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Foreign Evidence Gathering and Discovery for U.S. Civil Tax Determination Purposes

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With the rapid globalization of business relationships and the growing trend in international mergers and acquisitions, the location of U.S. tax information and documents is increasingly found within the jurisdiction of other sovereign nations. Many obstacles can confront both the Internal Revenue Service (the Service or the IRS) and a U.S. taxpayer in foreign evidence gathering during a civil audit by the Service and in foreign discovery during the litigation of a U.S. civil tax dispute. A foreign country can be expected to have a myriad of nondisclosure laws and a legal system based upon a civil law system, rather than a U.S. common law system.

Foreign information gathering begins prior to the administrative phase of a civil tax audit by the Service with the required record-keeping and information filings under the Internal Revenue Code (the Code or I.R.C.) and U.S. Treasury Regulations (the regulations).[1] During the audit stage, the Service may utilize the IRS summons, the formal document request, and tax treaties to obtain foreign information and documents located in foreign jurisdictions.

Procedures for requesting foreign information and documents during the trial stage of a civil tax dispute consist of the use of specific requests under tax treaties, judicial subpoenas, letters rogatory, U.S. court discovery rules, and the Hague

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1. Except as noted, all statutory and section references are to the Internal Revenue Code of 1986 (26 U.S.C.), as amended, and to the Treasury regulations promulgated thereunder.

Conventions. To use the acquired foreign documents at trial, a party must be prepared to authenticate the documents, certify any English translations, and consider the admissibility of the documents into the court record. Also, a party whose case relies on an interpretation of foreign law must give the court notice of its intention to request the court to consider the law of a certain foreign country and the relevant foreign statutes and caselaw. A trial in the U.S. Tax Court is a trial centered around the stipulation of documents. Since the Tax Court is the forum for over ninety percent of the tax disputes with the Service, document authentication and proof of foreign law are critically important issues when submitting documents for trial.

The transformation of the world's economy into a multitude of transnational interrelationships has affected routine business decisions for U.S. entities with foreign operations and foreign entities with U.S. operations within the reach of U.S. taxation and compliance. This article outlines key areas for consideration by both tax and transactional lawyers in foreign evidence gathering during a civil audit by the Service and in foreign discovery during the litigation of a U.S. civil tax dispute. The purpose of this article is to present an overview of these key areas based upon their importance in the tax area. Of course, a comprehensive discussion of any of these topics beyond the civil tax dispute arena would result in an extensive treatise on each subject.

I. Obtaining Foreign Information and Documents During the Audit Phase of an IRS Civil Tax Determination

As the globalization of business transactions increases, the U.S. Congress and the Treasury increase the record-keeping and information filing requirements in an effort to improve the transparency of foreign activities for U.S. tax compliance purposes. New provisions in the areas of the IRS summons and the formal document request and new international agreements of tax cooperation with other governments attempt to improve the Service's ability to effectively obtain foreign information during the audit stage. Prior to any audit by the Service, U.S. taxpayers are required to file a number of IRS reporting forms, providing a certain amount of information to the government.

A. Record-Keeping and Information Filing Requirements to Increase the Transparency of Transnational Business Activities

Various sections of the Code and the underlying regulations impose numerous record-keeping and filing requirements on U.S. taxpayers with foreign interests and on foreign entities with U.S. interests. All persons liable for U.S. taxes are required to keep books and records sufficient to determine their proper tax liability.[2] U.S. taxpayers who maintain all or part of their books and records outside

2. I.R.C. § 6001 (records, statements, and return requirements).

the United States are required to verify and substantiate items claimed to the same extent as taxpayers who maintain their books and records within the United States. Sections of the Code and regulations also impose filing requirements when a taxpayer's foreign transactions affect U.S. tax liability and when foreign persons or corporations engage in business in the United States.

U.S. shareholders of a controlled foreign corporation (CFC)[3] are required to maintain records and accounts necessary to carry out the deemed earnings distribution sections[4] and the deemed distribution reductions for the export trade corporation sections[5] of the Code.[6] The regulations require controlling U.S. shareholders responsible for providing records of a CFC to make such records available within a reasonable time after demand to verify such shareholder's income tax liability for deemed dividend distributions.[7] The regulations provide guidelines for determining when the books and records of a CFC are considered sufficient to verify the various classes of income, deductions, and exclusions under the deemed distribution provisions.[8]

Also, the Code imposes filing requirements for financial information of a foreign corporation on U.S. persons holding a more than 50 percent shareholder position in a foreign corporation, with a foreign tax credit reduction penalty for failing to furnish the required information.[9] Officers, directors, and 10 percent shareholders of a foreign personal holding company are required to file income and shareholder information,[10] and the foreign personal holding company is required to file information schedules with tax returns.[11]

A U.S. citizen or resident who is an officer, shareholder, or director of certain foreign corporations is required to file information forms.[12] A U.S. person holding an interest in a foreign partnership is required to file various forms.[13] The grantor

3. I.R.C. § 957(a) (corporation in which more than 50% of either the voting power or value of corporation's stock is owned by U.S. shareholders); *see* I.R.C. §§ 951(b) & 958 ("U.S. shareholder" is a U.S. citizen or resident, a domestic corporation, or a partnership, estate or trust that owns 10% or more of the voting stock of the foreign corporation); I.R.C. § 958(b) (constructive ownership rules apply to determine "U.S. shareholder" status).

4. I.R.C. §§ 951-964 (Subpart F deems the earnings of a CFC from certain transactions distributed to the U.S. shareholders).

5. I.R.C. §§ 970-971 (Subpart G provisions reduce subpart F income of export trade corporations).

6. I.R.C. § 964(c); *see In re*: Florida Peach Corp., 82-1 U.S.T.C. ¶ 9213 (Bankr. M.D. Fla. 1982).

7. Treas. Reg. § 1.964-3 (records provided by U.S. shareholders to verify liability under I.R.C. § 951).

8. Treas. Reg. § 1.964-4 (verification of income classes).

9. I.R.C. § 6038 (information on certain foreign corporations).

10. I.R.C. § 6035 (returns of officers, directors, and shareholders of foreign personal holding companies).

11. I.R.C. § 541 (§ 542 personal holding company filing).

12. I.R.C. § 6046 (information on organization, reorganization, and acquisitions of foreign corporations).

13. I.R.C. § 6046A (ownership interest in foreign partnership).

of, or transferor of, property to a foreign trust is required to file information forms.[14]

Each U.S. taxpayer who takes a position that a treaty of the United States overrules any provision of the Internal Revenue Code and effects a reduction of any tax must disclose such position.[15] A taxpayer who fails in a material way to disclose one or more positions taken for a taxable year is subject to a separate penalty for each failure to disclose a position.[16]

The sourcing rules under the Code and regulations impose requirements to verify the method utilized in allocating income and deductions between domestic and foreign operations.[17] The regulations impose record-keeping requirements with respect to foreign tax credits claimed under I.R.C. § 901.[18] The Code requires notice of property transfers from a U. S. person to a foreign corporation through a liquidation or reorganization, or through a distribution to a non-U.S. person.[19] Failure to furnish the information may result in a penalty equal to 25 percent of the amount of the realized exchange gain.[20]

With respect to foreign entities with U.S. interests, Congress enacted provisions in the 1989 and 1990 tax bills to provide statutory standards of record-keeping and document maintenance and to require the designation of a U.S. agent to establish jurisdiction for service of legal documents.[21] A domestic corporation that is 25 percent or more foreign-owned[22] is required to file transactional information as a reporting corporation.[23] A foreign corporation engaged in a U.S. trade or business must file transactional information as a reporting corporation.[24] Failure to file annual reporting information will subject the corporation to monetary penalties.[25] Also, monetary penalties apply to failures to maintain records relevant to the determination of the correct treatment of the transactions with the related parties and to failures to comply with the non-U.S. maintenance requirements.[26]

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14. I.R.C. § 6048 (returns as to certain foreign trusts). Tax Compliance Act of 1995, H.R. 981, 104th Cong., lst Sess., § 6048 (1995). This Act proposes to require U.S. grantors and beneficiaries to appoint a U.S. reporting agent to file reports on the activities and operations and to produce records and testimony for any request or summons from the Service on foreign business trusts.

15. I.R.C. § 6114(a); Treas. Reg. § 301.6114-1(a) (treaty-based return position).

16. Treas. Reg. § 301.6712-1 (failure to disclose a treaty-based return position).

17. I.R.C. §§ 861-863 (sourcing rules under the underlying regulations separate income into U.S. or foreign source and provide guidance for expense allocation and apportionment).

18. Treas. Reg. § 1.905-2 (allowance of foreign tax credits).

19. I.R.C. § 6038B(a) (notice of liquidations, reorganizations, or distributions to foreign persons).

20. I.R.C. § 6038B(b) (failure to furnish information penalty).

21. I.R.C. §§ 6038A, 6038C.

22. I.R.C. § 6038A(c) (a corporation is 25% foreign-owned if it has at least one direct or indirect 25% foreign shareholder).

23. I.R.C. § 6038A; Treas. Reg. § 1.6038A-1(c)(1) (reporting corporations).

24. I.R.C. § 6038C (any foreign corporation engaged in a U.S. trade or business is a reporting corporation).

25. I.R.C. §§ 6038A(d), 6038C(c) (penalty for failure to furnish information on Form 5472, or maintain records).

26. *Id.*; *see also* Treas. Reg. § 1.6038A-3(f) (maintenance requirements).

Failure to comply with the authorization of the agent requirement may trigger the application of the noncompliance penalty.[27] Under the noncompliance penalty, the Service may disallow any amount claimed by the reporting corporation as a deduction for amounts paid or incurred, or for the cost of property acquired, in transactions with a foreign related party based upon the "sole discretion" of the Service.[28]

Also, the Code requires return information from foreign persons holding direct investment in U.S. real property interests.[29] For attribution purposes, U.S. real property interests held by a partnership, trust, or estate are treated as owned proportionately by its partners or beneficiaries.[30] In the transfer pricing area between related companies, Congress added a penalty for large transfer pricing misstatements.[31]

The information filing documents represent a beginning point of review during the initial audit phase by the Service. The reporting documents provide the basis for informal document requests (IDRs) that request documents and more complete information. Noncompliance with the IDRs by the taxpayer probably would result in an IRS summons requesting compliance. Noncompliance with the summons by the taxpayer probably would result in the U.S. Justice Department, at the request of the Service, bringing a summons enforcement proceeding in a U.S. district court.

B. The IRS Summons

A summons directed at documents located abroad must meet a more stringent test of direct relevancy, necessity, and materiality than is required for comparable requests for documents located in the United States.[32] Although the standards set forth in *United States v. Powell* still apply for the administrative summons directed at records located in a foreign jurisdiction,[33] the U.S. courts consider

27. I.R.C. §§ 6038A(e) & 6038C(d) (enforcement provisions).

28. I.R.C. §§ 6038A(e)(3), 6038C(d)(3) (Service's "sole discretion" under the noncompliance rules).

29. I.R.C. § 6039C (returns of foreign persons holding direct investments in United States real property interests).

30. I.R.C. § 6039C(c)(3) (attribution of ownership).

31. I.R.C. § 6662(e) (penalty). The penalty can be excused with contemporaneous documentation showing that a reasonable transfer pricing methodology had been applied. *Id.*

32. United States v. Toyota Motor Corp., 569 F. Supp. 1158, 1162 (C.D. Cal. 1983) (relevance test is whether the documents might throw light upon the correctness of a return); *see* United States v. Arthur Young & Co., 677 F.2d 211, 218 (2d Cir. 1982), *cert. granted*, 459 U.S. 1199 (1983).

33. United States v. Powell, 379 U.S. 48, 57-58 (1964) (these standards are that the investigation is to be conducted pursuant to a legitimate purpose, the inquiry must be relevant to that purpose, the information sought is not already within the Service's possession, and the procedural steps required have been followed).

international law during summons enforcement proceedings.[34] In addition to defenses under *Powell*, a summoned party may assert that compliance will violate the laws of the foreign country. The summoned party has the burden of establishing that compliance would violate foreign law. The court balances conflicting national interests in its analysis of any foreign law violations.[35]

Although compliance might violate foreign law under a "blocking statute," such foreign statutes do not deprive a U.S. court of the power to order a party subject to its jurisdiction to produce evidence.[36] However, even though a blocking statute does not deprive the U.S. court of its power to order production, the statute is relevant to the court's comity analysis to the extent that its terms and enforcement identify the sovereign's reasons for the nondisclosure of the documents.[37]

In any civil action, the U.S. courts, under the principle of international comity,[38] balance the five factors in the *Restatement (Third) of the Foreign Relations Law of the United States* section 442(1)(c) when determining whether the requested documents are directly relevant, necessary, and material to an investigation conducted by a government agency or to any court discovery action. The factors are (1) the importance to the investigation or litigation of the documents requested,

34. United States v. Vetco Inc., 691 F.2d 1281, 1288 (9th Cir.), *cert. denied*, 454 U.S. 1098 (1981). Permission by the foreign government is required before any service and compliance with the laws and treaties of that country are carried out. An IRS agent lacks the authority to serve a summons outside the United States, and such an act would violate the sovereignty of the foreign country.

35. *See* United States v. Field, 532 F.2d 404 (5th Cir.), *cert. denied*, 429 U.S. 940 (1976) (balancing of conflicting national interests); *Vetco, Inc.*, 691 F.2d at 1289 (U.S. interest in collecting taxes and prosecuting tax fraud outweighs Swiss interest in protecting the secrecy of business records); United States v. Chase Manhattan Bank, N.A., 590 F. Supp. 1160 (S.D.N.Y. 1984) (summons enforced to compel a domestic bank to produce records located in its Hong Kong branch although a Hong Kong court had issued an injunction prohibiting disclosure under its bank secrecy laws); United States v. Ghidoni, 732 F.2d 814 (11th Cir.), *cert. denied*, 105 S. Ct. 328 (1984) (summons compelled taxpayer's production of foreign bank records through execution of a directive to foreign banks authorizing disclosure of records in spite of foreign bank secrecy laws); Garpeg, Ltd. v. United States, 583 F. Supp. 789, 796 (S.D.N.Y. 1984) (U.S. interest in enforcing its tax laws significantly outweighs Hong Kong's interest in preserving bank secrecy).

36. Société Int'l v. Rogers, 357 U.S. 197, 204-06 (1958). "Blocking statutes" safeguard information against disclosure by discovery prohibitions with sanctions and penalties, which allows its citizens and corporations to allege a foreign government compulsion defense (doctrine of foreign government compulsion). ANDREAS F. LOWENFELD, INTERNATIONAL LITIGATION AND ARBITRATION 698 (1993). Under the foreign compulsion defense, if two countries issue conflicting commands with respect to a given activity, the command of the country where the activity takes place prevails. *Société Int'l*, 357 U.S. at 204-06; United States v. First Nat'l City Bank, 396 F.2d 897 (2d Cir. 1968).

37. Société Nationale Industrielle Aérospatiale v. United States Dist. Ct., 482 U.S. 522, 544 n.29 (1987).

38. *See id.* at 543 n.27 (comity refers to "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws").

(2) the degree of specificity of the request, (3) in which of the countries involved the documents or information originated, (4) the possibility of alternative means of securing the information, and (5) the extent to which compliance with the request would undermine important interests of the country where the information is located.[39]

Section 7602 allows the Service to summon any person having control over potentially relevant records.[40] If a person or entity in the United States has "control" of records located in a foreign jurisdiction, a section 7602 summons served on the person or entity can obtain these records.[41] The Service can issue and enforce a summons on a third party to obtain records relevant to the tax liability of the taxpayer when the third party has a transactional nexus with the taxpayer or when the third party holds records or data relating to the taxpayer.[42] With regard to the collection of third-party data without a transactional nexus or not directly relating to the taxpayer, a third party may provide the data voluntarily and request an "accommodation" summons from the Service. Otherwise, the Service may be unable to pursue the route of a third-party summons in obtaining third-party data.

As mentioned, the territorial limits of summons authority encompass the service to a U.S. corporation for documents from its foreign branch or its foreign subsidiary.[43] A summons may compel a U.S. corporation to produce records of its

39. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 442(1)(c) (1987) [hereinafter RESTATEMENT (THIRD)]; United States v. Toyota Motor Corp., 569 F. Supp. 1158, 1162 (C.D. Cal. 1983); *see* Trade Dev. Bank v. Continental Ins. Co., 469 F.2d 35 (2d Cir. 1972); United States v. First Nat'l City Bank, 396 F.2d 897 (2d Cir. 1968).

40. United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984) (§ 7602 reflects "a congressional policy choice in favor of disclosure of all information relevant to a legitimate IRS inquiry"); *see also* United States v. Euge, 444 U.S. 707, 715-16, *reh'g denied*, 446 U.S. 913 (1980); First Nat'l City Bank v. Internal Revenue Serv., 271 F.2d 616 (2d Cir. 1959), *cert. denied*, 361 U.S. 948 (1960).

41. *See* Société Internationale v. Rogers, 357 U.S. 197, 204-06 (1958) (records within the control of the summoned party based on proceedings under the Trading with the Enemy Act); Marc Rich Co. A.G. v. United States, 707 F.2d 663 (2d Cir.), *cert. denied*, 103 S. Ct. 3555 (1983) (production of records held by Swiss subsidiaries with interlocking directorates); United States v. Vetco Inc., 644 F.2d 1281 (9th Cir.), *cert. denied*, 454 U.S. 1098 (1981) (summons for records of Swiss subsidiaries); *First Nat'l City Bank*, 271 F.2d at 616 (summons to U.S. bank for production of records located in Panama branch bank since U.S. bank was found to have control over the records of the foreign branch); International Commodities Corp. v. Internal Revenue Serv., 224 F.2d 882 (2d Cir. 1955) (summons to the president, a U.S. resident, of a foreign corporation to produce foreign records).

42. *See* United States v. City Nat'l Bank & Trust Co., 642 F.2d 388 (10th Cir. 1981) (summons served on taxpayer's bank); Donaldson v. United States, 400 U.S. 517 (1971) (summons served on taxpayer's employer); United States v. Bisceglia, 420 U.S. 141 (1975) (summons served on bank holding bills of unknown taxpayer); Tiffany Fine Arts, Inc. v. United States, 469 U.S. 310, 315-16 (1985) (§ 7609 summons served on a third-party recordkeeper).

43. *See* Société Internationale v. Rogers, 357 U.S. 197, 204-06 (1958).

wholly owned foreign subsidiary[44] or may compel a partner to secure and produce partnership records from a third party.[45]

Also, the territorial limits of summons authority would subject a foreign national in the United States to give testimony or be compelled to consent to the disclosure of information located abroad in violation of foreign secrecy laws.[46] The Service may issue an administrative summons with a consent directive to be executed by the taxpayer that authorizes and directs a foreign bank to disclose all information and documents concerning the taxpayer's bank accounts.[47]

The territorial limits of the summons would include service on the U.S. branch or a U.S. subsidiary of a foreign parent corporation. However, the parent-subsidiary relationship between a foreign parent and a domestic subsidiary alone cannot support jurisdiction.[48] Either "control" or "minimum contacts" can establish jurisdiction for a summons served on the domestic subsidiary of a foreign parent corporation seeking books and records of the parent.

"Control" of records in a foreign jurisdiction can exist through interlocking boards of directors, corporate officers holding positions with each corporation, and direct or indirect ownership.[49] If the U.S. subsidiary can secure documents of the parent to meet its own business needs and the documents are helpful for use in the litigation, the courts will not permit the subsidiary to deny control.[50] The location of the books and records is not relevant for summons enforcement when a domestic subsidiary has "control" pursuant to a contract or by other arrangements over the parent's records and the subsidiary was subject to in personam jurisdiction.[51]

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44. United States v. Vetco Inc., 644 F.2d 1281, 1324 (9th Cir.), *cert. denied*, 454 U.S. 1098 (1981).

45. United States v. Hankins, 565 F.2d 1344 (5th Cir. 1978); Fernandez v. Garza, 354 P.2d 260 (1960) (right of a partner for an accounting and a duty by the managing partner to render complete and accurate accounts of all the partnership business and to produce partnership records).

46. *See* United States v. Field, 532 F.2d 404 (5th Cir.), *cert. denied*, 429 U.S. 940 (1976) (subpoena served on foreign bank official in the United States since the interest of the United States in enforcing its laws outweighed the interest of the Cayman Islands in its secrecy laws); United States v. Davis, 767 F.2d 1025 (2d Cir. 1985) (individual compelled to consent to U.S. foreign evidence gathering in foreign courts).

47. *See* Doe v. United States, 487 U.S. 201 (1988) (consent directives are not testimonial and do not violate Fifth Amendment rights since they do not refer to a specific account, identify the bank, or require the taxpayer to acknowledge the existence of a foreign bank account or to admit to the authenticity of any documents); United States v. Ghidoni, 732 F.2d 814 (11th Cir.), *cert. denied*, 105 S. Ct. 328 (1984) (court compelled a taxpayer charged with wilful tax evasion to sign a consent statement authorizing a foreign bank to disclose his accounts); Marsoner v. United States, 40 F.3d 959 (9th Cir. 1994) (subpoena upheld for a foreign national to appear before the grand jury to sign a consent directive).

48. Saraceno v. S.C. Johnson & Son, Inc., 83 F.R.D. 65 (S.D.N.Y. 1979).

49. United States v. Toyota Motor Corp., 569 F. Supp. 1158 (C.D. Cal. 1983). The service of a summons to the president of a U.S. subsidiary of a foreign corporation was sufficient to effect service upon the foreign corporation. *Id.* at 1160.

50. Gerling Int'l Ins. Co. v. Commissioner, 839 F.2d 131 (3d Cir. 1988).

51. *See* Société Internationale v. Rogers, 357 U.S. 197, 204-06 (1958).

"Minimum contacts" can satisfy the jurisdiction requirement.[52] When the subsidiary acts as a substitute or agent for the parent, and the parent exercises a large amount of control over the subsidiary, the foreign parent may be "found" in the district where the subsidiary is located.[53] Facts indicating an agency relationship include: (1) representations to third parties of the affiliation between the corporations, (2) overlapping directors or employees, (3) sales or marketing activity by the subsidiary rather than product manufacturing, and (4) parental financing of the subsidiary's operations. The relationship of these "minimum contacts" to the subject matter involved, such as the investigation of the financial liability for business transactions, can support jurisdiction.[54]

Since the U.S. Congress did not believe that the case law developed any uniform jurisdictional standard of summons enforcement for requests of foreign records and testimony of foreign corporations doing business in the United States, it enacted provisions in the 1989 and 1990 tax bills to require the designation of a U.S. agent to establish jurisdiction.[55] The provisions require related foreign parties to designate a U.S. subsidiary as their agent to receive IRS document requests and the service of any summons for records and testimony.[56]

Congress enacted special summons enforcement provisions under section 6038A. The Service may issue a "section 6038A summons" if noncompliance by the taxpayer exists after issuing document requests and a pre-summons letter.[57] Special provisions permit the Service to disallow deductions and make adjustments if the taxpayer does not comply with the summons.[58]

Although the Service may require an English translation to accompany the documents reasonably necessary to conduct an audit, the Service cannot request the translation of irrelevant or duplicative documents.[59] The Service does have the right to request production, review the documents, and identify the specific documents that need translation. The taxpayer has the burden to produce English translations sufficient to show that the specific documents need not be translated because of irrelevancy or duplication.[60]

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52. International Shoe Co. v. Washington, 326 U.S. 310 (1945); Honeywell, Inc. v. Metz Appartewerhe, 509 F.2d 1137, 1143 (7th Cir. 1975).

53. Bulova Watch Co. v. K. Hattori & Co., 508 F. Supp. 1322 (E.D.N.Y. 1981) (personal jurisdiction exists if systematic activities of the subsidiary can be attributed to the parent); Tokyo Boeki (USA) Inc. v. SS Navarino, 324 F. Supp. 361 (S.D.N.Y. 1971) (subsidiary treated as a division or agent of the parent).

54. *See* Thunton v. Toyota Motor Sale, U.S.A., Inc., 397 F. Supp. 476 (N.D. Ga. 1975).

55. I.R.C. §§ 6038A, 6038C.

56. I.R.C. §§ 6038A(e)(1), 6038C(d)(1) (agreement to treat corporation as agent); *see* Treas. Reg. §§ 1.6038A-6, -7.

57. A summons issued under § 6038A must specify whether the summons is issued to the reporting corporation, as agent of the related corporation, or for records that the reporting corporation is required to maintain by section 6038A.

58. Treas. Reg. § 1.6038A-6(a).

59. Nissei Sangyo Am. Ltd. v. United States, 95-2 U.S.T.C. ¶ 50,327 (N.D. Ill. Apr. 25, 1995).

60. *Id.*; *see also* Treas. Reg. §§ 1.6038A-3(b)(3), -3(f)(2)(i).

Failure to substantially comply with a section 6038A summons raises the possibility of the application of a noncompliance penalty.[61] Under the noncompliance penalty, the Service may disallow any amount claimed by the reporting corporation as a deduction for amounts paid or incurred, or for the cost of property acquired, in transactions with a foreign-related party.[62]

A taxpayer has ninety days after the issue of the summons to begin a proceeding to quash the summons.[63] Also, the taxpayer has ninety days after the mailing of the statutory notice of noncompliance to begin a judicial proceeding in federal district court to review whether the taxpayer has substantially complied with the section 6038A summons.[64] Both proceedings suspend the statute of limitations.[65]

In a complex case with a U.S. taxpayer involving the potential of substantial tax deficiencies, the Service may issue a "designated" summons under section 6503(k).[66] The designated summons attempts to counter a U.S. taxpayer who resists disclosure of necessary information and who refuses to extend the statute of limitations on assessment, or terminates a statute extension, before a case has been fully developed by the Service. Such a refusal would force the Service to issue a statutory notice of deficiency based upon incomplete information, increasing the probability of the Service wasting litigation resources in court on the wrong issues or legal theories.

The requirements for a designated summons are that (1) the summons be issued sixty days before the statute of limitations runs, (2) the summons must state it is a designated summons, and (3) the Service may issue only one designated summons.[67] However, the Service may issue related summonses during the thirty-day period beginning on the date of the issuance of the designated summons. A related summons concerns the same tax return years as the designated summons.[68]

61. Treas. Reg. § 1.6038A-7 (noncompliance).

62. *Id.* The disallowance amount is determined at the Service's discretion based on available information. *Id.* The noncompliance penalty can be applied without a summons enforcement proceeding. Treas. Reg. § 1.6038A-6(c).

63. I.R.C. § 6038A(e)(4)(A) (proceeding to quash).

64. I.R.C. § 6038A(e)(4)(B); H.R. CONF. REP. No. 101-386, 101st Cong., 1st Sess. 590 (1989) (burden of proof on taxpayer to show by clear and convincing evidence an abuse of discretion under the rules).

65. I.R.C. § 6038A(e)(4)(D) (suspension of the statute of limitations); Treas. Reg. § 1.6038A-6(e) (suspends the limitation on the assessment and collection of tax under section 6501).

66. I.R.C. § 6503(k) (designated summons). A designated summons tolls the § 6501 statute of limitations and includes any type of summons issued for the purpose of determining the amount of any tax imposed under the Code.

67. *Id.* In *Derr* the taxpayer alleged that the government must show that the taxpayer did not cooperate with the IRS auditors, since the Service's manual guideline provides that the designated summons is to be used only after a taxpayer refuses to extend the statute of limitations and the examiner has exhausted all other means to obtain information. The court held that the Service's internal policies do not provide a taxpayer with legally enforceable rights and a designated summons must only satisfy the *Powell* test for enforcement. United States v. Derr, 968 F.2d 943 (9th Cir. 1992).

68. Section 6503(k) suspends the limitation statute for the related summons whether issued to the party to whom the designated summons was issued or to a third party.

Any summons served on a person or entity in the United States for books and records abroad is subject to the same defenses and objections as any summons for books and records in the United States. Typically, the claims of attorney-client privilege and the work-product protection take center stage in a request for overseas tax information and records of both domestic and foreign attorneys and accountants.[69] Maintaining the attorney-client privilege and the work-product protection have emerged as important areas of concern in all tax planning.

The holder of the privilege or protection would assert the defense by a motion to quash the summons. The attorney-client privilege protects (1) confidential disclosures made by a client to an attorney in order to obtain legal advice,[70] (2) the legal advice issued by the attorney in response to the client's communication, and (3) third-party reports[71] prepared for the attorney in the course of the attorney-client relationship that enable the attorney to advise and defend a client.[72] Also, the communication between employees of a subsidiary and the counsel for the parent corporation is privileged if the employee possesses information critical to the representation of the parent and the communication concerns matters within the scope of the employment.[73]

However, the attorney-client privilege does not protect communications relating to tax return preparation.[74] The attorney-client privilege does not protect accounting reports supporting tax return positions because the privilege only

69. For example, a summons may request internal memoranda between the foreign tax counsel of the taxpayer's foreign subsidiary and the tax counsel of the U.S. corporate taxpayer. United States v. Mobil, 149 F.R.D. 533 (N.D. Tex. 1993). Documents relating to the tax consequences of certain transactions between the parent and the subsidiary were information entirely constituting mental impressions, opinions, and legal theories of attorneys representing the subsidiary in administrative proceedings before the foreign taxing authority. *Id.*

70. Fisher v. United States, 425 U.S. 391, 403 (1975) (the privilege's purpose is to encourage clients to make full disclosures to their lawyers).

71. *See* United States v. Judson, 322 F.2d 460 (9th Cir. 1963) (financial documents prepared by an accountant hired by the client's attorney were protected); United States v. Kovel, 296 F.2d 918 (2d Cir. 1961) (the accountant's role between the client and the attorney concerning the client's financial picture).

72. *See* United States v. Bell, 95-1 U.S.T.C. ¶ 50,006 (N.D. Cal. Nov. 9, 1994) (summons seeking all economist's reports, consultant reports, management reports, and all other reports prepared by third parties concerning transfer pricing systems prepared at the direction of outside counsel on behalf of the taxpayer).

73. Upjohn Co. v. United States, 449 U.S. 383, 389-97 (1981).

74. United States v. Davis, 636 F.2d 1028, 1043 (5th Cir. 1981). Disclosure of tax information on a return waives all privileges for the return data and the details underlying the tax return data. United States v. Lawless, 709 F.2d 485, 488 (7th Cir. 1983). Reports (for example, § 482 pricing studies) prepared by accountants on behalf of the taxpayer's outside counsel to justify the return information are vital information, which the Service is entitled to have in order to properly challenge the taxpayer's position. GAB Business Serv., Inc. v. Syndicate 627, 809 F.2d 755, 762 (11th Cir. 1987) ("[a] party who bases a claim on matters which would be privileged, the proof of which will necessitate the introduction of privileged matter into evidence, and then attempts to raise the privilege so as to thwart discovery, may be deemed to have waived the privilege") (quoting Home Ins. Co. v. Advance Mach. Co., 443 So. 2d 165, 168 (Fla. Dist. Ct. App. 1983)).

protects communication relating to the rendering of legal advice and not to the discharge of ordinary business obligations.[75]

Corporate documents prepared for review by legal and nonlegal personnel often are not held as privileged, because they are not communications made for the primary purpose of generating legal advice.[76] Some legal advice mixed with business advice is not sufficient to trigger the attorney-client privilege for the document.[77] Because in-house counsel is usually involved in the company's business decisions, the in-house counsel's advice must be given in a professional legal capacity for the attorney-client privilege to apply.[78] An attorney's involvement in a transaction does not place a wall of privilege around all of the documents to the transaction.

The work-product doctrine, codified under Federal Rule of Civil Procedure 26(b)(3), is based upon the principle that materials prepared by an attorney in anticipation of litigation are protected from disclosure.[79] Also, the materials provided by or for a party and that party's representative (the party's attorney, consultant, or agent)[80] must have been prepared "in anticipation of litigation," which consists of "more than a remote possibility" of litigation.[81]

The work-product doctrine does not cover materials prepared in the ordinary course of business.[82] Courts have generally refused to apply the work-product doctrine to tax advice based on the mere possibility that the Service may later audit and challenge the taxpayer's return.[83] The reports of accounting firms engaged

75. Bradford v. Commissioner, 104 T.C. 33 (1995).

76. United States v. Chevron Corp., 1996 U.S. Dist. LEXIS 4154.

77. *Id.*

78. *Id.*; *see also In re* Sealed Case, 737 F.2d 94, 99 (D.C. Cir. 1984). The court may direct a taxpayer to produce copies of the mixed legal/nonlegal documents with the privileged portions redacted. The taxpayer may also refuse to provide redacted material where, with respect to each document, the privileged material is "so inextricably intertwined with the rest of the text that they cannot be separated." Resolution Trust Corp. v. Diamond, 773 F. Supp. 597, 601 (S.D.N.Y. 1991).

79. Hickman v. Taylor, 329 U.S. 495 (1947).

80. *See* FED. RULE CIV. P. 26(b)(3) (attorneys often rely on the assistance of agents in the preparation of materials for trial).

81. United States v. Adlman, 94-2 U.S.T.C. ¶ 50,389 (S.D.N.Y. May 16, 1994), *appeal docketed*, No. 94-6143 (2d Cir. May 31, 1994) (a document prepared based on a taxpayer's expectation that the Service will challenge a position in its corporate tax return was not prepared in anticipation of litigation under the work-product doctrine and a tax opinion issued by its accounting firm for the tax effect of a stock sale to the taxpayer's in-house tax attorney was not protected by the work-product doctrine and the attorney-client privilege). *See* United States v. Conner Peripherals, Inc., 95-1 U.S.T.C. ¶ 87,023 (N.D. Cal. 1994) (likelihood of I.R.S. audit based on industry's audit history in transfer pricing disputes).

82. *Id.* A taxpayer's analysis of contingent tax liabilities, although involving the weighing of legal arguments, predicting the position of the Service, and forecasting taxpayer's arguments in court, is not prepared in anticipation of a dispute with the Service over its tax return. A contingent tax liability analysis is considered to be performed for financial reporting purposes to anticipate the financial impact of potential litigation. *Id.*

83. United States v. El Paso Co., 682 F.2d 530, 542-43 (5th Cir. 1982) (documents must be prepared in the anticipation of trial, or produced during trial, for the work-product doctrine to apply).

primarily to assist a taxpayer with preparation of its tax returns are not privileged under Rule 26(b)(4)(B) or the work-product doctrine.[84]

However, materials may be prepared under "mixed purposes" of both litigation and ordinary business purposes.[85] The work-product doctrine is available only if the primary motivating purpose for creating the materials was to assist in pending litigation instead of financial reporting reasons.[86]

"Ordinary" work product can be discoverable by showing substantial need and undue hardship,[87] while "opinion" work product involving the mental impressions, conclusions, opinions, and legal theories of an attorney or other representative concerned with the litigation requires a higher level of protection.[88] Opinion work product can be discoverable only when the mental impressions are at issue in a case and the need for the material is compelling[89] or Rule 26(b)(4)(B) extends to facts known and opinions held by a nontestifying expert and there is a showing of "exceptional circumstances."[90]

The burden of proving that the attorney-client privilege or the work-product doctrine applies rests with the party asserting the privilege or protection.[91] To carry the burden of proof, a party must present "detailed facts which make clear that the specifically identified and described documents are protected under the doctrine."[92] The court usually rejects blanket privilege claims.[93]

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84. *See* Bernardo v. Commissioner, 104 T.C. 677 (1995); United States v. Bell, 95-1 U.S.T.C. ¶ 50,006 (N.D. Cal. Nov. 9, 1994).

85. *Bell*, 95-1 U.S.T.C. ¶ 50,006 (opinion letter requested by taxpayer's accountant from its attorney required for federal securities laws to disclose in financial reports attorney's opinion to potential liability, although the opinion letter contained attorney's mental impressions).

86. United States v. Gulf Oil Corp., 760 F.2d 292, 296 (Temp. Emer. Ct. App. 1985) (primary motivating purpose in the creation of the materials was to assist in pending litigation); United States v. Davis, 636 F.2d 1028, 1040 (5th Cir.), *cert. denied*, 454 U.S. 862 (1981) (work-product doctrine applies if the primary motivating purpose was to aid in possible future litigation).

87. FED. R. CIV. P. 26(b)(3).

88. FED. R. CIV. P. 26(b)(3), (4).

89. United States v. Miller, 600 F.2d 498, 502 (5th Cir.), *cert. denied*, 444 U.S. 955 (1979); Holmgren v. State Farm Mutual Auto Ins. Co., 976 F.2d 573, 577 (9th Cir. 1992); United States v. Mierzwicki, 500 F. Supp. 1331, 1335 (D. Md. 1980); United States v. Conner Peripherals, Inc., 95-1 U.S.T.C. ¶ 87,023 (threshold requirement to overcome the "opinion" work product protection not met).

90. FED. R. CIV. P. 26(b)(4)(B) (developed or acquired facts known and opinions held by a nontestifying expert in anticipation of litigation are only discoverable on a showing of "exceptional circumstances"). An expert's knowledge and views acquired prior to engagement are freely discoverable.

91. United States v. Schwimmer, 892 F.2d 237, 244 (2d Cir. 1989); United States v. Miller, 660 F.2d 563, 570 (5th Cir. 1981); BarclaysAmerican Corp. v. Kane, 746 F.2d 653 (10th Cir. 1984); Weil v. Investment/Indicators, Research & Management, 647 F.2d 18, 25 (9th Cir. 1981).

92. Sedlacek v. Morgan Whitney Trading Group, Inc., 795 F. Supp. 329, 332 n.3 (C.D. Cal. 1992); *see* United States v. Abrahams, 905 F.2d 1276 (9th Cir. 1990) (an assertion of privilege must be made with each specific category of requested information).

93. *See* Vaughn v. Rosen, 484 F.2d 829 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 977 (1974) (Freedom of Information Act requires the government to index documents claimed to be exempt from disclosure under the Act, rather than assert a blanket privilege). The Service is not required to produce documents pursuant to the Freedom of Information Act, 5 U.S.C. § 552, in violation

Disclosure of materials to persons other than the attorney, client, or their agents can waive both the attorney-client privilege and the work-product protection.[94] Voluntary disclosure of attorney-client communication constitutes a waiver of the attorney-client privilege as to all other communications on the same subject.[95] The party claiming the privilege has the burden of proving that it has not waived the privilege.[96]

Along with the summons method, the Service has the alternative methods of the formal document request (FDR) and a request pursuant to a tax treaty to obtain foreign information and documents. The Service may issue a summons, issue an FDR, request information through a treaty, or pursue concurrently all of the methods, depending upon the situation.[97]

C. The Formal Document Request Procedures

The FDR, under IRC § 982 for foreign-based documentation, is an alternative action to a summons or can be issued concurrently with a summons to increase the likelihood of compliance. An FDR is defined as "any request (made after the normal request procedures have failed to produce the requested documentation) for the production of foreign-based documentation."[98] The request must be "made in a course of an audit."[99]

The term "foreign-based documentation" refers to any documentation held outside the United States that may be relevant or material to the tax treatment of the examination item.[100] The term includes documents held by a foreign entity,

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of I.R.C. § 6103 (nondisclosure of tax returns and return information), trade secrets, or proprietary data. After the party makes a factual showing (for example, by a privilege log), the court may exercise its discretion to conduct an in camera (in chambers) review. However, the requesting party must support a reasonable good faith belief that an in camera inspection may reveal evidence that certain of the disputed materials are not privileged. United States v. Zolin, 491 U.S. 554, 572 (1989).

94. United States v. Bell, 95-1 U.S.T.C. ¶ 50,006 (work-product waiver occurs when disclosure substantially increases the opportunity for potential adversaries to obtain that information).

95. *United States v. Davis*, 636 F.2d at 1043 n.18; *see* Weil v. Investment/Indicators, Research & Management, Inc., 647 F.2d 18, 24-25 (9th Cir. 1981) (waiver occurs with an unintentional disclosure); Karme v. Commissioner, 73 T.C. 1163 (1980), *aff'd*, 673 F.2d 1062 (9th Cir. 1982) (if a taxpayer files a petition raising the issue of its own knowledge or state of mind as the basis for its claim, the taxpayer has waived its privilege and the government has the right to discover privileged communications as to the basis of the claim).

96. United States v. Landof, 591 F.2d 36, 38 (9th Cir. 1978).

97. *See* United States v. First Nat'l Bank, 699 F.2d 341 n.11 (7th Cir. 1983); United States v. Toyota Motor Corp., 561 F. Supp. 354 (C.D. Cal. 1983); United States v. Vetco, Inc., 644 F.2d 1324, 1332 (9th Cir. 1981); Treas. Reg. § 1.6038A-6(b) (outlines the coordination of the section 6038A summons with tax treaties).

98. I.R.C. § 982(c)(1). The informal document request is the normal request procedure prior to the FDR. The FDR is mailed by registered or certified mail to the taxpayer at the last known address providing the (1) time and place for production; (2) statement of the reason why previously submitted documents are insufficient; (3) description of the documents requested; and (4) consequences of noncompliance. Internal Revenue Manual [IRM] 4233, exhibits 500-9, -15.

99. H.R. Conf. Rep. No. 760, 97th Cong., 2d Sess. 592 (1982).

100. I.R.C. § 982(d)(1) (foreign-based documentation).

whether or not controlled by the taxpayer, and includes, but is not limited to, books and records.[101] Thus, section 982 may be used to request a domestic subsidiary to produce documents that are in the possession of its foreign parent. If the Service considers the taxpayer's noncompliance flagrant, the Service may impose the negligence penalty under section 6662(b).

If a taxpayer fails to comply with an FDR arising out of the examination of the tax treatment of any item within ninety days after the mailing of the request by the Service, the taxpayer is prohibited from introducing into evidence, in a civil proceeding concerning the tax treatment of the examined item, any foreign-based documentation covered by the request.[102] The section 982 exclusionary rule operates only during litigation for documents that the taxpayer did not produce in response to an FDR during audit.[103]

The taxpayer may bring a proceeding to quash the request within ninety days of its mailing.[104] The government would be expected to seek compliance in the proceeding.[105] The Service has the burden of showing both the relevance and materiality of the requested records.[106] The traditional *Powell* requirements must be satisfied prior to enforcing compliance with the FDR.[107]

The inadmissibility of foreign documents not produced pursuant to the request does not apply if the failure to produce is due to reasonable cause. However, the potential that a foreign jurisdiction may impose civil or criminal penalties on the taxpayer or any other person for disclosing the documentation is not a reasonable cause.[108]

A taxpayer may claim "lack of control" to establish that the failure to produce is due to reasonable cause. The foreign-based documents include documents held by a foreign entity whether or not controlled by the taxpayer. If the taxpayer does not have possession, custody, or control of the requested foreign-based documents, the taxpayer may have a reasonable-cause exception, depending upon the facts and whether the taxpayer can establish the lack of control over those documents.[109] However, the courts will not permit the subsidiary to deny control

101. I.R.C. § 982(d)(2). The taxpayer provided the documents within the Tax Court discovery rules, but not within the 90 days under the § 982 request. The admission of the documents were not prohibited by § 982 since the Service did not issue the FDR to the taxpayer but only to his wholly owned corporation. Santa Maria v. Commissioner, T.C. Memo. 1994-622.

102. I.R.C. § 982; *see* Flying Tigers Oil Co. v. Commissioner, 92 T.C. 1261 (1989) (exclusion extends to affidavits, accompanying documents, and testimony based on the excluded documents).

103. The § 982 exclusion would be useless to the Service if the taxpayer does not want to produce any of the requested documents for trial.

104. I.R.C. § 982(e) (statute of limitations under §§ 6501 and 6531 is suspended during the proceeding and the appeal period).

105. I.R.C. § 982(c)(2)(A) (proceeding to quash).

106. H.R. CONF. REP. NO. 760, 97th Cong., 2d Sess. 591.

107. *Id.*; International Marketing Ltd. v. Commissioner, 90-2 U.S.T.C. ¶ 50,476 (N.D. Cal. 1990) (*Powell* standards for FDR enforcement).

108. I.R.C. § 982(b)(2) (foreign nondisclosure laws are not a reasonable cause).

109. H.R. CONF. REP. NO. 760, 97th Cong., 2d Sess. 473 (1982), 1982-2 C.B. 600, 658.

if a U.S. subsidiary can secure documents of its foreign parent to meet its own business needs.[110]

D. Tax Treaties or Tax Information Exchange Agreements

With the increase in international business transactions, many foreign governments are realizing the mutual benefit and the necessity of increasing the level of cooperation in the area of tax matters or risk potential revenue losses, especially in the transfer pricing area.[111] Tax treaties, or tax information exchange agreements, are an important means of obtaining information and documents in foreign jurisdictions.

Article 26 of the U.S. Model Treaty and most U.S. tax treaties provide for the exchange of information between the competent authorities of the "Contracting States" to carry out the provisions of the treaty, prevent fraud, and administer statutory provisions against fiscal evasion.[112] The "exchange" article encompasses information in the possession of tax officials, other government agencies, and private parties subject to the laws of the requested country.

The U.S. Government obtains information pursuant to its tax treaties under various types of exchange programs. These programs are categorized as specific requests,[113] spontaneous exchanges,[114] routine exchanges,[115] simultaneous exami-

110. *See* Chris-Marine USA v. United States, 75 A.F.T.R.2d (P-H) 95-117 (M.D. Fla. 1995) (U.S. subsidiary had control for section 982 purposes over the documents of its foreign parent, because the U.S. company had the ability to produce some corporate records of the parent and the affiliates); Yujuico v. United States, 818 F. Supp. 285 (N.D. Cal. 1993) (taxpayer had practical control for section 982 purposes).

111. *See* 5 Rufus von T. Rhoades & Marshall J. Langer, Income Taxation of Foreign Related Transactions ch. 85 (looseleaf) (no official citation). The Council of Europe Convention on Mutual Administrative Assistance in Tax Matters took effect for the United States, Finland, Sweden, Norway, and Denmark on April 1, 1995. The Netherlands and Belgium are in the ratification process with the Convention open within the Organization for Economic Cooperation and Development (OECD) to Australia, Canada, Japan, and New Zealand. The Convention covers all compulsory taxes, except customs duties, and the criminal, civil, and administrative aspects of tax matters. Assistance includes the exchange of information, tax examinations, tax recovery, and document notification.

112. R. Hellawell & R. Pugh, Taxation of Transnational Transactions 1987-1988, at 212-26 (3d ed. 1987) (Model Convention for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital published by International Bureau of Fiscal Documentation, June 16, 1981).

113. Specific requests from the competent authority of a treaty partner identify the taxpayer, the tax years involved, and the information requested. A request from the competent U.S. authority must show that the taxpayer is subject to the tax laws of the United States and that the information is required in good faith for transactions or facts material to a tax covered by the tax treaty. IRM 42(10)(10).5, .6.

114. Spontaneous exchanges furnish to a treaty partner, without any specific request, information that is discovered during a tax examination or investigation of a particular taxpayer, which suggests or establishes noncompliance with the tax laws of a treaty partner. IRM 42(10)(10).(11).

115. Routine exchanges provide information that identifies taxpayer recipients of passive or investment income (dividends, interest, rents, and royalties). Information obtained under this program is retained by the Philadelphia Service Center on a Form 1099-type format and made a part of the Service's Information Retrieval Program (IRP). IRM 42(10)(10).5.

nation programs,[116] double taxation programs,[117] industrywide exchanges,[118] and exchange of "know-how" programs.[119]

During the audit cycle of a particular taxpayer, the Service uses the specific request procedures under a treaty. The Service requests documents to verify foreign taxes paid and the final assessments by the foreign tax authorities of the taxpayer's operations in the foreign country. Also, requests under the specific request procedures can relate to ownership of property, control of corporations, and financial transactions. A foreign government is not required to carry out procedures under a treaty request violating its own laws or to furnish information unobtainable under its own laws. The foreign competent authority, before providing the information and documents to the Service in response to a specific request, may give notice to the taxpayer for a response.

Tax treaties usually provide that information will not be exchanged disclosing any trade, business, industrial, commercial, or professional secret.[120] Tax treaties may provide that the competent authority will not exchange information if its disclosure would be contrary to public policy. Usually, tax treaties provide that exchanged information is secret and is disclosed only to persons (including a court or administrative body) concerned with the assessment, collection, and enforcement of the taxes in question.

Tax returns and return information can be disclosed to the competent authority of a government to the extent allowed under a tax treaty. Under U.S. law, section 6103(k)(4) of the Code provides an exception for tax treaties to the prohibition against disclosing tax returns and return information in section 6103(b). Most foreign governments have similar disclosure laws concerning tax returns filed in the country and other return information. Thus, the tax treaties in effect for

116. Under the simultaneous examination program, the United States and the treaty partner coordinate the examination of the same multinational taxpayer. By a formal exchange of letters between the respective competent authorities, each country agrees on the tax years, audit approach, direction of the audit, and the information to be exchanged. IRM 42(10)(10).5, .7.

117. Under the double taxation program, information is provided when, with respect to a particular transaction, a specific taxpayer invokes the mutual agreement procedures under a treaty. A U.S. taxpayer requests the competent U.S. authority to resolve a double taxation situation when there is taxation by a foreign treaty partner not in accordance with the treaty provisions. Usually, the taxpayer alleges that double taxation yields results contrary to the intent of the treaty. IRM 42(10)(10).5, .9.

118. The industrywide exchange program secures comprehensive data on a worldwide industry and its operating patterns from foreign countries through an exchange of experiences by revenue officials in examining multinational entities in specific industries. This program complements the Service's Industry Specialization Program (ISP) in establishing safe-harbor guidelines for industry transactions that are acceptable by several foreign tax authorities. IRM 42(10)(10).8.

119. The exchange during a "know-how" program initiates information gathering efforts with nontreaty countries and expands such efforts with treaty countries when there is little information-gathering activity. Information exchanges include patterns and operations of selected multinational industries, examination techniques, training, and analysis of the roles of various specialists in tax examinations. IRM 42(10)(10).(10).

120. A taxpayer can object to the proposed disclosure of trade secrets by presenting a request for competent authority assistance. Ann. 95-9, 1995-7 I.R.B. 57 (proposed revision of Rev. Proc. 91-23, 1991-1 C.B. 534).

the years at issue would govern the release of foreign tax returns and other return information.

A taxpayer may request assistance from the competent U.S. authority[121] to resolve issues arising under an income tax treaty between the United States and a foreign country.[122] Such issues involve the availability to the U.S. taxpayer of credits against foreign tax, reduced rates of foreign tax, and other benefits and safeguards provided under income tax treaties. The competent U.S. authority will not accept a taxpayer's request for assistance involving an issue that is either pending in a U.S. court or has been designated for litigation[123] without the consent of the Associate Chief Counsel (International).[124]

The competent U.S. authority and the competent authority of the treaty partner will exchange tax information to the extent necessary to resolve the tax dispute raised by the taxpayer. Typical cases deal with the reallocation of income or the interpretation and application of treaty provisions. Negotiated settlements of specific items on a taxpayer's tax return normally result.

The Service's exchanges with the foreign treaty partners are achieved through the Revenue Service Representative (RSR), if there is an RSR responsible for the treaty country. Each RSR is stationed in a certain country and is responsible for geographical areas consisting of a number of countries. The RSR presents the competent U.S. authority's requests to the competent authority of the treaty country.

The formal and informal understandings with the foreign government determine the extent and type of information that the RSR can gather. The Service may obtain a limited amount of information through its RSR beyond the treaty request formalities. The RSR can gather public record documents,[125] conduct interviews of consenting witnesses, serve summonses, and audit, to the extent permitted by the host country, U.S. citizens living and working in the foreign country.

During the Tax Court proceedings, the Service's counsel may use the specific request procedures under the treaty in effect during the years at issue to obtain the information and documents needed for trial.[126] Normally, the request will ask for authenticated documents from the competent authority for admissibility in a U.S. court. The Service's counsel may request copies of foreign tax returns filed by the taxpayer (or the taxpayer's foreign subsidiary), internal audit documents concerning those returns, final tax assessments, related correspondence

121. The Assistant Commissioner (International) is the U.S. Competent Authority. *See* IRM 42(10)(10).2; Delegation Order No. 114 (Rev. 9), 1990-2 C.B. 326.

122. Ann. 95-9, 1995-7 I.R.B. 57.

123. Rev. Proc. 87-24, 1987-1 C.B. 720.

124. Ann. 95-9, 1995-7 I.R.B. 57, 63.

125. *See Sources of Information from Abroad*, Document 6743 (Rev. 2-93) (public records available from various foreign countries).

126. *See* IRM 42(10)(10).5, .6.

between the taxpayer and the foreign tax officials, and relevant foreign tax provisions pertaining to the taxpayer's tax obligations.

II. Obtaining Foreign Information and Documents During the Trial Phase of a U.S. Civil Tax Dispute

During the trial stage of a civil tax dispute, procedures for requesting information and documents abroad may consist of subpoenas, letters rogatory, specific court discovery rules, and the Hague Evidence and Service Conventions. Counsel may utilize in a court proceeding any of these procedures, including tax treaty requests.

Since international cases usually involve large deficiency amounts asserted by the Service, the taxpayer often chooses the U.S. Tax Court as the forum to contest IRS deficiency notices, instead of paying the deficiency and suing for refund in Federal District Court or the U.S. Claims Court. The discovery issues outlined below relate primarily to tax deficiency cases litigated in the Tax Court. The discussions emphasize the procedures in the Tax Court, with some mention of the Federal Rules of Civil Procedure. The Tax Court may give particular weight to the Federal Rules of Civil Procedure when no applicable rule of procedure exists under the Tax Court Rules.[127]

A. The Judicial Subpoena

The judicial subpoena is a method for obtaining testimony and records from foreign jurisdictions during a legal proceeding.[128] A U.S. Tax Court subpoena requires the attendance of witnesses and the production of books and records "from any place in the United States."[129] Pursuant to I.R.C. § 7456(b), the Tax Court may subpoena books, records, and testimony from abroad when the subpoena is issued to a petitioner who is a foreign corporation, a foreign trust or estate, or a nonresident alien individual.[130]

If the court finds good cause for the production of documents, the court must order production of the documents. Section 7456(b) directs the Tax Court to order the petitioner (the foreign entity or nonresident alien individual) to make the relevant "books, records, documents, memoranda, correspondence and other papers," wherever situated, available to the Service for inspection, copying, or

127. T.C. Rule 1(a) (scope of rules).

128. Fed. R. Civ. P. 34 has been interpreted as establishing no legal distinction between constructive possession and control and physical possession for purposes of enforcing a subpoena to produce documents. Schwimmer v. United States, 232 F.2d 855 (8th Cir.), *cert. denied*, 353 U.S. 833 (1956).

129. I.R.C. § 7456(a)(1) (administration of oaths and procurement of testimony in Tax Court).

130. T.C. Rule 72(c); *see* Aruba Bonaire Curacao Trust Co. v. Commissioner, 777 F.2d 38 (D.C. Cir. 1985); Hong Kong & Shanghai Banking Corp. v. Commissioner, 85 T.C. 701 (1985); Gerling Int'l Ins. Co. v. Commissioner, 86 T.C. 31 (1986), *rev'd on other grounds*, 839 F.2d 131 (3d Cir. 1988) (Tax Court, not relying on §§ 7456 or 982, ordered U.S. corporation to produce books and records of CFC).

photographing.[131] The scope of a section 7456(b) court order is patterned after the judicial enforcement of an administrative summons under *Powell*.[132]

After a reasonable time for compliance, the court must order one of the three sanctions in section 7456(b) of (1) striking the pleadings, (2) dismissing the proceeding, or (3) rendering a default judgment against the petitioner.[133] Defenses asserted against enforcement of a subpoena are similar to those that arise with an administrative summons. The subpoenaed party may claim that compliance would violate foreign law, or that the party lacks "control" over the books and records.[134] The courts consider the principles of international law and comity prior to the issuance of a section 7456(b) order.[135] The courts also review the *Restatement* balancing test to determine if U.S. interests outweigh the interests of the foreign country.[136]

In the absence of control by a litigating corporation over documents in the physical possession of another corporation, the litigating corporation has no duty to produce.[137] However, the courts will not permit the agent-subsidiary to deny control of documents as a defense against a discovery request under the Tax Court rules if the relationship between the parent and subsidiary corporations is such that the agent-subsidiary can secure documents of the principal-parent to meet its own business needs and documents helpful for use in litigation.[138] Also, the requisite control, involving sister corporations, occurs when the sister corporation is the alter ego of the litigating corporation.[139]

131. *Hong Kong & Shanghai Banking*, 85 T.C. at 708.

132. *Id.* at 709, 711 (copy of court order).

133. *Aruba*, 777 F.2d at 46.

134. Application of Chase Manhattan Bank, 297 F.2d 611 (2d Cir. 1962). A subpoena directed a U.S. bank to produce records of its foreign branch bank, but compliance would violate local law. The subpoena was modified by the court and left outstanding to allow the bank to comply with its duty under the subpoena, if and when the U.S. Government asked foreign authorities to authorize under foreign law the branch bank to produce the documents. *Id.* at 613. Also, a party cannot make a blanket claim of privilege to a subpoena, but must submit the requested information for inspection to the court explaining how the privilege covers each document. *In re* Grand Jury Witness (Salas), 695 F.2d 359, 362 (9th Cir. 1982).

135. Hong Kong & Shanghai Banking Corp. v. Commissioner, 85 T.C. 701, 709 (1985).

136. *See* RESTATEMENT (THIRD), *supra* note 39, § 442(1)(c), note 7 (1987); United States v. Bank of Nova Scotia, 740 F.2d 817 (11th Cir. 1984) (grand jury subpoena for disclosure of suspects' bank records held by Grand Cayman Islands branch of Canadian bank); United States v. Davis, 767 F.2d 1025 (2d Cir. 1985) (court ordered a defendant in a criminal action to order a foreign bank to release the defendant's bank records).

137. Gerling Int'l Ins. Co. v. Commissioner, 839 F.2d 131, 140 (3d Cir. 1988); *see* Searock v. Stripling, 736 F.2d 650, 653 (11th Cir. 1984) ("[c]ontrol is the test with regard to the production of documents . . . defined not only as possession, but as the legal right to obtain the documents requested on demand").

138. *Gerling*, 839 F.2d at 141; *see* First Nat'l City Bank v. Internal Revenue Serv., 271 F.2d 616, 618 (2d Cir. 1959), *cert. denied*, 361 U.S. 948 (1960) (access to documents in the ordinary course of business creates sufficient "control" when the need arises because of governmental requirements).

139. *Gerling*, 839 F.2d at 141.

Under Federal Rule of Civil Procedure 45(b)(2), the U.S. district courts issue and serve subpoenas abroad in accordance with 28 U.S.C. § 1783. Section 1783 provides statutory authority to subpoena a U.S. national or resident in a foreign country.[140] Federal Rules of Civil Procedure 4(d) and 4(i) set out the methods of serving process on a person in a foreign country.[141] Since the U.S. Tax Court is not a "court of the United States" as defined in 28 U.S.C. § 451, the procedures afforded by 28 U.S.C. § 1783 are not available to the Tax Court. However, letters rogatory are provided under Tax Court Rule 81(e)(2) as an alternative method.

B. Letters Rogatory

The use of letters rogatory may be the only means to obtain evidence or for effecting service of process in a particular country. More assistance may be obtained from a foreign court than from government ministries in the country. The use of principles of comity in countries not parties to a treaty or convention may be the only choice in the discovery process.[142] Requests by letters rogatory depend entirely upon the comity of courts toward each other and the promise of reciprocity.[143]

The courts use letters rogatory to take testimony by deposition, to obtain documents and records, or to effect service of process for a summons or a subpoena.[144] Letters rogatory are defined as

> the medium, in effect, whereby one country speaking through one of its courts, requests another country, acting through its own courts and by methods of court procedure peculiar thereto and entirely within the latter's control, to assist the administration of justice in the former country; such request being made, and being usually granted, by reason of the comity existing between nations in ordinary peaceful times.[145]

The term denotes a formal request from a court with an action pending to a foreign court to perform some judicial act.[146]

Many countries require that letters rogatory be transmitted between the U.S. State Department and the appropriate foreign ministry rather than directly from a U.S. court to a foreign court. The Department of State is authorized to receive

140. 28 U.S.C. § 1783(a).

141. *Id.* § 1783(b). The RSR may be able to serve personally documents for the Service in order to avoid the procedures of Rule 4(i).

142. *See* Société Aérospatiale v. United States Dist. Ct., 482 U.S. 522 (1987).

143. 22 C.F.R. § 92.54.

144. Republic Int'l Corp. v. AMCO Engineers, Inc., 516 F.2d 161 (9th Cir. 1975) (letters rogatory issued by district court to effect service of process of summons and complaint by foreign court under local law to foreign party); *see* 22 C.F.R. § 92.54; Gary Born & David Westin, International Civil Litigation in the United States Courts 180 (2d ed. 1992); 4 James W. Moore, Moore's Federal Practice ¶ 28.05 (2d ed. 1995). The issuance of letters rogatory is recognized in the U.S. district courts under Federal Rule of Civil Procedure 28(b) and in the Claims Court under Cl. Ct. Rule 89.

145. The Signe, Tiedmann v. The Signe, 37 F. Supp. 819, 820 (E.D. La. 1941).

146. 22 C.F.R. § 92.54. Civil and criminal litigation and grand jury proceedings can use letters rogatory.

a letter rogatory request made by a tribunal in the United States and to transmit it to the foreign or international tribunal to whom it is addressed.[147] If the request needs to be translated into a foreign language, a certified translation needs to be provided. The potential usefulness of letters rogatory depends upon the foreign country involved and the type of judicial assistance being requested.

C. Court Discovery Rules

Specific court discovery[148] rules of requests for production, depositions, and interrogatories can be used to obtain evidence from abroad.[149] Only parties to the litigation can use Requests for Production of Documents and Things,[150] but a subpoena can compel a person not a party to the action to produce documents and things.[151] As previously discussed, section 7456(b) can be used for the production of records from foreign petitioners. Also, the Tax Court may issue a protective order to a party located abroad whereby documents or records may be impounded by the court to ensure their availability for review by the parties prior to trial and for use at trial.[152]

Counsel can use foreign depositions and interrogatories to obtain the testimony and records of a witness in a foreign country. Foreign depositions require that the witness be unavailable and the deposition be taken in compliance with law.[153] Overseas witnesses are considered "unavailable" under Rule 804(a)(2) when they are not subject to the jurisdiction of the U.S. courts, or, although subject to U.S. courts, refuse to testify. A deposition taken in accordance with a foreign government's laws satisfies the hearsay exception for former testimony under Federal Rule of Evidence 804(b)(1), unless the manner of taking the deposition

147. 22 C.F.R. § 92.66 (depositions taken before foreign officials or other persons in a foreign country).

148. Court discovery is designed to provide an opportunity to clarify questions of fact. P.T. & L. Constr. Co. v. Commissioner, 63 T.C. 404, 414 (1974).

149. *See* T.C. Rule 71 (interrogatories); T.C. Rule 72 (production of documents and things); T.C. Rules 74, 75, 81(e)(2) (depositions); T.C. Rule 143(f) (expert reports required 30 days before trial, but in large cases the parties usually request a court order from the judge requiring 90 days before trial); Fed. R. Civ. P. 26(f) (procedures for discovery planning); Fed. R. Civ. P. 26(a)(1), (2), (3) and (e) (disclosure with a duty to supplement disclosures); Fed. R. Civ. P. 37(c) (penalty for failure to disclose); Fed. R. Civ. P. 26(a)(2) (expert reports required 90 days before trial); Fed. R. Civ. P. 28(b) (foreign deposition pursuant to any applicable treaty or convention, notice, a commission by the court, or a letter of request that may be captioned a letter rogatory); *see* Société Aérospatiale v. United States Dist. Ct., 482 U.S. 522 (1987) (concerning production of documents, interrogatories, and request for admissions); Joseph M. Lookofsky, Transnational Litigation and Commercial Arbitration, A Comparative Analysis of American, European, and International Law 445-89 (1992) (extraterritorial service and evidence abroad).

150. *See* T.C. Rule 72.

151. Fed. R. Civ. P. 34(c) (refers to Rule 45 for use of a subpoena); T.C. Rule 72.

152. T.C. Rule 103(a)(10). The Tax Court may issue a protective order, upon a motion by a party or other affected persons, to protect trade secrets or other confidential information.

153. Fed. R. Evid. 804(a)(2).

makes it unreliable.[154] Foreign depositions are available with respect to parties and persons not party to the litigation. Only parties to the litigation can use interrogatories.

A party may avoid the participation of a foreign government in the litigation by the taking of depositions pursuant to a stipulation under Tax Court Rules 81(d) and 74. However, some countries consider the taking of a deposition to be an official government or judicial act. Thus, counsel should not plan a deposition in a foreign country without first determining whether permission must be obtained from the foreign country. For a deposition, the party needs to arrange for an interpreter and someone authorized to administer an oath under U.S. law.

Deposition by stipulation of the parties is the easiest method of taking a deposition subject to the laws of the foreign country. Otherwise, a deposition on notice, commission, or letters rogatory under Tax Court Rule 81(e)(2) or Federal Rule of Civil Procedure 28(b)[155] may be taken in a foreign country (1) before a person authorized to administer oaths or affirmations, either by the foreign law or by U.S. law; (2) before a person commissioned by the court to administer any necessary oath and take testimony; or (3) pursuant to a letter rogatory or a letter of request issued in accordance with the provisions of the Hague Evidence Convention.[156]

The party requesting the deposition must give reasonable notice in writing to the opposing party before a deposition on notice occurs with a diplomatic or consular officer.[157] A commission to take a deposition is a written authority issued by a court giving the power to take the testimony of a witness.[158] A notice or commission may designate the person before whom the deposition is to be taken either by name or descriptive title. A letter rogatory may be addressed to the "Appropriate Authority" in the country. A letter of request is addressed to the central authority of the requested country. The Hague Evidence Convention sets forth a recommended example of a letter of request.

If a deposition is to be taken in a foreign country, it must be by written questions unless otherwise directed by the court for good cause.[159] The Tax Court rules provide that the parties and their counsel may attend the deposition, but they

154. *See* United States v. Kelly, 892 F.2d 255, 261-62 (3d Cir. 1989), *cert. denied*, 110 S. Ct. 32 (1990); United States v. Salim, 855 F.2d 944, 947 (2d Cir. 1988).

155. *See* 22 C.F.R. § 92.51 (methods of taking depositions in foreign countries under FED. R. CIV. P. 28(b)).

156. Convention on the Taking of Evidence Abroad in Civil or Commercial Matters (The Hague Evidence Convention), July 27, 1970, 23 U.S.T. 2555, MARTINDALE-HUBBELL LAW DIGEST, INTERNATIONAL LAW DIGESTS, part VII, at 15; *see* 1 BRUNO A. RISTAU, INTERNATIONAL JUDICIAL ASSISTANCE (CIVIL AND COMMERCIAL) §§ 3-22 to -35 (depositions), 3-38 to -46 (letters of request), 5-8 to -45 (Hague Evidence Convention).

157. 22 C.F.R. § 92.52 (the issuance of a commission or other court order is not necessary for a notice deposition).

158. 22 C.F.R. § 92.53 (commission to take deposition).

159. T.C. RULE 84(a).

cannot participate in the deposition proceeding in any manner.[160] The Court rules provide for objections as to manner and form of the deposition and state that

> [e]rrors and irregularities occurring at the oral examination in the manner of taking the deposition, in the form of the questions or answers, . . . and errors of any kind which might have been obviated, removed, or cured if promptly presented, are waived unless reasonable objection thereto is made at the taking of the deposition.[161]

Evidence obtained by deposition, a letter rogatory, or a letter of request need not be excluded merely for the reason that it is not a verbatim transcript, the testimony was not taken under oath, or for any similar departure from the requirements for depositions within the United States under the Federal Rules.[162]

As in the summons and subpoena area, the taxpayer can assert the same objections based upon the attorney-client privilege and the work-product protection for nonproduction of documents in court discovery requests for production, depositions, and interrogatories. When the taxpayer requests documents in the control of the U.S. Government, the Service can claim nonproduction pursuant to the attorney-client privilege, the work-product protection,[163] and the deliberative process privilege (or executive privilege).[164] The assertion of the executive privilege is a policy decision, not merely a question of law.[165] The court may order an in camera review of the documents to determine whether the privilege or protection should apply.

The requesting party must make preliminary arrangements with the witnesses for the taking of the deposition. After preliminary arrangements have been made, considerable time may be required for the various courts or officials to issue appropriate instructions for taking the deposition. The laws of foreign countries differ greatly as to the procedure to be followed for the taking of these depositions.[166]

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160. T.C. RULE 84(c) (written depositions).

161. T.C. RULE 85(d); *see* Exxon Corp. v. Commissioner, T.C. Memo. 1992-92 (objection under Rule 85(d) must be made at the time of the deposition or objections to the use of prepared statements to answer written questions during the deposition will be waived).

162. FED. R. CIV. P. 28(b).

163. Bernardo v. Commissioner, 104 T.C. No. 33 (1995) (district counsel's internal notes, draft deficiency notices, and the appeals officer's memo made in anticipation of litigation were government work product and not discoverable, since the taxpayer failed to establish "necessity" for the documents).

164. The executive privilege protects intra-agency communications that are part of a deliberative process preceding the adoption of an agency policy or decision. Arthur Anderson v. Internal Revenue Serv., 679 F.2d 254, 255 (D.C. Cir. 1982). Documents that communicate agency working law are not protected. Taxation with Representation Fund v. Internal Revenue Serv., 646 F.2d 666 (D.C. Cir. 1981). Since executive privilege is not absolute, the government must establish that the probable harm to the consultative process resulting from disclosure outweighs the need of the party seeking discovery. P.T. & L. Constr. Co. v. Commissioner, 63 T.C. 404, 409 (1974).

165. United States v. Reynolds, 345 U.S. 1, 8 (1953).

166. *See* 22 C.F.R. pt. 92—Notarial and Related Services. Information concerning the identity and mailing addresses of foreign officials who are authorized to administer oaths and conduct such proceedings is available from numerous sources such as (1) *The Martindale-Hubbell International Law Directory*, (2) the ministry of justice in the foreign country, and (3) U.S. consulates and embassies.

The U.S. party seeking to take a foreign deposition needs to contact the U.S. Department of State to ascertain any requirements imposed by it, or by the foreign country in which the deposition is to be taken, including any required foreign language translations and any fees or costs. The party then files with the U.S. court, along with the application, any such foreign language translations, fees, costs, or other materials required. The State Department can provide information on whether consular officials in certain countries are able to take depositions.[167] Current tax treaties and conventions between the United States and the foreign country must always be carefully consulted.

D. The Hague Evidence and Service Conventions

The Hague Evidence and Service Conventions provide optional procedures for obtaining evidence and jurisdiction abroad, but do not deprive a U.S. court of its jurisdiction to order under the Federal Rules a foreign party to produce evidence located within a signatory nation.[168] The Hague Evidence Convention simplifies the obtaining of information and documents by establishing standards and methods to bridge the differences between the common law and civil law procedures among the participating countries[169] and the Hague Service Convention prescribes rules that simplify and expedite the procedures for serving judicial and extrajudicial documents.[170]

The Hague Evidence Convention establishes three methods for obtaining evidence from abroad: (1) the letter of request, (2) the use of diplomatic and consular officials, and (3) the use of designated private commissioners. Under the letter of request, a litigant requests the court where the action is pending to transmit a "Letter of Request" to the "Central Authority" in the foreign country where the evidence is located. The Central Authority transmits the request to the appropriate court or authority conducting the evidentiary proceeding. Under the second procedure, a diplomatic officer or consular agent of the requesting country takes the evidence in the foreign country. The third procedure permits the trial court, with the consent of the appropriate foreign authorities, or a court of the foreign state to appoint a commissioner to take evidence.

The Hague Service Convention applies only in civil or commercial cases for

167. *See* 22 C.F.R. pt. 92 (taking of depositions by consular officers in foreign countries).

168. *See* Société Aérospatiale v. United States Dist. Ct., 482 U.S. 522 (1987) (request for the production of documents pursuant to FED. R. CIV. P. 34, interrogatories pursuant to Rule 33, and request for admissions pursuant to Rule 36).

169. Foreign depositions "pursuant to any applicable treaty or convention" under Rule 28(b) refers to the Hague Evidence Convention or other treaties. MOORE, *supra* note 144, ¶ 28.01[12]—Advisory Committee Note of 1993. The Hague Evidence Convention contains provisions similar to 28 U.S.C. §§ 1781-1784.

170. Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters (Hague Service Convention), Feb. 10, 1969, 20 U.S.T. 361, MARTINDALE-HUBBELL, *supra* note 156, part VII, at 1; *see* RISTAU, *supra* note 156, §§ 4-11 to -30 (Hague Service Convention).

the purposes of creating appropriate means for service abroad and to improve mutual judicial assistance by simplifying and expediting procedures.[171] For "service abroad," the Hague Service Convention applies if the internal law of the forum country defines the applicable method of serving process as requiring the transmittal of documents abroad as a necessary part of the service.[172]

The Hague Service Convention requires each country to designate a "Central Authority" to receive requests from other signatory nations to assist in the service of process.[173] The Central Authority, or its designated authority, completes a certificate indicating that the requested service of the document in the request has been made or setting forth the reasons for the refusal of the requested service. A contracting country may refuse to comply with a request for service if compliance would infringe its sovereignty or national security. The reasons for any noncompliance must be provided on the certificate of service.

Any request for service must conform with the model annexed to the Hague Service Convention. A summary of the document to be served must be served with the document. Also, the request and accompanying documents are written in either English, French, or the language of the country addressed. Documents are served under the destination country's internal law for service of documents upon persons within its territory or under the originating country's law for service if not incompatible with the destination country's internal law.

III. Authentication of Foreign Documents

To use the acquired foreign documents at trial, a party must be prepared to authenticate the documents and certify any English translations. The opposing party may be unwilling to stipulate to the authentication of a foreign document in court. Also, if a document that a party intends to offer in evidence is in a foreign language and the opposing party will not stipulate to its English translation, a certified translation by an officially recognized translator must be obtained.

As previously mentioned, foreign depositions can be used to obtain the testimony and records of a witness in a foreign country. Deposition procedures are available to obtain the necessary authenticating testimony for documents. Along with the use of depositions, other procedures can be used to authenticate foreign documents, depending upon whether the documents are public documents or business records.

Foreign public documents include those emanating from a judicial or other tribunal, including the public prosecutor, the clerk of court, or the process server, and any document signed by an individual in an official capacity. These documents

171. Volkswagenwerk v. Schlunk, 486 U.S. 694, 704 (1988).

172. *Id.* at 700. The service of process is defined as a formal delivery of documents that is legally sufficient to charge a party with notice of a pending action. RISTAU, *supra* note 156, § 4-5(2).

173. The U.S. State Department is the "Central Authority" for receiving foreign service requests and the Justice Department is designated for purposes of completing the certificate of service with the assistance of a U.S. marshal, or deputy marshal, in the judicial district for service.

include administrative documents, notarial acts, or private documents bearing official certifications, such as a certificate of registration on official authentication of a signature.[174]

The primary methods of authenticating foreign public documents are the procedures in the Hague Authentication Convention for public documents,[175] and the procedures available under Federal Rule of Evidence 902(3) and 902(5) and Federal Rule of Civil Procedure 44(a)(2).[176] Under the Hague Authentication Convention, documents are certified by use of a standardized form, called an *apostille*, which entitles recognition by courts as a matter of treaty right.

The Hague Authentication Convention abolishes the requirement of diplomatic or consular legalization for foreign public documents. The competent authority of the country from which the document emanates issues an *apostille*. The competent authority certifies the authenticity of the signature, the capacity in which the person signing the document has acted, and, where appropriate, the identity of the seal or stamp it bears.

The public documents covered under the Convention are (1) documents from an official connected with the courts or tribunals, (2) administrative documents, (3) notarial acts, and (4) official certificates placed on documents signed by persons in their private capacity, such as official certificates recording the registration of a document or the fact that it was in existence on a certain date and official and notarial authentications of signatures. The Convention does not cover documents executed by diplomatic or consular agents and administrative documents dealing directly with commercial or customs operations.

The authentication methods of the Federal Rules of Evidence and Federal Rules of Civil Procedure are always available for a U.S. court. Rule 901 of the Federal Rules of Evidence provides the fundamental principle that the "requirement of authentication or identification as a condition precedent to admissibility is satisfied by evidence sufficient to support a finding that the matter in question is what its proponent claims."

Rule 902(3) of the Federal Rules of Evidence authorizes the use of the chain-certification method.[177] Under this method, a person authorized under the laws of the foreign country first executes or attests to the document. A certification by another local official accompanies the original attestation followed by a certificate of another official of higher rank. The process continues until an official is reached about whom the U.S. consular or diplomatic official ordinarily knows

174. *See* 22 C.F.R. § 92.36 (authentication of public foreign documents defined).

175. 1961 Hague Convention Abolishing the Requirement of Legalization for Foreign Public Documents (Hague Authentication Convention), MARTINDALE-HUBBELL, *supra* note 156, part VII, at 26; *see* RISTAU, *supra* note 156, §§ 6-3 to -11 (Hague Authentication Convention).

176. *See* 22 C.F.R. §§ 92.37 (authentication procedure), 92.38 (forms of certificate of authentication), 92.39 (authenticating foreign public documents—federal procedures).

177. *See* Exxon Corp. v. Commissioner, T.C. Memo. 1992-92 (chain-certification method under Rule 902(3)).

enough to permit the issuance of the ultimate certification. This method does not require that the consular or diplomatic official be able to certify the original attesting person's signature, incumbency of the office purportedly held, or the authority to prepare and attest the copy.

Under Federal Rule of Civil Procedure 44(a)(2) and Federal Rule of Evidence 902(5), official publication of the foreign official records or documents can prove such records and documents. These provisions eliminate the requirement of preliminary proof of the genuineness of purportedly official publications, such as those containing statutes, court reports, rules, or regulations.[178]

Both Rule 902(3) and Rule 44(a)(2) allow the court discretion to treat official documents as presumptively authentic without final certification or permit the documents to be evidenced by an attested summary, with or without final certification, if reasonable opportunity has been given to all parties to investigate the authenticity and accuracy of the official documents. This procedure may be useful in cases in which the United States does not have a consul in the foreign country or, because of other reasons, a final certification cannot be obtained.[179]

For foreign business records, authentication may be achieved by stipulation of the parties, voluntary appearance of the custodian of record, self-authenticating documents under Rule 902(9), affidavit of the custodian of record, testimony from a foreign government official, letters rogatory, Rule 803(24), or foreign depositions.[180] If the parties do not dispute the foreign documents, it may be possible to obtain agreement by the opposing party in the litigation to stipulate the authenticity of the records. However, testimony by an expert witness or a knowledgeable fact witness would be needed to provide any weight to the value of the stipulated documents in court.

With respect to foreign custodians of business records, problems over the authentication of such records can arise from the inability to compel the custodian of the records to appear as a witness at trial in the United States.[181] Appearance is voluntary for a custodian who is a nonresident alien. If the custodian is a U.S. citizen or resident, such appearance may be compelled by 28 U.S.C. § 1783 in a U.S. district court or by a subpoena in the U.S. Tax Court.

178. *See* Advisory Committee's Note, FED. R. EVID. 902(5).

179. *See* United States v. Leal, 509 F.2d 122, 126 (9th Cir. 1975) (foreign official refused to go to the U.S. embassy for a final certification, but chose to follow the procedures of his own government for authenticating documents by writing a letter on his stationery attesting that the copies were taken from the original documents).

180. *See* 22 C.F.R. § 92.65 (depositions to prove genuineness of any foreign document).

181. The Ninth Circuit admitted certain business records into evidence under 28 U.S.C. § 1732 (the Federal Business Records Act) when the foundation was laid by an affidavit of the custodian of the records. The records were hotel registration records required to be maintained by the laws of Hong Kong. The court found that many of the guarantees of trustworthiness underlying the official documents and business records exceptions to the hearsay rule were inherent in the documents. Since none of the hotel employees could be subpoenaed to testify, the government action in obtaining the sworn affidavit before the U.S. vice consul was justified. *Leal*, 509 F.2d at 127.

Commercial paper and related documents are considered self-authenticating to the extent provided by "general commercial law" under Federal Rule of Evidence 902(9). Rule 902(9) may be considered when originals or copies of negotiable instruments, securities, bills of lading, and other commercial paper and related documents are needed as evidence and authenticating testimony is not readily obtainable. If foreign officials obtained the foreign business records by operation of law, a knowledgeable foreign official, willing to testify in this country, could provide the necessary authenticating testimony.[182]

If the authenticating witness declines to give testimony voluntarily, and jurisdiction cannot be obtained by use of 28 U.S.C. § 1783, a party may proceed by means of a letter of request or letter rogatory, and have the requested court propound appropriate questions to the witness establishing the authenticity of the business records. Under Tax Court Rule 81(e)(2), evidence obtained in response to a letter rogatory need not be excluded merely for the reason that it was not a verbatim transcript or that the testimony was not taken under oath or for any similar departure from the requirements of a deposition taken within the appropriate rules.

The Tax Court, in *Karme v. Commissioner*, held that foreign business records are admissible under the exception set forth in Rule 803(24) when there are "circumstantial guarantees of trustworthiness" and the statement is material, probative, and "the interests of justice will best be served by admission of the statement into evidence."[183] The *Karme* court observed that a cover letter under the letterhead of the Netherlands Antilles Inspectorate of Taxation stated that the records were obtained from the Netherlands Antilles bank and that the transactions reflected in the records clearly related to transactions described in the testimony of the petitioners and other witnesses.[184] The Court further stated that "[t]hese distinctive characteristics, in conjunction with [the special agent's] description of the acquisition of the records and their consistency with the rest of the evidence, satisfy the authentication requirements of Rule 901."[185]

IV. The Determination of Foreign Law Under U.S. Tax Court Rule 146

Under Tax Court Rule 146 and the Federal Rule of Civil Procedure 44.1, the "Court, in determining foreign law, may consider any relevant material or

182. United States v. Quong, 303 F.2d 499 (6th Cir.), *cert. denied*, 371 U.S. 863 (1962). Royal Canadian Mounted Police with a search warrant obtained business records from the custodian of record. The action of the police and their testifying in the U.S. district court occurred through operation of the treaty between the United States and Canada. *Id.* at 503-04.

183. Karme v. Commissioner, 73 T.C. 1163, 1181 (1981), *aff'd*, 673 F.2d 1062 (9th Cir. 1982); *see* United States v. Friedman, 593 F.2d 109, 118-19 (9th Cir. 1979).

184. *Karme*, 73 T.C. at 1180. The documents could not be brought within the FED. R. EVID. 803(6) "business records" exception since the special agent was not a "custodian or other qualified witness" capable of testifying that the records were kept in the course of a regularly conducted business activity.

185. *Id.*

source, including testimony, whether or not submitted by a party or otherwise admissible. . . .''[186] Although Rule 146 overrides the hearsay objections, foreign documents must still meet the authenticity requirement before admissibility under the rule.

The court does not take judicial notice of foreign law.[187] A party, intending to raise an issue concerning the law of a foreign country, must provide notice in the pleadings or other reasonable written notice.[188] A party whose case is in any way dependent upon an interpretation of foreign law must so indicate in the pleadings or give the court other reasonable notice. There are no formal requirements that notice of intent to raise an issue of foreign law be inserted in the pleadings, but reasonable notice must be given.

A party can give notice to the court by filing a document entitled ''Notice of Foreign Law.'' The notice would recite that the party notifies the court and the opposing party that it intends to request the court to consider the law of a particular foreign country. The notice should reference the relevant foreign statutes and cases. The court's determination is treated as a ruling on a question of law.[189] Since the court's determination is treated as a ruling on a question of law, the scope of any appellate review is not limited by the ''clearly erroneous'' standard, but would be a de novo review.[190]

Admission under Rule 146 is based upon whether the documents will assist the court with interpreting and understanding the foreign law. The Tax Court in *Exxon* interpreted this ''assist the court'' standard of admissibility under Rule 146 as extremely broad and not encumbered by the federal rules of admissibility.[191] The court stated that ''[w]hile the documents may not be subject to the hearsay rule, we do not necessarily receive those documents as conclusive evidence of the statements made therein . . . [but] . . . they will be accorded weight that is consistent with their reliability.''[192]

The Tax Court, in *Procter & Gamble Co.*, admitted certain documents under Rule 146 for the limited purpose of interpreting foreign law.[193] Documents to be admitted under the restriction of interpreting the '' 'laws of such country' . . . include not only explicit constitutional or statutory provisions and explicit rules and regulations by controlling authority, but also any existing practice or

186. T.C. RULE 146; FED. R. CIV. P. 44.1 (similar provision in the U.S. CL. CT. RULE 125 and FED. R. CRIM. P. 26.1).

187. T.C. RULE 146.

188. *See* Owens-Illinois, Inc. v. Commissioner, 76 T.C. 493 (1981) (foreign law discoverable under T.C. RULES 70(b) and 146).

189. T.C. RULE 146; FED. R. CIV. P. 44.1. *See* Owens-Illinois, Inc. v. Commissioner, 76 T.C. 493 (1981) (discussing pretrial discovery of foreign law and expert testimony regarding foreign law).

190. *Owens-Illinois*, 76 T.C. at 498-99.

191. Exxon Corp. v. Commissioner, T.C. Memo. 1992-92.

192. *Id.* n.7.

193. Procter & Gamble Co. v. Commissioner, 95 T.C. 323 (1990).

policy of such foreign country.''[194] The Tax Court in *Exxon* held that law expressed in informal form constitutes ''law'' under Rule 146 without the requirement of formal codification.[195]

V. Conclusion

Along with the expansion of business transactions and relationships on a global scale, the tax questions raised by the Service concerning these transactions and relationships during an audit are growing in quantity, complexity, and dollar amounts. The U.S. Congress is focusing more attention on foreign operations of U.S. entities and foreign entities doing business in the United States and asking whether the U.S. Treasury is receiving its fair share of tax revenue. Also, the U.S. Tax Court's docket is swelling with petitions from U.S. and foreign multinationals objecting to the adjustments and disallowances set forth in the notices of deficiency from the Service on extremely complex issues.

Thus, the need for foreign evidence gathering and discovery during nondocketed and docketed case status is exploding. The lead time required to obtain foreign documents and testimony necessitates advance planning and the early employment of foreign tax attorneys and accountants in the countries in question. To minimize the time and expense for both the U.S. taxpayer and the Service, mutual cooperation during all phases of any potential dispute would benefit both parties. Otherwise, the search by the attorneys of both parties for authenticated and translated foreign documents and foreign witnesses to give testimony may become comparable to Sir Galahad's quest for the Holy Grail.

194. *Procter & Gamble*, 95 T.C. at 337; *see also* U.S. Padding Corp. v. Commissioner, 88 T.C. 177, 187-88 (1987), *aff'd*, 865 F.2d 750 (6th Cir. 1989).

195. Exxon v. Commissioner, T.C. Memo. 1992-92.