of the HIRE Act,¹⁶⁴ both of which create a significant deterrent to U.S. taxpayer investment abroad.¹⁶⁵ Next the United States turned its attention to domestic investment vehicles and asset classes by enacting strict and burdensome regulations on the gold industry. The disclosure regime requires all businesses to issue an IRS Form 1099 for each sale of goods or services in excess of \$600.¹⁶⁶ Gold companies are thus required to report purchaser information to the IRS for each sale of gold in excess of \$600 (as little as 0.43 ounces as of December 1, 2010),¹⁶⁷ as well as reporting sales of gold to U.S. citizens from certain sources.¹⁶⁸ This regime will significantly increase compliance costs that will be passed on to investors. Gold dealers are also restricted from contracting with certain sources of gold,¹⁶⁹ which will

¹⁶¹ Press Release from Carl Levin, U.S. Sen., *Permanent Subcommittee on Investigations Issues Report On Offshore Tax Haven Abuses That Cost U.S. Taxpayers Over \$40 Billion Each Year* (August 1, 2006), <http://levin.senate.gov/newsroom/release.cfm?id=260030>.

¹⁶² See STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY (Subcomm. Print Aug. 1, 2006) (prepared by Chairman Norm Coleman & Ranking Minority Member Carl Levin), <http://levin.senate.gov/newsroom/supporting/2006/PSI.taxhavenabuses.080106.pdf>; STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 109TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE (Subcomm. Print July 17, 2008) (prepared by Chairman Carl Levin & Ranking Minority Member Norm Coleman), <http://hsgac.senate.gov/public/ files/071708PSIReport.pdf>.

¹⁶³ Kevin McCoy, *IRS: Offshore Tax Crackdown Should Produce 'Billions'*, USA TODAY (Nov. 18, 2009, 12:42 AM), http://www.usatoday.com/money/perfi/taxes/2009-11-17-offshore-tax-evaders-irs_N.htm.

¹⁶⁴ Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ See Whittaker, *supra* note 10.

¹⁶⁸ Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

¹⁶⁹ *Id.*

reduce the number of gold dealers in the market. These additional regulations are likely to cause U.S. investors to avoid the gold market. Overall, investors are likely to seek alternative investments.

Retirement vehicles and investment regimes are another domestic focus during the last few years. Congress has held several hearings in which witnesses have testified regarding a plan to exchange the existing Section 401(k) tax incentive system for a Guaranteed Retirement Account ("GRA") system¹⁷⁰ run in the same manner as Social Security.¹⁷¹ The likely resulting decimation of the Section 401(k) system may cause a massive capital transfer from private retirement account investments to a government-run and managed retirement system consisting of Social Security and GRAs—which may be an inviting target for Congress to borrow against in order to fund future budget deficit spending in much the same way as Congress has historically borrowed against the Social Security Trust Fund.¹⁷² This temptation is particularly problematic as the U.S. Treasury is currently in debt to the Social Security Trust Fund in excess of \$2.5 trillion.¹⁷³

The United States has legitimate articulated reasons for implementing tax enforcement overseas, creating consumer protection regulations for the booming gold industry, and reforming the diminished retirement account system. However, these measures also have a capital control effect on U.S. investors. The regulations, incentives, taxes, and civil and/or criminal penalty threats all urge U.S. investors to invest domestically (instead of offshore), in assets other than gold, and in assets where the government potentially controls the capital (GRAs). It is not possible to determine whether this capital control effect is planned or unintentional; however the current U.S. budget and debt crises may be contributing factors in the U.S. government's decision to embark on a broad array of capital control measures to harness the investment potential of American assets.

¹⁷⁰ *Hearing on Workers' Retirement Security*, *supra* note 13, at 32 (statement of Teresa Ghilarducci, Irene and Bernard L. Schwartz Professor of Econ. Policy Analysis, The New Sch. for Soc. Research, Dep't of Econ).

¹⁷¹ *Id.*

¹⁷² Sahadi, *supra* note 15.

¹⁷³ OFFICE OF THE CHIEF ACTUARY, SOC. SEC. ADMIN., TRUST FUND DATA: INVESTMENT HOLDINGS (Feb. 13, 2011), <http://www.socialsecurity.gov/cgi-bin/investheld.cgi>.