Offshore Paradise? Taxation of United States Citizens in Costa Rica and Tax Policy Commentary of Its Implications

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I. INTRODUCTION

Taxes are a necessary evil. They are utopic, in theory, but intricate in practice. Incredibly talented scholars have antithetical views on taxation. Moreover, our increasingly globalized world has made tax regimes even more complex. The different tax policies in various jurisdictions around the world make taxation a major factor in individuals' decisions on where to move, live, work, and play.

The United States set a momentous emigration record in 2017; 1,376 Americans renounced their citizenship—the second highest number in any single year.[1] While the specific reasons behind this mass emigration remain unclear, it may be a consequence of the convoluted American[2] tax system, and its unfavorable treatment of citizen expatriates who do not reside in the United States.[3] During the Clinton Administration, the 104th United States Congress contentiously debated the possibility of levying an exit tax on those wishing to renounce their citizenship.[4] Congress eventually implemented an exit tax years later in the 2008 Heroes Earnings Assistance and Relief Tax Act (the "HEART Act").[5] The HEART Act is a perfect example of an attempt by the United States government to mitigate the hardships that arise from taxpayer use offshore havens for advantageous tax treatment.

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[1] Robert W. Wood, *Americans Renouncing Citizenship Hits New Record; Tax Bill Won't Change That*, FORBES (Nov. 3, 2017), https://www.forbes.com/sites/robertwood/2017/11/03/americans-renouncing-citizenship-hits-new-record-tax-bill-wont-change-that/#7fd3a48a5f85.

[2] This Note uses the term "American" to refer exclusively to the United States of America. This is done to avoid repetition of the term "United States" but in no way seeks to diminish the Continent's neighboring nations.

[3] *Id.*

[4] *See Background and History of Tax on U.S. Expatriation*, TAXES FOR EXPATS, https://www.taxesforexpats.com/expat-tax-advice/Background-and-History-of-Tax-On-Expatriation.html (last visited Sep. 6, 2019) ("In the mid-1990s, the expatriation of several wealthy U.S. citizens drew enormous media attention and massive Congressional scrutiny. President Clinton himself supposedly read an article in Forbes and demanded action. . . ") .

[5] Rolando Garcia & Angela Qian, *Exiting the U.S. Tax System*, THE TAX ADVISER (Apr. 1, 2018) ("In 2008, Congress created a 'mark-to-market' exit tax regime through Sec. 877A, enacted as part of the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008, P.L. 110-245").

Technically speaking, tax avoidance is a *legal* reduction of taxes, whereas tax evasion is an *illegal* reduction of taxes.[6] However, the line between tax avoidance and tax evasion is not always so clear.[7] The Organization for Economic Cooperation and Development (the "OECD") has studied the tax structures of numerous countries (both member and non-member) around the world to determine which constitute "tax havens."[8] Such a classification is relevant for various reasons. The OECD is a member organization that manages international economic development. The United States is a member nation. This paper will frequently allude and cite articles and conclusions of the OECD, which should be given considerable weight. Generally, tax havens are countries that facilitate tax avoidance (or even tax evasion) through their legal and financial structures. There is much debate between the OECD and other financial and governmental organizations about whether or not certain countries constitute tax havens. Costa Rica is one of the countries that has spurred significant debate, and given rise to contradictory conclusions.[9]

Costa Rica is a popular destination for American expatriates. According to the United States Department of State, as many as fifty thousand Americans live in Costa Rica.[10] This number is significant, especially considering that the country has a population of fewer than five million.[11] There are many reasons why Costa Rica is an appealing destination for expatriates.[12] In fact, a recent congressional report considered the possibility of Costa Rica as an offshore tax haven.[13] This begs the question: is Costa Rica truly a tax haven, and, if not, will it become one in the near future? Moreover, from a policy perspective, does Costa Rica have the right to be a tax haven without international tension arising as a consequence? As this Note will suggest, these are not straightforward questions to answer.

A. Note Structure

This Note will first analyze and compare the personal income tax policies of Costa Rica in Section I. Section II will discuss the same

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[6] Jane G. Gravelle, CONG. RESEARCH SERV., RL40623, TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION 1 (2015).

[7] Alan Gunn, *Tax Avoidance*, 76 MICH. L. REV. 733, 734 (1978).

[8] *Id.*

[9] Gravelle, *supra* note 6, at 6 (noting that Costa Rica has been included in previous tax haven lists. It has also been added by the OECD to what is known as a "gray list" or countries known as "other financial centers").

[10] Note that this number excludes those who have renounced their citizenship in seek of a more favorable tax treatment; *The Joys of Retiring in Costa Rica,* INT'L LIVING, https://internationalliving.com/ countries/costa-rica/retire/.

[11] *Id*.

[12] *Top 5 Reasons Expatriates are Choosing to Live in Costa Rica*, EXPAT FIN. BLOG (Feb. 22, 2019) https://expatfinancial.com/top-5-reasons-expatriates-are-choosing-to-live-in-costa-rica/.

[13] Gravelle, *supra* note 6, at 4.

considerations with emphasis on the United States' tax system. Section II will also introduce some of the policy concerns hidden amidst the North American[14] tax scheme. This Note will then discuss in Section III how the United States forces other nations to report income to it by introducing FATCA (as defined below), which continues to shed light on the major policy issues that arise with foreign compliance regulations and costs.

Section IV will discuss the "Exit Tax," and the complications that arise when looking to renounce American citizenship in pursuit of a more equitable tax structure. Nonetheless, this Note will consider constitutional and policy issues arising from the Exit Tax.

The entanglement of both Costa Rica's and the United States' tax structures and the effect of such for foreign policy will be analyzed in Section V, which introduces the term "tax haven." Meanwhile, this Note will explore the repercussions that arise domestically and internationally once the term tax haven is associated with a nation.

The balancing test described in Section V will be applied in Section VI, which, simultaneously, will describe policy issues emerging as a result of the test's subjective nature.

In a forward-looking manner, Section VII will look at specific goals Costa Rica has set and analyze recent current events that could potentially fluctuate the tax haven analysis, while demonstrating how the country must consider the international implications when making its domestic tax and economic choices.

Finally, in its conclusion, this Note will restate the hypothesis that Costa Rica is not a tax haven and continues to move further away from tax haven status.

Overall, this Note will argue that the main reason why Costa Rica does not qualify as a tax haven is because of the constant changes in its tax policies. Moreover, this Note will conclude that Costa Rica is heavily concerned with United States tax policies, and such a structure has an impact on foreign relations.

II. PERSONAL INCOME TAX STRUCTURE IN COSTA RICA

The most important taxes in Costa Rica are sales and "business" taxes.[15] Conversely, personal income taxation—particularly its collection aspect—is complicated to employ because individuals do not have social security numbers. Thus, it is expensive and close to impossible to accurately monitor every taxpayer's personal income tax liability, even in a country with such a small population. Consequently, personal income tax rates in Costa Rica

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[14] Likewise, this ter mis used to refer to the United States exclusively, and Canada. This is done exclusively for stylistic purposes.

[15] LA GACETA DIARIO OFICIAL, Alcance No. 202, *Fortalecimiento de las Finanzas Publicas,* 2018; Ley Publica Costa Rica No. 9635, Articulo I.

are very low; the country relies mainly on sales and corporate taxation to raise revenue.

The only individuals subject to Costa Rica's *personal* income tax are those employed in the country. Costa Rica only taxes income generated within its territory, a practice known as "source income". Businesses withhold income taxes from their employees in a way that mildly resembles the American system. However, there are several differences. One of these differences is that the withholding rate depends on the characteristics of the business, rather than the individual (as a result, an individual's personal income or family size becomes irrelevant for purposes of corporate withholding).[16]

The Costa Rican Ministry of Finance[17] publishes an annual table to determine the rate at which each company must withhold from their employees' salaries.[18] The rates fluctuate based on factors such as (1) the date of the company's formation, (2) the number of employees, and (3) other taxes that businesses must pay (such as the corporate income tax).[19] Using this table, each business determines the amount of income that it must withhold from its employees. The rates of withholding can range from a low of 15% to a high of 50%.[20]

Another significant difference between the American withholding system and that of Costa Rica is that the latter is much simpler. The United States Internal Revenue Service (the "IRS") places the onus legal responsibility of filing a W-4[21] on each individual taxpayer. Employers must withhold state, local, and federal taxes (which include Medicare and Social Security). Therefore, each taxpayer must personally determine how many deductions he or she is allowed for each of these taxes. Conversely, Costa Rica's withholding structure applies only at the federal level.[22]

Consistent with the concept of source-based taxation, non-citizens (including non-citizen residents) working in Costa Rica are subject to the country's personal income tax. However, the process for these non-citizen workers is somewhat different. Non-citizens who have an employment

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[16] *Tasa del Impuesto de Renta*, MINISTERIO DE HACIENDA COSTA RICA, https://www.hacienda.go.cr/contenido/14448-ejemplos-calculos-impuesto-sobre-la-renta (Table 2).

[17] Referred to as "Ministerio de Hacienda" in Costa Rica and other Latin American countries.

[18] *Retenciones de fuente por Salario*, MINISTERIO DE HACIENDA COSTA RICA, https://www.hacienda.go.cr/contenido/15413-retenciones-por-salarios-jubilaciones-y-otros-pagos-laborales.

[19] Ministerio de Hacienda, *supra* note 16 (Interpretation of the table published by Ministry of Hacienda).

[20] *Id.*

[21] Withholding form in the United States of America filled by every individual to determine the amount of taxes their company must withhold for them.

[22] *Guia para Educacion Superior, Estado, Tributacion, y Ciudadania,* MINISTERIO DE HACIENDA DE COSTA RICA 1, 42 (2014), available at https://educacionfiscal.org/files/201612/Guia%20educacion%20universitaria%20Costa%20Rica%20web.pdf.

relationship in Costa Rica are subject to a flat income tax rate of 10%,[23] which is lower than even the lowest withholding rate for citizens. Similarly, self-employed non-citizens working in Costa Rica are subject to a flat income tax rate of 15%.[24] Clearly, the rates are significantly lower than those in the United States, especially considering the fact that Costa Rican tax rates are not progressive.

In addition to the personal income tax, Costa Rica levies other types of taxes. Much like in the United States, Costa Rica has property taxes, excise taxes, transfer taxes, and of course, the "sales" tax.[25] Property taxes in Costa Rica are significantly low when compared to other nations. The country calculates its real property tax rate by city, which usually results in a tax rate of about 0.25%.[26] This is considerably lower than real estate taxes in most states that levy a property tax.

Costa Rica also taxes certain personal property, such as vehicles, and taxes transfers of such property. The property tax on vehicles, also known as the circulation tax, is paid yearly and collected by the government-owned insurance company, the Instituto Nacional de Seguros (hereinafter "INS").[27] The circulation tax is known as "marchamo," and all owners of circulating vehicles receive a sticker from the government to place on their windshield, indicating they have paid the tax. The value of this tax varies by vehicle.[28] In 2015, the Tax Ministry reported that owners of luxury brands, such as Lexus, Ferrari, and Mercedes-Benz, would have to pay a circulation tax ranging from $9,000 to $16,000.[29] States generally do not have a circulation tax. For those who do, the tax is considerably lower. Compare Costa Rica's scheme with that of the state with the highest vehicular tax, Rhode Island—such tax averaged at around $1,100 for a normal-sized vehicle.[30] Furthermore, luxury vehicle taxes do not exist in the United States federal taxing regime. Even if some states apply a luxury sales tax, the fact that there is no federal luxury tax further distinguishes vehicle taxation in Costa Rica and the United States.

Other than the circulation tax, the most common form of taxation that a

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[23] *Costa Rica-Income* Tax, KPMG (Jan. 1, 2018) https://home.kpmg.com/xx/en/home/insights/2017/03/costa-rica-income-tax.html (Costa Rican Tax Table).

[24] *Id.*

[25] *Tributos Vigentes en Costa Rica*, MINISTERIO DE HACIENDA (Apr. 2016), http://www.hacienda.go.cr/docs/570540179b204_tributosvi.pdf.

[26] Ivo Henfling, *North Americans Living in Costa Rica Do Not Like FATCA*, AMERICAN-EUROPEAN (Sept. 13, 2012), https://www.american-european.net/costa-rica-real-estate-blog/costa-rica-living/north-americans-living-in-costa-rica-do-not-like-fatca/.

[27] Redaccion L.R., *Marchamo de Costa Rica*, *Everything You Need to Know*, LA REPUBLICA (Aug. 14, 2019), https://www.hacienda.go.cr/contenido/386-marchamo-electronico.

[28] *Id.*

[29] Manual Avendaño Arce, *Conozca Los Cinco Carros Que Pagan Marchamo Mas Caro En Costa Rica*, CONSUMO (Nov. 23, 2015), https://www.nacion.com/economia/consumo/conozca-los-cinco-carros-que-pagan-marchamo-mas-caro-en-costa-rica/BSUNVN2DMBHJ7HL2AJAAKOZRCQ/story/.

[30] *Id.*

Costa Rican citizen or tourist confronts every day is the sales tax. The Costa Rican sales tax more closely resembles a European-style value added tax ("VAT"), as opposed to a state sales tax in the United States. Costa Rica currently levies its VAT at a rate of 13% for services and products.[31] In the 2014 Costa Rican presidential election, then-candidate Luis Guillermo Solís promised to increase the VAT from 13% to 15%.[32] However, political complications have compromised this now implemented tax increase.[33] The 2018 elections have brought issues related to the VAT back to life. This tax has been a topic of major debate amongst the candidates.[34] In spite of complications in increasing the VAT rate, the president has focused on perfecting issues with its collection.[35] Since his election, a tighter grip on the collection of the IVA has increased the living expenses for Costa Rican, and North American expatriates living within the territory.[36] The same is true for tourists visiting the country.[37] The President's decision to implement strong enforcement practices resonates policy wise with North American principles: those deciding not to move nor visit Costa Rica because of a higher sales tax are not obliged to do so. The privilege of visiting and living in the country is the same policy standard for worldwide taxation within the United States: the benefits come at a price.

Like in most countries, taxation in Costa Rica is complex. Nonetheless, with the exception of the circulation tax, Costa Rica's taxing regime is generally beneficial to the taxpayer, and more financially lenient than that of the United States. The chief benefit is that Costa Rica only taxes source income—that is, income earned within its jurisdiction. Unlike the United States, Costa Rica does not tax residents on income generated outside the country, which is known as worldwide income taxation. One major reason behind Costa Rica's decision to tax only source income is the cost associated with tracking, and eventually collecting tax on foreign earned income.[38]

While this seems like a basic proposition, the "fairness" of source based

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[31] *Iva y Renta,* MINISTERIO DE HACIENDA, http://www.hacienda.go.cr/contenido/13373-iva-y-renta.

[32] Forbes Staff, *No Habrá IVA de 15% en Costa Rica: Gobierno,* FORBES (Jan. 27, 2017, 11:49 AM), https://www.forbes.com.mx/no-habra-iva-del-15-costa-rica-gobierno/.

[33] *Id.*

[34] *Costa Rica Enacts Tax Reform*, EY (Dec.10, 2018), https://taxnews.ey.com/news/2018-2438-costa-rica-enacts-tax-reform.

[35] MINISTERIO DE HACIENDA, *supra* note 31.

[36] While enforcement of collection should not increase the living expenses, the impressive lack of enforcement previously made these expenses practically inexistent; Tatiana Mora, *Pago del IVA Sera Escalonado para Personas Fisicas o Registradas Ante el ITC*, INSTITUTO COSTARRICENSE DE TURISMO, https://www.ict.go.cr/es/noticias-destacadas/1494-pago-del-iva-sera-escalonado-para-personas-fisicas-o-juridicas-registradas-ante-el-ict.html.

[37] *Id.*

[38] CONTRALORÍA GENERAL DE LA REPUBLICA, *El Sistema Tributario en Costa Rica: Contribuciones de un Debate Nacional* 92 (María Teresa eds., 2d ed. 2002), https://cgrfiles.cgr.go.cr/publico/docsweb/documentos/publicaciones-cgr/otras-publicaciones/sistema-tributario.pdf.

taxation has been defended by many outside Costa Rica—mainly those residing in countries with worldwide taxation.[39] How worldwide taxation affects ownership, investments, debt and employment domestically has been analyzed previously by lawyers and economists.[40] However, such a structure does not only have an impact within the United States, but internationally as well. It is likely that Costa Rica avoids worldwide taxation in pursuit of protecting individuals from rigid tax laws while avoiding intervention with foreign tax regimes. Is it fair that such countries have to structure their tax systems just to create a symbiosis with the United States tax system? The inquiry seems merely subjective, but has now gained notoriety in the OECD, as can be evidenced by discussions between developing and developed member nations.[41]

Let's dive into the specifics of the Costa Rican tax system, ignoring momentarily its consequential policy implications. Consider John, an American resident living and working in Costa Rica. John's employer, a Costa Rican business, will withhold 10% of John's salary and this will be the entirety of his Costa Rican personal income tax liability. If John earns $20,000 of income in a year, he will owe $2,000 in income taxes to Costa Rica. The personal income tax exists only at the federal level, which means that John will not owe any personal income taxes to the province (most closely comparable to a state in the United States) where he resides or works.

In order to fully understand the effect of Costa Rican tax rates and regulations on American expatriates, it is important to analyze how the United States taxes these same individuals. In isolation, the Costa Rican tax system is beneficial to American citizens.[42]However, when taken in tandem with the United States' tax treatment, the analysis is more complex. We know that Costa Rica taxes 10% of John's income, but how does the United States treat this foreign earned income?

III. American Taxation of Foreign Income

A. American Taxation: Worldwide Income

The United States taxes its citizens on their worldwide income, which is inconsistent with the international pattern.[43] As aforementioned, this has

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[39] James R. Hines Jr., *Reconsidering the Taxation of Foreign Income,* 62 TAX L. REV. 269, 292 (2009).

[40] *Id.* at 285.

[41] Angel Gurria, *OECD Improve Tax Fairness and Help the Developing World*, OECD (Apr. 24, 2009), https://www.oecd.org/general/improvetaxfairnessandhelpthedevelopingworld.htm.

[42] Ley del Impuesto Sobre La Renta: Determinación de Residencia Fiscal y Certificados de Residencia Fiscal, 2003 (Ley No. 7092, Articulo I) (Costa Rica).

[43] 26 U.S.C. § 911 (2020). *See generally* J. Richard (Dick) Harvey, Jr, *Worldwide Taxation of U.S. Citizens Living Abroad Impact of FATCA and Two Proposals*, (VILL. U., Working Paper No. 2013-3057, 2013).

been a topic of much discussion and debate.[44] An American citizen who no longer resides in the United States still has to pay income tax on his or her worldwide income, regardless of where it was earned. In addition to a personal income tax on their worldwide income, citizens and residents of the United States must pay taxes on the transfer of worldwide assets—namely, estate and gift taxes.[45] The presence of tax treaties can significantly reduce the effect of several of these taxes.[46] However, there is currently no tax treaty between the United States and Costa Rica.

The issues with the American system have been thoroughly debated. The fact that there is no credit for *all* income taxes paid to other jurisdictions disfavors international commerce. The rapid growth of globalization has challenged the uniformity of the American tax system, since most countries are willing to all credit foreign earned income. As discussed, the United States gives a credit for taxes paid to foreign governments but does not exclude income earned in foreign nations from taxation.[47] The United States' decision to tax foreign income further challenges the concepts of ownership, costs of production, and several other economic theories. Different tax rates among foreign countries also pose a threat, as they complicate and further discourage trade and foreign investment given certain circumstances.

In spite of criticism, there has been no recent discussion challenging the constitutionality of worldwide taxation nor the exit tax. Previous scholars have thoroughly debated the policy repercussions of taxing expatriation, and forcing compliance of financial institutions outside national boundaries.[48] The policy arguments against the North American taxation system are generally twofold: on the one hand, debate about what the founding fathers meant with *realization* is determinative of the constitutionality as applied to several of the tax schemes currently in place.[49] On the other hand, whether or not these systems are exploitative and further the economic and political gap between nations has been explored by scholars in the field.[50]

B. United States Taxes and International Economic Inequality

As hinted throughout this article, the United States tax system is overbearing, and has an inevitable effect on foreign relations. This article will analyze the international structure in some detail, but in order to fully understand its effect when taken in tandem with another jurisdiction's tax

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[44] *Id.*

[45] Jeffrey M. Colón, *Changing US Tax Jurisdiction: Expatriates, Immigration, and the Need for a Coherent Tax Policy*, 34 SAN DIEGO L. REV. 1, 17 (1997).

[46] *Id.*

[47] Hines Jr., *supra* note 39, at 278.

[48] Mark E. Berg, *Bar the Exit (Tax)! Section 877A, the Constitutional Prohibition Against Unportioned Direct Taxes and Realization Requirement*, 65 TAX LAW. 181, 213 (2012).

[49] *Id.* at 183.

[50] *Id.* at 181, n.3.

structure, it is important to develop an understanding of the international forum's response to such economic entanglement.

The first important note is that the OECD has acknowledged the presence of competitive tax systems and described how a nation's tax scheme is imperative to its combatting of a global economic climate.[51] The necessity for each country to subsidize school, healthcare, politics, military and other important expenses goes hand in hand with each nations well-being. While this defends the tax structure of a country which fends for its own economic welfare, keep in mind the power disparities between nations around the globe—more specifically, the United States and Costa Rica.

Just how a high tax system can protect a nation's interests, it can also limit developing countries from increasing their gross domestic product ("GDP")[52]. Thus, while it is true that there is evidence of many North Americans renouncing their citizenship to avoid heavy taxation, it is not unreasonable to assume that there are many who simply renounce their dream of retiring abroad as a consequence of such structure.

The already complex domestic tax scheme becomes only more convoluted when considering its interaction with foreign tax schemes. All of the exemptions, deductions, and other "tweaks" discussed below were likely constructed in furtherance of defending foreign relations and economic trade and business.

C. Exclusions and Deductions of the American Tax System

The IRS allows certain exclusions, deductions, and credits to mitigate some of the potential hardships that result when two jurisdictions tax the same income (thus resulting in what is known as double taxation). One of the most important exclusions is the Foreign Earned Income Exclusion (the "FEIE").[53] A taxpayer must meet one of two requirements to qualify for the FEIE: (1) the bona fide residence test; or (2) the physical presence test. An American citizen satisfies the bona fide residence test if he or she resides in another country for the entire taxable year.[54] The physical presence test requires a taxpayer to spend 330 full days in a foreign country.[55]

FEIE remains one of the most important exclusions because it allows a

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[51] Angel Gurría, *Challenges in Designing Competitive Tax Systems,* OECD (June 30, 2011), https://www.oecd.org/tax/exchange-of-tax-information/challengesindesigningcompetitivetaxsystems.htm.

[52] According to US Legal, Gross Domestic Product is "the most comprehensive single measure of aggregate economic output. It represents the market value of the total output of the goods and services provided by a nation's economy." *Gross Domestic Product Law and Legal Definition,* US LEGAL, https://definitions.uslegal.com/g/gross-domestic-product/.

[53] Taylor Denson, *Goodbye Uncle Sam? How the Foreign Account Tax Compliance Act is Causing a Drastic Increase in the Number of Americans Renouncing their Citizenship*, 52 HOUSTON L. REV. 967, 973 (2015).

[54] 26 U.S.C. § 911 (d)(1)(A) (2020).

[55] 26 U.S.C. § 911(d)(1)(B) (2020).

certain amount of foreign income—determined yearly by the Internal Revenue Service ("IRS")—to be domestically tax-free.[56] Similarly, the Foreign Housing Exclusion allows an American taxpayer who lives in another country to deduct certain household expenses from his or her gross income, so long as those expenses are not extravagant under the circumstances.[57] Finally, another major form of alleviation that the United States allows to reduce potential double taxation is the Foreign Tax Credit ("FTC"), which grants taxpayers a credit for income taxes paid to foreign countries against the United States income tax.[58]

So how would the United States tax an American citizen (like John) who works in Costa Rica? Assuming that John lives, and remains employed, in Costa Rica for more than 330 days of the taxable year, he could benefit from FEIE, the Foreign Housing Exclusion, and the Foreign Tax Credit. Costa Rica would tax John's income at a flat rate of ten percent. Under the Foreign Housing Exclusion, John could deduct household expenses, even if his employer expenses them,[59] as long as they are not extremely lavish. John could also credit income taxes paid to Costa Rica against his United States income tax liability. Using the same facts as the previous hypothetical, if John earns $20,000 and pays $2,000 in income taxes to Costa Rica, he would have a $2,000 credit applicable against the United States income tax. Finally, since John earned income in a foreign country, and he satisfies the physical presence test, he could use FEIE to exclude income up to the amount that the IRS allows in that particular tax year. All in all, John receives an advantageous tax result. If John's salary is higher than what the FEIE exclusion allows, John will have to pay income tax on the remaining amount. Note that this example and explanation is simplified. Evolution in the United States tax laws have resulted in other limitation placed on the credits allowed for income earned outside the United States.[60]This emphasizes the classic "cat-and-mouse" game between the IRS and taxpayers: regulations should be strict enough to provide protection from possible loss of funds in offshore transactions, yet simultaneously lenient enough to promote foreign trade and business.

The United States significantly benefits from this process. John, who does not reside in the United States, nevertheless pays United States income tax solely because of his citizenship. While this unique citizen-based

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[56] "Domestically" if considered from the perspective of the Unites States; *Foreign Earned Income Exclusion*, IRS, https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion (last updated Feb. 19, 2020).

[57] Denson, *supra* note 53, at 974.

[58] *Id.* at 973.

[59] *Id.* at 974 (noting that the Foreign Household Exclusion includes household expenses that are covered by the employer).

[60] *See generally* Julie Roin, *Rethinking Tax Treaties in a Strategic World with Disparate Tax Systems,* 81 VA. L. REV. 1753 (1995).

taxation has spurred debates over whether the American government is overreaching, the United States is faced with a significant obstacle—ensuring that its citizens living abroad actually report their income. Moreover, the government's attempts to diminish or eliminate double taxation are weak, and such occurrence is nonetheless resounding.[61] Whether or not this double taxation, considered together with the exit tax, results in decreased expatriation is uncertain, yet probable.

The inherent structures of the Costa Rican and American income taxing regimes rarely change. Instead, so-called tax reform almost always results in mere increases or decreases in income tax rates.[62] The constant changes to Costa Rican tax rates are fatal to its potential status as a tax haven. There is simply too much uncertainty.

IV. Introducing FATCA and Defying Havens

Costa Rica has always had friendly relations with the United States.[63] But its increased popularity as a destination for American expatriates has tested that amity. In order for the United States to collect income taxes from citizens living abroad, they must first know that such income exists. This is easy within the jurisdictional boundaries of the United States—reporting income to the IRS is an obligation of any institution earning income or making payments. Extending the IRS's reach outside the United States is a much more complicated problem, to which the Foreign Account Tax Compliance Act ("FATCA" or the "Act") was the solution.[64] What better way to learn of financial transactions across borders than forcing foreign nations to report them? Or, even better, doing so while shifting the cost of such compliance outside the United States?

A. Origins of FATCA

Congress passed, and President Barack Obama signed, FATCA in 2010.[65] But this was not the United States government's first response to the lack of reporting of foreign accounts.[66] Even as early as 1937, Secretary of

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[61] David R. Burton, *Tax Reform: Eliminating the Double Taxation of Corporate Income*, THE HERITAGE FOUND. (May 18, 2017), https://www.heritage.org/taxes/report/tax-reform-eliminating-the-double-taxation-corporate-income.

[62] *The History of Tax Reform*, WEEK (Nov. 12, 2017), https://theweek.com/articles/736325/history-tax-reform. (explaining that historical changes seen in tax reform have been a result of fluctuations in tax rates).

[63] PETER J. MEYER, CONG. RESEARCH SERV., R40593, COSTA RICA: BACKGROUND AND U.S. RELATIONS, (2009).

[64] Melissa A. Dizdarevic, Comment, *The FATCA Provisions of the Hire Act: Boldly Going Where No Withholding Has Gone Before,* 79 FORDHAM L. REV. 2967, 2969 (2011).

[65] J. Richard (Dick) Harvey, Jr., *Offshore Accounts: Insider´s Summary of FATCA and Its Potential Future*, 57 VILL. L. REV. 471, 472 (2011).

[66] *Id.*

the Treasury Henry Morgenthau determined that disappointingly low tax revenue was a result of the failure to report income by individuals and financial institutions.[67] Similarly, in 1975, the famous John Doe Summons proved that the IRS needed information about unknown taxpayers.[68] With the information that the IRS obtained from this summons, it began to address the failure to report offshore accounts.[69]

One overriding factor seemed to trigger these events: the lack of reporting from foreign financial institutions. The United States did not require financial institutions to report, withhold, or submit information to the IRS with respect to foreign or U.S. taxpayers.[70] To remedy this issue, the government implemented the United States Qualified Intermediary System (known as "QI") in January 2001.[71] This system attempted to compel financial institutions to disclose reporting and withholding information with respect to all U.S. sourced income. The program was beneficial in many ways, but it had one major flaw—the financial institutions only reported and withheld U.S. sourced income, meaning that offshore income could still go unreported.

As time progressed, the lack of reporting foreign sourced income persisted. There was no law, treaty, or regulation that would require a foreign bank or institution to communicate John's earnings in our hypothetical John Example, or, for that matter, any other U.S. citizen living and earning income abroad. In 2009, the United States responded to this issue by creating the Offshore Voluntary Compliance Initiative.[72] The IRS reported that 14,700 U.S. taxpayers admitted that they did not report offshore accounts.[73]

Another program that now works in tandem with FATCA is the Bank Secrecy Act. This law requires Americans to report any account associated with an offshore financial institution that contains more than $10,000 to the IRS.[74] The government requires individuals to file a self-reported form known as the Report of Foreign Bank and Financial Accounts ("FBAR"). Despite FBAR's success in diminishing significant underreporting, the program does not require individuals to report information related to foreign stocks or securities not held in financial accounts or investment vehicles.[75] As a result, investments in, foreign hedge funds, foreign private equity

[67] *Id.* at 473, n.7.

[68] Cecilia K. Dempsey, Note, *The Application of John Doe Summons Procedure to the Dual-Purpose Investigatory Summons*, 52 FORDHAM L. REV. 574, 574 (1984).

[69] INTERNAL REVENUE SERVICE, DEP'T OF THE TREASURY, INTERNAL REVENUE MANUAL § 25.5.7.5.2(6)(d) (Feb. 18, 2016).

[70] *Id*.

[71] *See* 26 C.F.R.§ 1.1441–1(e)(5) (1975).

[72] *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014*, IRS (July 1, 2014), https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised.

[73] *Id.*

[74] *Id.*

[75] *Id.*

funds, foreign financial accounts owned by a financial institution, or foreign real estate accounts are exempt from FBAR reporting requirements.[76]

Pre-FATCA, tax avoidance was a reality, and notwithstanding the small victories, a large number of offshore accounts remained unreported. Because of this, Congress introduced FATCA in January 2009, and, after modifications, it was passed in 2010 as a part of the Hire Act.[77] Under FATCA, all foreign financial institutions are required to identify the nationality of their customers and determine whether they are United States citizens.[78] The government instructed financial institutions to close the accounts of those who were not willing to provide the requisite information.[79] FATCA was a force to be reckoned with, and it appeared to insulate the IRS from every possible instance of underreporting.

B. General Problems with FATCA

The arrival of FATCA did not come without problems—both regarding systematic issues and policy.[80] With respect to systematic issues, the biggest challenges arising from FATCA are due diligence and the cost of compliance.[81] Hypothetically, an offshore bank would be required to conduct the necessary due diligence to comply with FATCA even if 90 percent of its customers were *not* United States citizens. That is, foreign financial institutions ("FFIs") must comply with FATCA even if only a minority of their customers are American citizens. The cost of this due diligence would be significant nontheless.

Another major systematic issue related to FATCA is data privacy and protection. Hackers could compromise social security numbers and information related to funds held by FFIs—a significant potential danger.[82] Do these institutions have the same protections as those in the United States? It is not difficult to imagine that a bank or financial institution located in a third world country does not count with the same political and economic protections as those within the United States. Thus, this tension in and of

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[76] *See generally Report of Foreign Bank and Financial Accounts* (FBAR), IRS https://www.irs.gov/businesses/small-businesses-self-employed/report-of-foreign-bank-and-financial-accounts-fbar (last updated Jan. 9, 2020).

[77] Harvey Jr., *supra* note 65, at 482.

[78] *Id.*

[79] *Id.*

[80] Antonio Bolaños Álvarez & William Zamora Hernández, *Alcance Jurídico del Acuerdo Intergubernamental Entre el Gobierno de los Estados Unidos de América y el Gobierno de la República de Costa Rica para Mejorar el Cumplimiento Fiscal Internacional e Implementar FATCA,* UNIVERSIDAD DE COSTA RICA 1, 25 (2015).

[81] Nirav (Jonathan) Dhanawade, Comment, *I Got 99 Problems and They're All FATCA*, 35 NW. L. REV. 139, 148 (2014).

[82] Andrew Grossman, *FATCA: Citizenship-Based Taxation, Foreign Asset Reporting Requirements and American Citizens Abroad,* https://www.nyulawglobal.org/globalex/Fatca_Citizenship_Based_Taxation.html (2018).

itself impedes foreign economic growth and development.

The intricacies of due diligence inform other areas of concern with respect to FATCA, but this Note will focus on the two most significant: (1) the fact that FFIs are now severing ties with American customers to avoid the FATCA rules altogether; and (2) foreign unhappiness and frustration with the United States' purported overreach. The first problem arises when FFIs cut ties with American customers, attributing their decision to the incredibly high costs of complying with FATCA requirements.[83] If a bank does not have enough resources to cover the costs of FATCA, it must renounce American customers. Then, Americans living abroad are forced to find another banking institution. United States citizens abroad could also experience difficulty when purchasing insurance plans and pension funds; rejecting U.S. customers could become more cost effective than complying with FATCA regulations. Thus, FATCA is directly costing FFI's money not only through compliance, but direct client loss.

The second part of the analysis addresses FATCA's burden on foreign policy. The structure of FATCA makes it difficult to conduct uninterrupted and unencumbered foreign policy.[84] This is partly due to the tension between FATCA and tax treaties. FATCA overrides any provision in a preexisting tax treaty.[85] There are severe consequences if an FFI does not comply with FATCA provisions, including higher withholding rates that often cause a deferral in refund receipts.[86] However, the outcome extends beyond mere economic hardships for FFIs—foreign trust in the legitimacy of tax treaties with the United States is greatly compromised, causing tension in foreign relations.[87] Not only does it highlight foreign treaties and previous agreements as replaceable and irrelevant when considered with domestic law, but foreign agreement with the Act is inherent through incredible discrepancies in bargaining power. No nation will resist engaging in economic business with the United States, no matter how high the costs of compliance may be.

Issues related to bank secrecy laws also play a part in damaging foreign relations between the countries. Many countries have laws barring financial institutions from transferring client information to a foreign government.[88]

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[83] Joanna Heiberg, *FATCA: Toward A Multilateral Automatic Information Reporting Regime*, 69 WASH. & LEE L. REV. 1685, 1702 (2012).

[84] *See generally Foreign Account Tax Compliance Act (FATCA): A Critical Tax Evasion Tool,* INST. TAX'N & ECON. POL. REP. (May 2017), https://itep.org/foreign-account-tax-compliance-act-fatca-a-critical-anti-tax-evasion-tool/.

[85] Heiberg, *supra* note 83*,* at 1703.

[86] *Id.*

[87] Dizdarevic, *supra* note 64, at 2970.

[88] *See* David Jolly & Brian Knowlton, *Law to Find Tax Evaders Denounced*, N.Y. TIMES, Dec. 27, 2011, https://www.nytimes.com/2011/12/27/business/law-to-find-tax-evaders-denounced.html ("Enforcement of the law will be tricky, as many countries... forbid banks or companies to transfer such information directly to a foreign government.") (quoting Jeffrey Owens, tax expert at the Organization for Economic Cooperation and Development).

The inherent friction between domestic national laws and FATCA requirements has caused many countries to interpret FATCA as an overreach by the United States government, infringing on the sovereignty of foreign nations and placing an unnecessary burden on the relationships between nations. Even so, the IRS has neither responded to these foreign concerns nor changed FATCA requirements, and financial institutions in countries with bank secrecy laws often face withholding punishments as a result.[89] It is not difficult to see how the extensive and complex requirements of FATCA could interfere with relations between the United States and other sovereign nations.

C. Costa Rica and FATCA

Even though the United States enacted FATCA in 2010, the United States Department of Treasury did not sign an Intergovernmental Agreement ("IGA") with Costa Rica until November 26, 2013.[90] IGA Agreements take several forms, but the FATCA treaty with Costa Rica is in the 1A category.[91] This means that even though FFIs in Costa Rica provide information about American citizens to the IRS, the United States government will also provide information to Costa Rica regarding Costa Rican citizens living in the United States.[92]

This news created an uproar. Since its passage in 2013, FATCA has caused several problems within Costa Rican FFIs. The media reported a general feeling of disdain for the Act, mainly out of fear that Costa Rica's popularity among the expatriate population would decline, thus affecting the economy.[93] Some media channels in Costa Rica promoted FATCA, stating that those who were retired in Costa Rica and had nothing to hide did not have to worry.[94] Another contrasting reaction was concern for the Canadian citizens in Costa Rica, and how the IRS's implementation of FATCA would seize fiscal control from both countries and threaten their national sovereignty.[95]

D. Probable Consequence: Organization for Economic Cooperation and Development

As expected, the Act was controversial; there were both advocates and

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[89] Colón*, supra* note 45, at 1704.

[90] *Foreign Accounts Tax Compliance Act – FATCA*, U.S. EMBASSY IN COSTA RICA, https://cr.usembassy.gov/business/foreign-accounts-tax-compliance-act-fatca/.

[91] *Id.*

[92] *Id.*

[93] Jaime Lopez, *Worried about FATCA in Costa Rica? You Are Not Alone,* COSTA RICA STAR (Sept. 22, 2014), https://news.co.cr/worried-about-fatca-in-costa-rica-you-are-not-alone/35076/.

[94] Henfling, *supra* note 26.

[95] Jaime Lopez, *FATCA Puts Canada and Costa Rica in the IRS Pockets*, COSTA RICA STAR (Mar. 6, 2014), https://news.co.cr/fatca-puts-canada-and-costa-rica-in-the-irs-pockets/33627/.

detractors. However, there was a more unexpected consequence arising from FATCA: the OECD. The OECD, an international lawmaking organization, arose during a period of turmoil, and survived by maintaining a low profile.[96] It was first established to administer the reconstruction of Europe, and, more generally, to promote economic growth and expansion.[97] More importantly, its research institution has more than 2,000 employees who collect data to further the OECD's mission.[98] The OECD makes recommendations, decisions, and facilitates agreements with other governmental bodies.[99]

The first of those—recommendations[100]—are nonbinding policy agreements.[101] With respect to tax, the OECD had previously implemented recommendations to advocate for decreased tax avoidance.[102] These recommendations focus on the exchange of information between countries, endorsing the use of nonbinding, but strongly supported, agreements.[103] However, not all of the OECD's agreements and legal actions are nonbinding. The second category of OECD legal actions—decisions—are binding on member countries.[104] The part the OECD plays in the interaction of tax systems directly emphasizes many of the policies issues with the United States tax system, and more specifically, with the direct application of FATCA in a foreign jurisdiction. This theme will be highlighted further throughout the Note.

V. RENOUNCING CITIZENSHIP: THE EXIT TAX

John, our hypothetical American citizen residing in Costa Rica is enjoying his life, as long as his deductions and exemptions allow his United States income tax liability to remain low. However, his concerns begin once his income starts exceeding the allowed deductions, requiring him to pay a significant amount in income taxes to the United States—a country that is no longer his home. It is at this point that John considers renouncing his American citizenship.

It would not be the first time that a taxpayer wished to renounce his or her citizenship for tax purposes. However, renouncing United States citizenship is not without myriad negative consequences. Some commentators believe that the debilitating tax effects stemming from

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[96] James Salzman, *The Organization for Economic Cooperation and Development's Role in International Law*, 43 GEO. WASH. INT'L. L. REV. 255, 255 (2005).

[97] *Id.* at 256.

[98] *Id.* at 257.

[99] *Id.* at 258.

[100] Also known as "Acts of the Organization" amongst the OECD and its member nations.

[101] Nicola Bonucci, *The Legal Status of an OECD Act and the Procedure for its Adoption,* OECD, available at http://www.oecd.org/education/skills-beyond-school/31691605.pdf

[102] Salzman*, supra* note 96, at 258.

[103] *Id.*

[104] *Id.*

renunciation is yet another example of an American overreach.[105]

A. History of the Exit Tax

The Clinton administration proposed an exit tax in February 1995.[106] The proposed exit tax would apply to expatriates as well as those wishing to relinquish their citizenship.[107] The Clinton administration's exit tax was based on a mark-to-market regime; that is, for tax purposes, the government would assume that the expatriate sold all of his or her assets for fair market value.[108] An expatriate would be subject to the exit tax on any gain exceeding $600,000.[109] The Clinton Administration was not the first to mention the exit tax; Senator Moynihan made a similar proposal earlier.[110] Senator Moynihan's proposal included a broader variety of exemptions and differed from the Clinton administration's proposal in other ways, although the general concept was the same.[111] These proposals laid the groundwork for the current exit tax, which Congress adopted in the HEART Act for all residents wishing to relinquish their citizenship prior to 2008.[112]

B. The Art of the HEART Act

The heart (pun intended) of the exit tax that Congress passed in 2008 was based on the Clinton Administration's proposal. The approved program consisted of a one-time tax on the "net unrealized gain in a citizen's property as if the property had been sold for its fair market value on the day before citizenship relinquishment or residency termination."[113] Modeled after the Clinton Administration's original proposal, the statute allowed an exemption of $600,000 as well.[114]

The HEART Act reaffirmed that until an American citizen relinquished his or her citizenship, that citizen would still be taxed according to the regular rules.[115] The statute also made several changes from the original proposal with respect to taxation of gifts and bequests, tax treaties, and tax deferments.[116] Section 2801 of the Internal Revenue Code requires any U.S.

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[105] *See e.g.*, Peter J. Spiro, *Citizenship Overreach*, 38 MICH. J. INT'L L. 167, 186 (2017) (referring to the United States' citizenship-based income tax regime, including the expatriation rules, as "[c]itizenship [o]verreach.").

[106] William L. Dentino & Christine Manolakas, *The Exit Tax: A Move in the Right Direction,* 3 WM. & MARY BUS. L. REV. 341, 380 (2012).

[107] *Id.*

[108] *Id.* at 381.

[109] *Id.*

[110] S. 700, 104th Cong. Statute 1 (1995).

[111] *Id.*

[112] Dentino & Manolakas, *supra* note 106, at 381–82.

[113] I.R.C § 877A(a)(1) (2018).

[114] *Id*. § 877A(a)(3).

[115] *Id*. § 877A(g)(3).

[116] Dentino & Manolakas, *supra* note 106, at 395.

citizen that received a gift or bequest from an expatriate to pay a "succession tax" equal to the value of the property received and multiplied by the greater of the estate tax rate or the gift tax rate.[117] The government would continue to tax individuals that renounced their citizenship prior to June 17, 2008 under the alternative tax regime.

The HEART Act caused much unhappiness. Since its implementation in 2008, litigants have raised constitutional challenges to the exit tax.[118] However, the United States Constitution does not recognize expatriation as a fundamental right.[119] This has been a government defense of the constitutionality of the exit tax. Conversely, a perhaps more convincing argument lies in the fact that the exit tax is a direct tax, which, in order to be consistent with the Constitution, must be apportioned among the states. The exit tax naturally is not. Constitutional challenges to the exit tax have been unfruitful and given rise only to weak contradicting precedent.

Another argument in opposition of the exit tax is that the exit tax violates international law. The Universal Declaration of Human Rights, which the United Nations and United States adopted in 1948, defends the right to expatriate and migrate.[120] A country cannot burden expatriation to such a significant degree that the right is completely extinguished.[121] Even though some argue that the exit tax burden does not constitute a *de facto* prohibition on expatriation, there may be circumstances where the burden effectively does.[122]

C. Policy Issues with the Exit Tax

The constitutionality of the exit tax is not the only challenge that it faces. The exit tax has similar enforcement concerns to those of FATCA.[123] The reporting of foreign financial institutions is crucial to determining the assets of U.S. citizens living abroad, and thus assessing their exit tax liability. The valuation of assets is intricate, and, at times, may be subjective.[124] The timing of expatriation is another potential issue. Individuals may expatriate at different times based on the value of their assets. An individual with appreciating assets may choose to expatriate faster than they would otherwise.[125] The result for international policy purposes remains the same:

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[117] *Id.*

[118] Steven J. Arsenault, *Surviving the HEART Attack: Expatriation and the Tax Policy Implications of the New Exit Tax*, 24 AKRON TAX J. 37, 61 (2009).

[119] *Id.*

[120] *Id.* at 62.

[121] JOINT COMMITTEE ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURE FOR FISCAL YEARS 1995-1999 (1994).

[122] *See generally* William Thomas Worster, *The Constitutionality of the Taxation Consequences for Renouncing U.S. Citizenship,* 9 FLA. TAX REV. 923 (2010).

[123] I.R.C. § 877 (2018); I.R.C. § 877A (2018).

[124] I.R.C. § 877A (2018) (guidance for expatriates under § 877A).

[125] Arsenault, *supra* note 118, at 65.

individuals will reconsider and measure the time and cost of moving to Costa Rica. When the cost of expatriating is too high, an individual could forego his plans to expatriate and move. The diminishing number of expatriations increase US tax law by continuing flows of income for the US government but halt the Costa Rican economy.

Finally, the exit tax significantly increases the potential for double taxation.[126] The individual responsible for the exit tax almost certainly pays taxes in another jurisdiction. As FATCA shows, however, the American government is not particularly concerned with double taxation. The implementation of the Exit Tax portrays that the United States has little concern about developing nations and their economies. This same pattern is now being reflected within the state tax schemes of the United States: individuals working in New York will often retire in Florida, and feed Florida's economy.[127] Note, however, that the equivalent to a state exit tax does not exist.

VI. THE CONVOLUTED TASK OF DEFINING A TAX HAVEN

The first step in analyzing whether Costa Rica is in fact a tax haven is to define the term "tax haven." Scholars generally agree on the definition of a tax haven; more specifically, indicia reflecting that a country has achieved tax haven status. These characteristics include: (1) problems with the exchange of information; (2) lack of transparency; (3) no taxes or very low taxes; and (4) no requirement of substantial activity.[128]

There are other general characteristics that are shared by tax havens. Tax havens are usually more affluent than non-havens, they are not flush with natural resources, and they have a close proximity to large capital exporters.[129] Furthermore, they are likely not sovereign states and tend to have parliamentary rather than presidential political systems.[130]

Even though many of the requirements of tax haven status relate to corporate taxation, the tax haven analysis also addresses personal income taxation—namely, issues such as bank secrecy laws and preferential rates for foreign investors.[131] Strictly from a corporate perspective, the Costa Rican tax system analysis is straightforward. Engaging in the tax haven

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[126] Marie-Thérèse Yates & Jacopo Crivellaro, *Global Mobility and Exit Taxes: An Overview*, 29 GLOBAL EMP.: GLOBAL IMMIGRATION & MOBILITY Q. (2016).

[127] Beth DeCarbo, *In Florida, Homeowners Come for the Weather and Stay for the Tax Relief*, WALL ST. J. (Jan. 8, 2020), https://www.wsj.com/articles/in-florida-homeowners-come-for-the-weather-and-stay-for-the-tax-relief-11578501325.

[128] ORG. FOR ECON. COOPERATION AND DEV., HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE, 23 (1998).

[129] Dhammika Dharmapala, *What Problems and Opportunities are Created by Tax Havens?*, 24 OXFORD REV. ECON. POL'Y 1, 4 (2008).

[130] *Id*. at 5.

[131] Elke Asen, *The Good and Bad About Tax Havens*, TAX FOUND. (Aug. 1, 2019), https://taxfoundation.org/tax-haven/.

analysis from a personal income standpoint is much more convoluted. Investors often explore new markets to globally diversify their portfolios.[132] An analysis of the tax rates that a foreign government applies to these portfolios and the patterns of foreign investment by individuals in the United States is what determines whether a country is an international tax haven for foreign investment purposes.

Economists have suggested other definitions of tax haven status, focusing primarily on the tax rates themselves rather than on other characteristics. One example is James Hine, who focuses primarily on countries with low or zero tax rates.[133] Another example is Gabriel Zucman, who focuses almost exclusively on bank secrecy. Zucman's ultimate conclusion is that countries with bank secrecy laws help wealthy individuals more easily hide their income, as there is no need to report to their home countries.[134]

Of course, the various scholars have chosen different characteristics that they believe to be most important to the tax haven analysis. These definitional discrepancies are concerning, but in practice, each individual country will ultimately determine when to label another nation a tax haven.

When determining the importance of an undefined term, it is important to remember the international implications that arise with its association. The facts seem to imply that the tax haven test is somewhat of a balancing test: there are countries that would easily comply with all characteristics, but some others may not clearly favor one conclusion over the other. In spite of this, the international weight carried by such a term is too strong in relation to ambiguity of its test. When analyzing Costa Rica's haven structure, keep in mind the very serious repercussions that arise from being considered an international tax haven.

VII. CLOSE TO HAVEN

This Note shows that a complex tax structure affects expatriation. The difficulties that a U.S. citizen faces when moving to Costa Rica are not to be taken lightly. The American tax system is financially burdensome, whereas the Costa Rican tax system is much more favorable to taxpayers. In spite of this, this Note concludes that Costa Rica is not currently a tax haven for expatriates. In fact, it is moving even further away from tax haven status.

Very generally, Costa Rica is not a tax haven because: (1) its taxing regime does not bear the indicia of a tax haven; (2) it taxes and withholds

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[132] *Id.*

[133] Conor Clarke, *What are Tax Havens and Why are they Bad?*, 95 TEX. L. REV. 59, 70 (2016) (reviewing GABRIEL ZUCMAN, THE HIDDEN WEALTH OF NATIONS: THE SCOURGE OF TAX HAVENS (2015)).

[134] GABRIEL ZUCMAN, THE HIDDEN WEALTH OF NATIONS: THE SCOURGE OF TAX HAVENS 115 (2015).

income that American citizens earn in Costa Rica; (3) it has high luxury and property taxes; (4) it complies with FATCA; and (5) the exit tax. Section VI analyzes each of these determinations in closer detail and reaches such conclusions while highlighting some major public policy concerns.

A. General Application of the Tax Haven Test

As discussed, the only way to determine whether a country is a tax haven is balancing natured test that weighs the various indicia of tax haven status. The characteristics of a tax haven, as this Note explains above, include: (1) the country's transparency; (2) the country's affluence; (3) whether the country has low or no natural resources; and (4) whether the country has low or no taxes. Costa Rica's taxes are significantly lower than those of the United States, yet they are still significant. As detailed in Section I, Costa Rica goes as far as taxing income and property that the United States does not tax.[135] Furthermore, Costa Rica is rich in natural resources, mainly bauxite and copper.[136] The country is not economically affluent—its fiscal health is deteriorating and there is significant economic inequality.[137]

U.S. citizens living in Costa Rica are still subject to taxation, and while such structure could be beneficial, they are not exempt from it. Costa Rica's personal income tax is relatively significant for these individuals, and businesses must withhold taxes from those working in the country[138]. Costa Rica also taxes U.S. citizens on their real property and vehicles, and they are subject to the 13% VAT[139]. Recognized tax havens, like Bermuda, do not have a VAT, nor do they withhold personal income tax.[140] Corporate profit shifting, a common practice in Bermuda, has not materialized to any significant degree in Costa Rica.[141] The country's compliance with North American treaties and other laws prevents the frequent occurrence of activities that are common in true tax havens.

Responsible reporting and compliance requirements are not the only reasons that Costa Rica does not constitute a tax haven. The country also

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[135] *See supra,* text accompanying section I.

[136] Thomas L. Karnes et al., *Costa Rica*, BRITANNICA, https://www.britannica.com/place/Costa-Rica/Resources-and-power.

[137] *The World Bank in Costa Rica,* WORLD BANK (last updated Oct. 10, 2019), http://www.worldbank.org/en/country/costarica/overview.

[138] Tipos de Retenciones en la Fuente Impuesto Sobre de la Renta, MINISTERIO DE HACIENDA 6 (2013).

[139] *Generalidades del Impuesto sobre el Valor Agregado (IVA)*, MINISTERIO DE HACIENDA, https://www.hacienda.go.cr/contenido/15035-generalidades-del-impuesto-sobre-el-valor-agregado-iva (2019).

[140] Bermuda Tax Guide, PFK WORLDWIDE TAX GUIDE 1, 2 (Jan. 1, 2013), http://www.pkf.com/media/1954302/bermuda%20pkf%20tax%20guide%202013.pdf.

[141] Ben Chu, *Offshore Tax Havens: How do They Work? What Can be Done About Them?*, INDEPENDENT, https://www.independent.co.uk/news/business/analysis-and-features/offshore-tax-havens-how-do-work-what-done-change-paradise-papers-panama-bermuda-caymans-turks-caicos-a8039916.html.

relies on the imposition of smaller scale taxes that do not exist in the Cayman Islands or Bermuda, such as the departure tax and the luxury tax. These taxes help Costa Rica further distance itself from tax haven status. Finally, international corporate participation is much less common in Costa Rica than in other known tax havens. Large corporations do not often place their headquarters in Costa Rica for the sole purpose of avoiding taxes. Most international corporations that are domiciled in the country chose Costa Rica because of other factors, such as a less expensive workforce, more access to sustainability, and geographic location.

B. Tax Haven Tendencies in Costa Rica

Costa Rica's compliance with FATCA and its ongoing (and positive) relations with the United States support the proposition that the nation is far from a tax haven. However, the future of Costa Rica and its financial well-being is much more turbulent. Certain characteristics seem to imply that Costa Rica's tax structure may implement some tax haven tendencies.

First, the presence of strict secrecy laws. The Financial Secrecy Index of 2018 determined that Costa Rica has a secrecy score of 68.65 percent.[142] This is comparable to the secrecy scores of large tax havens, such as Bermuda, which has a score of 73.06 percent.[143] According to a Tax Justice Network report, Costa Rica's reporting of Consistent Personal Income Tax is "exceptionally secretive."[144] This report is not to be taken lightly. Needless to say, a country's secrecy score should not necessarily be determinative of its tax haven structure. It would be preposterous to conclude that in order to fully be accepted as an international economic "team player", one has to be willing to share all national transactions, notwithstanding the cost of doing so.

Second, the implementation of completely tax-free zones around the Nation. Costa Rica becoming a tax haven has previously been discussed in light of the proliferation of Tax-Free Zones, or "Zonas Francas." These zones are one of the strongest indicators of Costa Rica's potential fiscal concerns. The Free Zone Regimen (or, "Regimen de Zonas Francas") is a regime promoting development in certain areas of the country. This regime seeks to fight unemployment and poverty; the government provides benefits that incentivize companies and individuals to develop and invest in those areas.

The Costa Rican legislature passed the Free Zone Regimen via Law #7210 on November 23, 1990.[145] The law intends to create tax advantageous

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[142] Financial Secrecy Index, TAX JUSTICE NETWORK, https://www.financialsecrecyindex.com/PDF/CostaRica.pdf.

[143] *Id.*

[144] Lopez, *supra* note 95.

[145] Ley de Regimen de Zonas Franceas, Ley 7210 (2019).

zones in underdeveloped parts of the country.[146] The goal of law #7210 was simple—increase investment and development. In fact, the legislature specified these goals in the bill.[147] The Free Zone Regimen had a unique plan; it would allow businesses to escape any taxation for a certain set amount of years, depending on the region in which they were located.[148] The law divided "free zones" into categories based on the socioeconomic characteristics of each region. The less prosperous the area, the greater the time period of tax-exempt status for these international companies.[149] The legislature believed that once a company successfully invested in a particular region, it would continue to invest in that area and contribute tributary income even when the Free Zone Regimen expired. Law #7210 also allowed companies who made an effort to reinvest in Costa Rica to become candidates to receive an extension on the time period in which their activities were tax-free.[150]

The legal backlash toward the Free Zone Regimen continues today. Following the passage of Law #7210, governmental bodies continued to pass laws to appeal to international corporations. These laws have made it even easier for foreign corporations to obtain tax benefits. Furthermore, in 2017, Costa Rica amended immigration laws to allow for a smoother migration for members of international companies residing in tax-free zones.[151] These international employees would be able to obtain residency with much fewer requirements than others, and in less time.[152] Costa Rica has a strong interest in maintaining these zones, as they contribute to approximately 6 percent of the country's income.[153]

The policy concerns arising from such issues should not be ignored. Tax Free Regimes have been incredibly beneficial to Costa Rica's economic well-being. They have also been responsible for job opportunities in areas with high unemployment. Despite these positive results, the international response to the regime was overwhelmingly negative. An article KPMG published in January 2018 detailed how Brazil deemed Costa Rica a "privileged tax regime" due to the tax benefits arising from Zonas Francas.[154] The economic success of Law #7210 is recognizable, but so is

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[146] *Id.*

[147] *Id.*

[148] *Id.*

[149] *Id.*

[150] *Id.*

[151] Marco Avellán & Simón Sauve, *Migración Abre Registro para Empresas de Zonas Francas para Facilitar Trámites*, ECONOMIA Y POLITICA (Jan. 15, 2017), https://www.elfinancierocr.com/economia-y-politica/migracion-abre-registro-para-empresas-de-zonas-francas-para-facilitar-tramites/Y6RES24F7BFTBEVJI3QQ76AE54/story/.

[152] *Id.*

[153] *Id.*

[154] *Brazil: Changes to "tax haven" and "privileged tax regimes" lists*, KPMG (Jan. 17, 2018), https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion.

its tax haven natured personality. It is precisely the presence of such a dichotomy that highlights public policy concerns: should Costa Rica endanger its own economic well-being merely to avoid international scrutiny? Naturally, they should not be forced to choose when the implementation of such structures is *bona fide,* that is, not in pursuit of tax avoidance, but just the economic welfare the Nation.

Finally, previous denomination as a tax haven affects the current balancing test. In the past, the international community has concluded that Costa Rica is in danger of becoming a tax haven.[155] The media's response has been similar. Past events, such as the Panama Papers, have led to an increasing international perception of Costa Rica as a tax haven.[156] In 2017, the Costa Rican Department of Treasury opened 120 investigations arising from the Panama Papers leak.[157] Costa Rica investigated 41 individuals from 79 countries for crimes including failure to distribute dividends, reporting inaccurate and fraudulent expenses and losses, and declaring zero tax liability for several fiscal periods.[158] Furthermore, many of these companies and individuals are also under scrutiny for the possible offshore transferring of money between Costa Rica and Panama.[159]

The Panama Papers shed light on much more than a potential fiscal problem in Costa Rica shared amongst its Central American neighbors. The European Union actually placed Panama on a tax blacklist.[160] The world has not taken the EU's classification of Panama as a tax haven lightly. The president of Panama, Juan Carlos Varela, has argued that the EU's classification was both unfair and a mistake.[161] According to Panama government officials, the country has taken several measures to fight corruption and achieve financial stability.[162] Since then, European Union officials have removed Panama from the tax haven blacklist.[163] Many oppose the EU's removal of Panama from the blacklist because it has been the center of several financial scandals in the past.

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[155] *Notorious Tax Haven to be Let Off the Hook in EU's Blacklist Review*, OXFAM INT'L (Mar. 6, 2019), https://www.oxfam.org/en/press-releases/notorious-tax-havens-be-let-hook-eus-blacklist-review (indicating that Costa Rica was previously on the "gray list" of countries that could eventually become tax havens).

[156] Wendy Anders, *Costa Rican Treasury Opens 120 Investigations for Panama Papers Connections*, COSTA RICA STAR (Mar. 22, 2017), https://news.co.cr/costa-rican-treasury-opens-120-investigations-for-panama-papers-connections/58248/.

[157] *Id.*

[158] *Id.*

[159] *Id.*

[160] Katie Martin, *Davos 2018: 'Unfair' Panama was Put on Tax Blacklist Says President*, FASTFT WORLD (Jan. 25, 2018), https://www.ft.com/content/f0840308-01b7-11e8-9650-9c0ad2d7c5b5.

[161] *Id.*

[162] *Id.*

[163] Bjarke Smith-Meyer, *8 Countries Removed from EU Tax Haven Blacklist, Sparking Criticism*, POLITICO (Jan. 23, 2018), https://www.politico.eu/article/8-countries-removed-from-eu-tax-haven-blacklist-sparking-criticism/.

The recognition of Panama as a tax haven is highly relevant to the financial status of Costa Rica. The two countries are not only neighbors, but also share a similar culture, language, and geographic and social categories. Many of the arguments distancing Costa Rica from a tax haven also apply to Panama. Even more concerning, Panama's tax structure is much more complex than that of Costa Rica. Unlike Costa Rica, Panama does have a personal income tax scheme for those earning over $11,000 dollars per year.[164] Furthermore, Panama has a flat corporate income tax rate of 25%.[165] The fact that Panama's personal and corporate income tax rates are much higher than those of Costa Rica is concerning—and a possible indicator that Costa Rica may be a tax haven after all.

The fact that the EU momentarily deemed Panama to be a tax haven does not mean that the country's financial scheme will continue to bear the indicia of a tax haven.[166] In the past, European and South American countries have classified Costa Rica as a tax haven as well. For example, Brazil and France have previously included Costa Rica on tax haven lists.[167] In 2018, Brazil removed Costa Rica from its list, reducing Brazil's concerns with offshore investment in Costa Rica.[168] In 2010, Costa Rica faced sanctions from the French government, which feared that Costa Rica's lack of regulations would incentivize tax evasion—a typical characteristic of a tax haven.[169] The minister of presidency at the time, Rodrigo Arias, clarified that the only haven that Costa Rica wished to be was a "peace haven," condemning France's perception of the country as a tax haven.[170] Additions and subsequent removals from these tax haven lists have become a part of Costa Rica's financial culture. While the financial structure of Costa Rica is dangerously close to that of a tax haven, there are several future events that will soon occur that could once and for all eliminate the possibility of Costa Rica achieving tax haven status.

C. Issues with Foreign Pressure of Tax Havens

Developed countries have the strongest issues with tax havens: it is their taxes that are at risk with the existence of such financial structures. Thus, the

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[164] Emile Martin, *Panama Taxation and Working Conditions*, INTERNATIONS, https://www.internations.org/panama-expats/guide/working-in-panama-15671/panama-taxation-and-working-conditions-4.

[165] *Id.*

[166] Francesco Guarscio, *EU Removes Panama, Seven Others from Tax Haven Blacklist, Triggering Criticism,* REUTERS (Jan. 23, 2018), https://www.reuters.com/article/us-eu-tax-blacklist/eu-removes-panama-seven-others-from-tax-haven-blacklist-triggering-criticism-idUSKBN1FC13K.

[167] *France Exclude Costa Rica from Tax-Haven List*, TICO TIMES (Fed. 28, 2012) https://ticotimes.net/2012/02/28/france-excludes-costa-rica-from-tax-haven-list.

[168] *Id.*

[169] Chrissie Long, *Costa Rica: A Tax Haven?* TICO TIMES (Mar. 5, 2010), http://www.ticotimes.net/2010/03/05/costa-rica-a-tax-haven.

[170] *Id.*

fear of tax havens is merely in pursuit of self-interest. This Note has highlighted the constant prioritization of each nation's own economic welfare. Is it correct, then, that such international scrutiny is exerted on tax havens when they are seeking to advance their own economic development?

Organizations like the OECD have attempted to mitigate concerns like such by promoting political negotiation and discussion. However, the OECD has also faced backlash. Certain individuals consider that such organizations and their international forums serve merely to reflect and further the interests of the developed nations, and therefore serve no true purpose.[171]

Without a true international forum, and increased economic pressure, is it difficult to imagine why a nation would protect its tax haven status in order to defend economic growth? In a way, the United States 2017 Tax Cuts and Jobs Act[172] makes the United States a corporate tax haven. It is rather unlikely that any developing nation's pressure would cause the United States to reconsider domestic protection in fear of tension in foreign relations. Moreover, the United States proves once again that the true definition of a tax haven includes only underdeveloped nations. In any other case, an overbearing tax scheme would merely be considered protective.

VIII. AVOIDING HAVEN STATUS: FUTURE HARDSHIPS

The financial future of Costa Rica is tumultuous. The 2018 election resulted in significant changes that may affect the nation's economy. The United States' own tax overhaul has also given rise to a new era, one in which Costa Rica may eliminate its advantageous tax structure. The results of the 2018 elections could potentially lead to a change in Costa Rica's tax structure. The new president may seek to move the corporate tax structure further left. Similarly, President Trump's proposed tariffs on certain Costa Rican products could burden the financial relationship between the two countries. Furthermore, Costa Rica's interest in carbon neutrality increases the potential for the enactment of a carbon tax.[173] Finally, Costa Rica's participation with the OECD may lead to more treaties mandating less secrecy and further transparency between members, thus decreasing the likelihood that Costa Rica ever reaches tax haven status.

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[171] Christopher Lingle, *OECD Policy Equals Fiscal Imperialism*, JAPAN TIMES (June 30, 2001), https://www.japantimes.co.jp/opinion/2001/06/30/commentary/world-commentary/oecd-policy-equals-fiscal-imperialism/#.XiZ7Qy2ZNDV.

[172] Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (codified as amended in scattered sections of 26 U.S.C.).

[173] *Putting a Price on Carbon with a Tax*, WORLD BANK, https://www.worldbank.org/content/dam/Worldbank/document/SDN/background-note_carbon-tax.pdf (stating that Costa Rica has a 3.5% tax on "hydrocarbon fossil fuels." Even if there is no set carbon tax per se, this does indicate the indicia of environmental taxation).

A. Costa Rica 2018 Elections

The 2018 Costa Rican elections were unlike any other the country has seen. The results from the primary elections resulted in two diametrically opposed candidates (in spite of their shared last name): Fabricio Alvarado, a far-right candidate running a campaign that emphasized religion and promoted corporate growth and international trade[174], and Carlos Alvarado, a socialist candidate seeking to increase regulations and taxes on corporations to pursue the well-being of less fortunate economic classes. On April 1, 2018, Carlos Alvarado defeated Fabricio Alvarado in the presidential election.[175]

Newly elected President Carlos Alvarado proposed an increase in the VAT from 13% to 15%.[176] During the campaign, he also promoted the implementation of an increased luxury tax to raise revenue for government programs.[177] Alvarado's international plan composed of increased international regulation for commercial protection.[178]

The President's proposed agenda would significantly change Costa Rica's tax structure. The president's goal of inciting new job opportunities is evident, and thus the new government may amend the current taxing regime's treatment of both foreign individuals and corporations.[179] Furthermore, the president has argued that a two percent increase in the VAT rate would allow Costa Rica's tax structure to "resemble those of developed countries."[180]

In general, Carlos Alvarado's proposed tax plan includes an increase in all forms of taxation to improve education, transportation, and the development of public programs. The President has stated that the country should not depend so heavily on the aid of international corporations and individuals.[181] The centrist and right-wing parties have virulently opposed this view, arguing that such actions would significantly damage the

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[174] *Id.*

[175] *Meet Costa Rica's 48th President, Carlos Alvarado*, TICO TIMES (Apr. 1, 2018), https://ticotimes.net/2018/04/01/carlos-alvarado-novelist-musician-and-presidential-candidate-in-costa-rica-2.

[176] Laura Ávila, *¿Cuáles son las Propuestas de Carlos Alvarado y Fabricio Alvarado para Impulsar la Economía?*, EL FINANCIERO (Feb. 7, 2018), https://www.elfinancierocr.com/economia -y-politica/cuales-son-las-propuestas-de-carlos-alvarado-y/7IQ7CSPBQRB7LIL4ZIWRINNC2Y/story/.

[177] *Id.*

[178] *Id.*

[179] Jeffry Garza, *Amazon Ayuda a Carlos Alvarado a Cumplir Promesa de 3 Mil Nuevos Empleos*, LA REPUBLICA (June 27, 2019), https://www.larepublica.net/noticia/amazon-ayuda-a-carlos-alvarado-a-cumplir-promesa-de-3-mil-nuevos-empleos.

[180] Manuel Avendaño Arce, *Carlos Alvarado Necesitamos un IVA del 15% Para Atacar el Déficit Fiscal,* EL FINANCIERO (Oct. 21, 2017), https://www.elfinancierocr.com/economia-y-politica/carlos-alvarado-necesitamos-un-iva-del-15-para/7B4GV6KDO5BDRHNYTPIUL4C44U/story/.

[181] Josué Alfaro, *Paso a Paso: ¿Qué Dice el Plan Fiscal del Gobierno?,* SEMANARIO UNIVERSIDAD (July 9, 2018), https://semanariouniversidad.com/pais/paso-a-paso-que-dice-el-plan-fiscal-del-gobierno/.

country's economic stability.[182] A tax structure like that proposed by the President could potentially result in economic hardships for Costa Rica, but it could also allow the country to move further away from tax haven status. Or it could result in precisely the opposite. Increased distance from international relationships could isolate Costa Rica, making the country's tax structure appear to be a tax haven. Carlos Alvarado's proposal includes the creation of a bank.[183] He has been unclear on whether or not this bank would conform to the regulations in international treaties, such as FATCA. He has also failed to fully explain the proposed bank's intended relationship with American citizens, and other foreign clientele. How the new presidency will affect Costa Rica's tax structure remains an open question.

B. The Fiscal Plan

Even though several of President Alvarado's tax proposals are merely hypothetical at this juncture, his administration has nonetheless solidified tax reform (referred to by Costa Ricans as the "Fiscal Plan") that involves change. The passage of this particular reform mitigates against Costa Rica's potential status as a tax haven because it places a greater tax burden on both U.S. citizens and expatriates.

The legislature first passed the Fiscal Plan in September 2018, and discussions on how to perfect the plan have continued through the end of that year.[184] The structure of the plan, seeking to increase taxes altogether, including property taxes and the VAT, is inspired by the government's debt, which has now surpassed 50% of the total production of the country (GDP).[185] The government deemed the new tax program necessary to stabilize the country's economic future, but the people's perception of the Fiscal Plan was not welcoming.

Discussing tax policy in a country like Costa Rica is not a simple task. Costa Rica's citizens have grown accustomed to low taxes, and their lack of a keen understanding of tax law is evident. In early December 2018, the Ministry of Taxation published a list of businesses that reported no taxable income.[186] These businesses utilized *legal* means to decrease their tax liability—that is, they engaged in tax avoidance, not tax evasion[187] Several

[182] Natasha Cambronero, *Fabricio Alvarado Dispuesto a Aportar Figuras al Gobierno de Unidad Convocado por Carlos Alvarado*, LA NACIÓN (Apr. 2, 2018), https://www.nacion.com/el-pais/politica/fabricio-alvarado-dispuesto-a-aportar-figuras-al/DMLGK2S7CVAO5IFQ566QFSESRY/s tory/.

[183] *See* Ávila, *supra* note 176.

[184] *Todo lo que Usted Necesita Saber Sobre el Plan Fiscal,* LA REPÚBLICA (Aug. 24, 2018), https://www.larepublica.net/noticia/todo-lo-que-usted-necesita-saber-sobre-el-plan-fiscal.

[185] *Id.*

[186] Luis Madrigal, *Hacienda Revela Identidad de Grandes Empresas que Reportan Cero Ganancias Reiteradamente*, DELFINO (Dec. 5, 2018, 12:53 PM), https://delfino.cr/2018/12/hacienda-revela-identidad-de-grandes-empresas-que-reportan-cero-ganancias-reiteradamente/.

[187] *Id.*

news outlets nonetheless erroneously described it as "tax evasion."[188] These events caused an uproar in Costa Rica; the nation's people were outraged at the behavior of these corporations.[189] It would only be fitting to hypothesize that the country's inherent nature is changing. Costa Rica's low tax fame is no longer applauded, but in contrast, excoriated.

C. *Carbon Neutral*

The new presidency is not the only change afoot in Costa Rica. Climate change has also become a particularly relevant issue, and Costa Rica has become one of the leading countries in addressing problems related to global warming.[190] Costa Rica has set a challenging goal for 2021—to achieve total carbon neutrality.[191] This announcement has resulted in major changes in the country's economy, including tourism—one of its most significant sources of revenue.[192]

Costa Rica's dedication to the environment has increased its tourism[193], thus affecting one of the country's most important taxes—the departure tax. Costa Rica has implemented the lump-sum $29 departure tax for years.[194] (It is another source of revenue for the country.) More recently, airlines have collected the $29 tax by including it in the ticket price.[195] The government receives most of the revenue that this tax raises, but a portion is reinvested into the infrastructure and development of the airport itself.[196]

This is not the only tax change arising from Costa Rica's environmental awareness. Many countries are now considering implementing a carbon tax because it would be a win for the environment, while, at the same time, not likely to burden low-income households.[197] The world is welcoming the idea of a carbon tax. As one of the world's leaders on environmental issues, Costa

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[188] Álvaro Murillo, *¿Por Qué Empresas Millonarias Reportan Cero Ganancias en Hacienda? Algunas dan Explicaciones*, SEMANARIO UNIVERSIDAD (Dec. 6, 2018), https://semanariouniversidad.com/pais/por-que-empresas-millonarias-reportan-cero-ganancias-en-hacienda-algunas-dan-explicaciones/.

[189] *Id.*

[190] *Costa Rica Unveils Plan to Achieve Zero Emissions by 2050 in Climate Change Fight*, GUARDIAN (Feb. 25, 2019, 4:13 PM), https://www.theguardian.com/world/2019/feb/25/costa-rica-plan-decarbonize-2050-climate-change-fight; Somini Sengupta & Alexander Villegas, *Tiny Costa Rica Has a Green New Deal, Too. It Matters for the Whole Planet.*, N.Y. TIMES (Mar. 12, 2019), https://www.nytimes.com/2019/03/12/climate/costa-rica-climate-change.html.

[191] *Costa Rica Makes a Big Splash in Luxury Tourism*, Q COSTA RICA NEWS (Mar. 30, 2018), http://qcostarica.com/costa-rica-making-a-big-splash-in-luxury-tourism/.

[192] *Id.*

[193] *Id.*

[194] *Departure Tax (Exit Tax)*, COSTA RICA GUIDE, https://costa-rica-guide.com/practical/documents-requirements/departure-tax/.

[195] *Id.*

[196] *Id.*

[197] Adam Wentworth, *Carbon Tax is a Win-Win for Climate and Low-Income Households*, CLIMATE ACTION (Apr. 9, 2018), http://www.climateactionprogramme.org/news/carbon-tax-is-a-win-win-for-climate-and-low-income-households.

Rica is likely to follow.

Carlos Alvarado has pledged to continue Costa Rica's emphasis on environmental protection.[198] After his win, he claimed that Costa Rica would emancipate from all petroleum and move to clean transportation.[199] His campaign also promised to ban all oil and gas explorations in the country, proving once again that the President is committed to the protection of the country's environment.[200]

Yet there has been no mention of a carbon tax by the President. However, it would not be unreasonable to assume, given his previous political statements, that he would consider implementing a carbon tax while in office. A carbon tax would certainly make Costa Rica's tax structure less friendly, and potentially complicate the tax haven inquiry.

D. Trumped Tensions

Carlos Alvarado is not the only political figure challenging norms. The United States Congress, upon the urging of President Donald Trump, recently enacted sweeping tax reform. Under President Trump, the United States also continues to alter international treaties. Even though Costa Rica and the United States share amicable international relations, the Trump Administration has caused some tension between the two countries.

The first spark was lit when President Trump announced that he intended to withdraw the United States from the Paris Climate Agreement in 2017. In his announcement, President Trump argued that the agreement was not in the United States' best interest.[201] Costa Rica disappointment was caused, in part, by the country's substantial involvement in drafting the agreement. The head negotiator of the agreement was Christiana Figueres, a Costa Rican politician and the former executive secretary of the UN Framework Convention on Climate Change.[202]

When questioned on the subject, Figueres clarified that President Trump could not officially withdraw until 2019, and, even further, could not completely leave the agreement for another full year. This, however, did not appease the Costa Rican government or its people. Costa Rica's presidency, Ministry of Foreign Relations, and Ministry of the Environment and Energy

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[198] Lorraine Chow, *Costa Rica´s New President Vows 'Emancipation' from Dirty Transport*, ECOWATCH (Apr. 4, 2018, 2:16 PM), https://www.ecowatch.com/costa-rica-renewable-energy-quesada-2556249115.html.

[199] *Id.*

[200] *Id.*

[201] Michael D. Shear, *Trump Will Withdraw U.S. from Paris Climate Agreement*, N.Y. TIMES (June 1, 2017), https://www.nytimes.com/2017/06/01/climate/trump-paris-climate-agreement.html.

[202] Tripti Lahiri & Echo Huang, *An Architect of the Paris Climate Agreement isn't Losing Sleep Over Trump Pullout*, QUARTZ (June 5, 2017), https://qz.com/998566/an-architect-of-the-paris-climate-agreement-says-shes-upbeat-not-worried-in-the-face-of-us-pull-out-plans/.

released a joint statement condemning Trump's decision.[203] The statement clarified that "Costa Rica demands full compliance with the Paris Agreement as a commitment to the future of our species."[204] This is only one of the many tensions between Costa Rica and the United States that have arisen since the commencement of the Trump presidency.

Tensions between the two nations manifested to an even greater degree in 2018, when President Trump declared that the United States would impose tariffs on Costa Rican aluminum and steel.[205] The United States government has yet to announce the percentage of the tariffs, but it is believed that they will be approximately 25 percent for steel and 10 percent for aluminum.[206] Even though Costa Rica exports less of these products than, say, Canada or Brazil, the country has increased its steel and aluminum exports significantly in recent years.[207] The president of Costa Rica has argued that such a tariff would violate existing international agreements and significantly damage international relations.[208]

These are just two examples of existing challenges to the otherwise peaceful relationship between the United States and Costa Rica. However, there is a possibility that this friction in foreign relations could result in changes in Costa Rica's current tax structure.

E. OECD

International relationships affect a country's taxing regime. Besides the currently unsteady relationship with the American government, one other major obstacle obstructs Costa Rica's road to tax haven status—the OECD.

Even though Costa Rica is not yet a part of the organization, it will likely become a member nation shortly. Joining the OECD is a priority for Costa Rica; membership in the organization would allow Costa Rica to enter into more international treaties, further developing its economy.[209] The organization does not merely deal with international economic matters, but also with the internal affairs of its member countries.[210] For example, the OECD gets involved in intranational matters, such as taxation, social

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[203] *Costa Rican Government Responds to Trump´s Climate Accord Exit*, TICO TIMES (June 2, 2017), http://www.ticotimes.net/2017/06/02/costa-ricas-response-trumps-climate-accords-exit.

[204] *Id.*

[205] Laura Alvarado, *New Steel Tariffs Announced by Trump´s Administration will Affect Costa Rica*, COSTA RICA STAR (Mar. 4, 2018), https://news.co.cr/new-steel-tariffs-announced-trumps-administration-will-affect-costa-rica/71253/.

[206] *Id.*

[207] *Id.*

[208] *Trump Confirms Tax on Steel That Would Affect Costa* Rica, USEXPATCOSTARICA (Mar. 1, 2018), https://www.usexpatcostarica.com/trump-confirms-tax-on-steel-that-would-affect-costa-rica/

[209] ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), https://www.oecd.org/about/ (last visited Mar. 1, 2020).

[210] *Id.*

security, school systems, and transportation.[211]

A previous OECD report stated that economic and social inequality in Costa Rica is a chief concern.[212] The majority of the country's working class has not graduated from high school, which has negatively affected employment.[213] Ironically, the report's recommendations with respect to taxation are quite the opposite—Costa Rican taxes to finance social security surpass the average amount of such taxes in other OECD countries, which is concerning.[214] The report specifies that reducing social security taxation is integral to the country's economic welfare.[215]

Despite these reports, Costa Rica is not yet formally a member of the OECD. Case studies like the one above concludes that the country has a fruitful potential for economic growth, especially with respect to its advanced sustainability.[216] In order to fully address the country's social and economic issues, reporting between OECD members must be completely transparent.[217]

Costa Rica must improve its tax compliance, reporting, and collection processes to comply with OECD requirements. Unlike one-sided treaties with the United States, membership in the OECD would not significantly strain Costa Rica's foreign relations. Nor would the OECD have any underlying imperialistic goals guided by self-interest. The organization is interested in making each member country better. If Costa Rica becomes an official member of the OECD, it is highly unlikely that any nation could ever label it a tax haven again because the OECD has stringent reporting rules and more efficient collection methods.

Issues with the organization are also evident: the United States is responsible for about 20.5% of the organization's funding.[218] Moreover, developed nations are likely to protect their interests over those of developing nations, under the excuse of furthering of a stronger global economy (which may, or may not be true). Finally, the accountability methods of such organizations are always in issue. As discussed, the OECD's accountability mechanisms are merely "guiding" and not

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[211] *Id.*

[212] *Costa Rica Policy Brief*, OECD (Feb. 29, 2016), available at http://www.oecd.org/countries/costarica/costa-rica-towards-a-more-inclusive-society.pdf.

[213] *Id.*

[214] *Id.*

[215] *Id.*

[216] World Business Council for Sustainable Development, *New Report Shows that Costa Rica is Raising the Bar for Sustainability Reporting Admissions*, CORP. SOC. RESP. NEWSWIRE (Mar. 12, 2018), http://www.csrwire.com/press_releases/40844-New-Report-Shows-That-Costa-Rica-Is-Raising-the-Bar-for-Sustainability-Reporting-Ambitions.

[217] ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), *supra* note 209.

[218] *Member Countries' Budget Contributions for* 2019, OECD, https://www.oecd.org/about/budget/member-countries-budget-contributions.htm (last visited Mar. 1, 2020).

binding.[219] This structure complicates relations between the Unites States and Costa Rica, and further separates the bargaining power of both nations.

IX. CONCLUSION

Is Costa Rica safe from tax haven status? There are many looming changes to Costa Rica's tax structure. It is, however, highly unlikely that Costa Rica's international neighbors will ever truly consider it to be a tax haven again. One thing is for certain: it is crucial that Costa Rica considers the impact that classification as a tax haven would have on its tourism, economy, and foreign relations.

The main reason why Costa Rica's taxing regime is so advantageous toward North Americans is to attempt to lure international corporations and individuals into the country. The new president believes that the economic benefits for non-Costa Rican citizens under the current regime are too generous. This statement has some validity: the country depends too much on North Americans for its economic well-being. However, the political situation in the country does not allow much room for improvement. Absent tax benefits, there would be little incentive for infrastructure nor corporate development in Costa Rica, and current socioeconomic problems, such as unemployment and poor education, are a clear obstacle to economic growth.

This Note began by explaining that Costa Rica's tax regime was both fluctuating and unstable. Constant change has prevented Costa Rica from ever solidifying its status as a tax haven. Furthermore, this instability also blunts financial growth. However, would it be the worst thing for the country to become a tax haven? Would it be the worst thing for Costa Rica to grow and stabilize its economy, even in light of the negative consequences associated with having an advantageous tax structure? Would it affect Costa Rica's standing in the world to any significant degree?

All countries must defend their own personal interests and grow their economies. What better way to do that than through taxation? With the right tools, Costa Rica could use its tax system more efficiently, spurring sustainable economic development without becoming a tax haven. At the end of the day, Costa Rica's tax structure needs a lot of work. A priority of any presidential administration should be to use taxation to improve a country that already possesses incredible potential embedded in its natural resource wealth and applaudable culture.

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[219] *Public Procurement Toolbox*, OECD, https://www.oecd.org/governance/procurement/toolbox/principlestools/accountability/ (last visited Mar. 1, 2020).