International Lawyer

Volume 20 | Number 4 Article 6

1986

Information Gathering on Tax Evasion in Tax Haven Countries

Gregory P. Crinion

GREGORY P. CRINION*

ARTICLES

Information Gathering on Tax Evasion in Tax Haven Countries

I. Introduction

Since the mid-1950's the United States tax authorities and Congress have increasingly concentrated on attacking international tax evasion in tax haven countries.[1] Detecting and proving the tax evasion, however, has been the major problem faced by the tax authorities.[2] Information on the existence, ownership, and value of deposit accounts in tax haven countries has proven extremely difficult to obtain.[3] This is due, in part, to the fact that foreign financial institutions are not subject to the same disclosure requirements as are American financial institutions. Thus, U.S. tax authorities do not have the same ready access to tax information held in the foreign country as they do to information held by institutions in the United States. Another factor in the U.S. tax authorities' inability to

*Attorney, Exxon Company, U.S.A.; B.B.A., University of Wisconsin-Eau Claire; M.B.A., University of Minnesota; J.D., University of Wisconsin Law School. The views and opinions expressed herein are solely those of the author and not necessarily those of the author's employer.

1. *Tax Evasion Through the Netherlands Antilles and Other Tax Haven Countries: Hearings Before a Subcommittee of the House Committee on Government Operations*, 98th Cong., 1st Sess. 3 (1983) (statement of William J. Anderson, Director, General Government Division, General Accounting Office) [hereinafter referred to as *Netherlands Antilles Hearings*]. STAFF OF A SUBCOMMITTEE OF THE SENATE GOVERNMENTAL AFFAIRS COMMITTEE, 98th CONG., 1st SESS., STAFF STUDY OF THE CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES 128-30 (Comm. Print 1983) [hereinafter referred to as SENATE STAFF STUDY] contains a listing of twenty-four congressional hearings and reports on international tax evasion topics.

2. *Crime and Secrecy: The Use of Offshore Banks and Companies: Hearings Before the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs*, 98th Cong., 1st Sess. 16 and 21 (1983) (statement of Roscoe L. Egger, Jr., commissioner, IRS) [hereinafter referred to as *Senate Hearings*].

3. R. GORDON, TAX HAVENS AND THEIR USE BY UNITED STATES TAXPAYERS–AN OVERVIEW, REPORT TO THE COMMISSIONER OF INTERNAL REVENUE 8-9 (1981) [hereinafter referred to as GORDON REPORT].

obtain necessary information is that the other principal source of the information is the tax haven government.[4] The tax haven government generally fails to provide the requested information either because it does not compile that information,[5] because its bank and commercial secrecy laws prohibit disclosure of that information,[6] or because it does not have any agreement with the United States authorizing the release of that information.[7]

The inability of the U.S. tax authorities to obtain even minimal information on tax haven activities precludes any realistic estimate of the magnitude of the tax evasion problem.[8] The U.S. tax authorities are unable to make a reliable estimate since they do not have information on the amounts transferred into or through tax havens, the source and ownership of those funds, or the extent to which those funds are merely being laundered through the tax haven countries.[9] While the tax authorities contin-

4. Given that the taxpayer will obviously not voluntarily disclose the necessary information and the foreign financial institutions are not subject to U.S. reporting laws, this leaves the tax haven government as the only possible source. This assumes that where the domestic tax haven laws do not require routine domestic financial institution reporting, the tax haven government could compel disclosure of the information in specific instances.

5. GORDON REPORT, *supra* note 3 at 169.

6. *Id.* For a discussion of the Swiss banking secrecy laws *see*, Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 NEW ENG. L. REV. 18 (1978) and Honegger, *Demystification of the Swiss Banking Secrecy and Illumination of the United States–Swiss Memorandum of Understanding*, 9 N.C.J. INT'L L. AND COM. REG. 1 (1983). Reprints, translations, and summaries of bank secrecy laws in several tax haven countries may be found in SENATE STAFF STUDY, *supra* note 1 and in TAX HAVEN INFORMATION BOOK, Department of the Treasury, IRS, DOC. 6743 (1982). In general, the bank secrecy laws require that banks maintain absolute confidentiality regarding their client's accounts and transactions except where disclosure is required, as in criminal investigations by the domestic government. Violation of the secrecy laws typically subjects the violator to civil and criminal sanctions.

7. "It is an established principle of international law that a country is not obligated to assist in the enforcement of the penal or tax laws of another country in the absence of an applicable treaty or bilateral agreement." *Senate Hearings, supra* note 2 at 38 (statement of John M. Walker, Jr., Assistant Secretary, Enforcement, Department of the Treasury). *See*, Gordon Report, *supra* note 3 at 9 and *Netherlands Antilles Hearings, supra* note 1 at 232-33 (statement of Roscoe L. Egger, Jr., commissioner, IRS).

8. A study was conducted by the Internal Revenue Service [hereinafter referred to as IRS] for the purpose of estimating the levels of tax haven usage. While data was compiled regarding general tax haven usage, the report from the study stated that given the multiple veils of secrecy, no estimate could be made of either the size of U.S. owned funds hidden from tax authorities or the amounts by which those funds increase year by year. GORDON, ESTIMATES OF LEVELS OF TAX HAVEN USE: A STUDY TO QUANTIFY THE USE OF TAX HAVENS, TAX HAVEN STUDY GROUP, IRS 26 (1981) [hereinafter referred to as ESTIMATES OF LEVELS OF TAX HAVEN USE].

Another problem incurred in the estimation of tax haven usage is defining which countries are tax havens. There is no agreed upon list of tax haven countries. SENATE STAFF STUDY, *supra* note 1 at 10; GORDON REPORT, *supra* note 3 at 40-41 and 177; Tax Havens in the Caribbean Basin, Department of the Treasury 3-4 (1984); and Irish, *Tax Havens*, 15 VAND. J. TRANSNAT'L L. 449, 452 n.5 (1982).

9. GORDON REPORT, *supra* note 3 at 36.

ually assert that tax evasion is a serious problem,[10] the IRS has been able only to estimate that the tax loss due to tax evasion in tax haven countries amounts to many billions of dollars.[11]

A statistical analysis provides some insight into the potential magnitude of international tax evasion activities.[12] Table 1 (subhead A) compares the foreign asset holdings of banks in selected countries to merchandise exports for those countries.[13] This ratio (which is generally considered an indicator of a country's functioning as a tax haven) illustrates the extent to which a country is holding foreign assets in excess of the amount needed to finance its foreign trade.[14]

Four of the five Caribbean tax haven countries listed (the Bahamas, Bermuda, the Cayman Islands and Panama) have consistently held foreign assets far in excess of their merchandise exports and far above the average for all non-oil producing developing countries.[15] The fifth country, the Netherlands Antilles, is an exception, but its excess asset holdings are increasing at a much faster rate than those of the other Caribbean tax haven countries.[16] The second part of Table 1 (subhead B) is a comparison in absolute terms of foreign assets held by Caribbean tax haven countries to the holdings of all non-oil producing developing countries. The principal holders of excess foreign assets in the Caribbean are the Bahamas, the Cayman Islands, and Panama. Together they hold over $300 billion in excess foreign assets.[17] Even if only a small percentage of this excess represents tax evasion activity, the tax revenue loss is substantial.

The United States tax authorities have been attacking these tax evasion efforts through both civil and criminal enforcement methods.[18] As of February 1983, at least 126 cases involving bank or commercial secrecy were pending in U.S. courts.[19] These cases involved laundering or secreting illegal profits, secreting legitimate assets for illegitimate purposes, and using offshore entities as an integral part of an overall crime scheme.[20]

10. *Id.* at 3; Tax Havens in the Caribbean Basin, note 8 *supra* at 3; and, *Senate Hearings, supra* note 2 at 15.

11. *Senate Hearings, supra* note 2 at 15, *Netherlands Antilles Hearings, supra* note 1 at 224 and 239 (statement of Roscoe L. Egger, Jr., IRS Commissioner), and Wall St. J., Oct. 10, 1985, at 1, col. 5.

12. For a detailed statistical analysis measuring the use of tax havens, *see generally,* ESTIMATES OF LEVELS OF TAX HAVEN USE, *supra* note 8.

13. Tax Havens in the Caribbean Basin, *supra* note 8 at 13.

14. *Id.* at 12.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Senate Hearings, supra* note 2 at 20 and 259.

19. *Id.* and SENATE STAFF STUDY, *supra* note 1 at 146-159.

20. *Id.*

TABLE 1
Foreign Assets of Deposit Banks
1978–1982

	1978	1980	1982
A. *Ratio of Foreign Assets to Merchandise Exports*			
World	0.87	0.85	1.34
Industrial Countries	0.90	0.99	1.45
Oil-Producing Developing Countries	0.10	0.10	0.22
Non-Oil Developing Countries	1.27	1.00	1.73
Selected Caribbean Countries			
Bahamas	46.20	24.47	36.42[e]
Bermuda	32.75	57.00	108.33[e]
Cayman Islands	i	i	i
Netherlands Antilles	1.06	1.90	3.90[e]
Panama	61.96	91.64	114.30
United States	0.74	0.79	1.72
B. *Foreign Assets Above or Below the Average Level ($ billions)*			
Selected Caribbean Countries in Relation to Average for All Non-Oil Developing Countries			
Bahamas	94.8	11.4	134.6[e]
Bermuda	1.3	2.2	3.2[e]
Cayman Islands	49.0	84.5	127.7
Netherlands Antilles	−0.6	3.0	6.0[e]
Panama	16.4	32.6	41.4
Total Five Countries	160.9	123.7	312.9
United States in Relation to Average for All Industrial Countries	22.8	−24.7	56.8

[e]Estimate.
[i]Since merchandise exports are negligible, the ratio approaches infinity.

The Bahamas, the Cayman Islands, Switzerland, Panama, Luxembourg, Costa Rica, and Liechtenstein were a few of the tax haven countries involved.[21] In January 1984, the IRS identified 464 criminal tax cases involving the Caribbean Basin area alone from the period January 1978 to August 1983.[22] At that time, the government was actively investigating

21. *Id.*
22. Tax Havens in the Caribbean Basin, *supra* note 8 at 34.

130 of these cases and had recommended prosecution in 153 cases. In 81 cases, successful prosecution resulted in an increase in the average taxable income for each case of about $1.7 million. One hundred cases had been discontinued or dismissed for a variety of reasons, including the inability to obtain information from tax haven countries.[23]

The United States has also pursued a policy of terminating or renegotiating certain bilateral tax treaties because of the risk of treaty shopping and banking and commercial secrecy abuses.[24] In July 1983, the Treasury announced that it was terminating tax treaties with a number of countries, including Anguilla, Barbados, Belize, Dominica, Grenada, Montserrat, St. Christoper-Nevis, St. Lucia, and St. Vincent and the Grenadines.[25] At about the same time, the Treasury announced that Antigua and Barbuda cancelled their treaty with the United States.[26] In addition, the treaty negotiations with the British Virgin Islands regarding the amendment of an existing income tax treaty were cancelled and the existing treaty terminated. Negotiations with the Netherlands Antilles on a new income tax treaty are continuing.[27]

The basic prerequisite for successful tax enforcement efforts is the compilation of information on taxpayer activities. An information exchange under existing bilateral tax treaties is one traditional information gathering method. Historically, the U.S. tax authorities, however, have not been successful in obtaining sufficient information through traditional methods. It is non-traditional, ad hoc methods which have uncovered the most valuable information for fighting tax evasion activities in tax haven countries. Nonetheless, new and expanded exchange of information agreements and multilateral investigation procedures may prove more successful in the future.

This article examines several of the information gathering procedures utilized by the U.S. tax authorities to combat the tax evasion problem. Part II of this article examines unilateral methods of the U.S. tax authorities to obtain information on tax evasion. Such methods include IRS administrative summonses and the grand jury subpoena, the use of IRS

23. *Id.* at 34-35. *See* Wall St. J., Sept. 18, 1985, at 1, col. 5, for statistics on IRS criminal investigations into money laundering activities alone.

24. *Id.* at 44. The Treasury Department also indicated that it is Treasury policy not to enter into any new treaties which would allow the unwarranted extension of benefits to residents of third countries. The objective of this policy is to limit treaty shopping, to expand and improve the U.S. treaty network by precluding third country residents from obtaining the benefits of a bilateral tax treaty without actually entering into one, and to encourage adherence to the letter and spirit of the law. *Id.* at 44-45.

25. *Treasury News*, 20 TAX NOTES 175 (1983).

26. *Id.*

27. Tax Havens in the Caribbean Basin, *supra* note 8 at 46.

paid informants, and exclusive IRS investigations such as mail watches, employment of foreign revenue service representatives, and passive gathering of public information. Part III of this article examines the use of existing IRS reporting requirements as information gathering tools, while Part IV analyzes the involvement of the judiciary in the United States and the foreign country in the information gathering process through the use of letters rogatory. Part V discusses the U.S. tax authorities' bilateral efforts to discover information on tax evasion. These efforts include bilateral tax treaties, exchange of information agreements, simultaneous examination procedures, and the United States–Switzerland Mutual Assistance Treaty. Finally, Part VI discusses additional information gathering methods that will likely be utilized in the future, including the Switzerland–United States Memorandum of Understanding and multilateral tax treaties, the possibilities of which are presently being discussed by the United States and other countries.

This article concludes that the U.S. tax authorities are determined to combat the tax evasion problem and are willing to go to great lengths to do so. The U.S. tax authorities have been aggressive in their pursuit of tax evaders, and past efforts are evidence that the tax authorities have not hesitated to utilize domestic and foreign laws to their limits. It is very likely that the tax authorities will continue their aggressive posture against tax evasion and that they will continue to devise newer, more intrusive, and even more effective procedures to fight the tax evasion problem.

II. Unilateral IRS Information Gathering Methods

The U.S. tax authorities have achieved the greatest successes in obtaining information on the illegal use of tax havens through unilateral IRS action. Likely reasons for the success of these efforts are as follows: First, the tax authorities were not obliged to depend on foreign governments which may be reluctant to render assistance due to their own conflicting policies and laws.[28] Second, the U.S. tax authorities have innovatively applied existing law to new circumstances.[29] Finally, the U.S. tax authorities have been tenacious in seeking necessary information.[30] The IRS administrative summons and grand jury subpoena are two unilateral methods employed by the U.S. tax authorities to obtain information on the illegal use of tax havens.

28. *See supra* note 6 and *infra* notes 180 and 209 and accompanying text.
29. *See infra* notes 122-34 and accompanying text.
30. *See infra* notes 182-197 and accompanying text.

A. The Administrative Summons and the Grand Jury Subpoena

Section 7602(a)(2) of the I.R.C.[31] authorizes the IRS to order a taxpayer to appear before the IRS and produce any books and records relevant to the taxpayer's return. Section 7602(a)(2) of the I.R.C.[32] also authorizes the IRS to order the holder of the taxpayer's books and records to appear and produce those books and records. The administrative summons may be used only until the IRS refers a case to the Justice Department.[33] This referral includes a recommendation by the U.S. Attorney General that a grand jury investigation be conducted.[34] After referral, however, the grand jury may obtain testimony and evidence by issuing subpoenas, enforceable under authority of the overseeing court.[35]

In general, courts have treated subpoenas and administrative summonses similarly, applying the same legal principles to each.[36] There are, however, some differences between the summons and subpoena, most notably that the administrative summons can be issued more readily than a subpoena,[37] and the information obtained from the summons may be used in both civil and subsequent criminal prosecutions. In addition, the summons can be issued to U.S. citizens outside the United States, although it is not likely to be enforceable.[38] The subpoena, on the other hand, can be issued and can require disclosure of information in a much shorter period of time than may a summons.[39] A subpoena issued to a U.S. citizen abroad is enforceable.[40]

The U.S. tax authorities have frequently used the administrative summons and encouraged the use of the grand jury subpoena in international tax evasion investigations. U.S. courts have enforced this use of the summons and subpoena so long as there exists a minimum connection with the United States. The following discussion of cases involving the

31. 26 U.S.C. § 7602(a)(2) (1982).
32. *Id.*
33. *Id.* at § 7602(c)(1) (1982).
34. *Id.* at § 7602(c)(2)(A)(i) (1982).
35. Fed. R. Crim. P. 17.
36. Gordon Report, *supra* note 3 at 205.
37. *Id.* at 204-05.
38. There is no limitation in 26 U.S.C. §§ 7602 and 7603 (1982) regarding the service of the summons. However, 26 U.S.C. § 7604(a) provides that the summons is enforceable by the district court in the district in which the taxpayer resides or may be found. Thus, a taxpayer residing outside the United States is likely not subject to an administrative summons. *Cf.* Navickas, *Swiss Banks and Insider Trading in the United States*, 2 Int'l Tax and Bus. L. 159, 162-65 (1984) (SEC summons is enforceable outside the United States because the statute expressly allows service "wherever the defendant may be found." (citing 15 U.S.C. § 78aa (1982))).
39. Gordon Report, *supra* note 3 at 204.
40. 28 U.S.C. § 1783 (1982).

use of a summons or subpoena is divided into four sections, each of which covers one fact situation where the U.S. tax authorities have conducted tax evasion investigations. The four fact situations are:

- Where the summons or subpoena is served on a foreign corporation without substantial U.S. operations
- Where the summons or subpoena is served on a U.S. corporation to obtain books and records held by the corporation's foreign operation;
- Where the summons or subpoena is served on the domestic operation of a foreign corporation seeking books and records held by the foreign corporation; and,
- Where the summons or subpoena is served on a non-resident alien present in the United States while on business for his employer and seeking books and records held by the alien's foreign corporate employer.

1. *Foreign Parent Corporation without Substantial U.S. Operations*

In re Arawak Trust Company (Cayman)[41] involved the validity of U.S. grand jury subpoenas of Arawak Trust Company, a Cayman Islands corporation.[42] While investigating a money laundering scheme in which illegal payments to the Teamsters Union Fund were allegedly transferred through Arawak,[43] the grand jury issued subpoenas on Arawak to Marine Midland Overseas Corporation, an Arawak shareholder.[44] The court stated that for an entity to be subject to U.S. territorial jurisdiction, it must be present within the United States, although U.S. residence is not required, and presence is established by conducting substantial and continuing activities within the country.[45] The court then held the subpoenas invalid for lack of territorial jurisdiction, noting that Arawak maintained no office in the United States, did not hold itself out as doing business in the United States, and held no significant property interests within the United States.[46] The court recognized that Arawak maintained a correspondent banking relationship with a New York firm and that it entered into over 600 transactions for each of the previous three years with its New York correspondent involving over $60 million,[47] but refused to find presence merely on that basis.[48]

41. 489 F. Supp. 162 (E.D.N.Y. 1980).
42. *Id.* at 163.
43. *Id.*
44. *Id.* Marine Midland owned 28 percent of Arawak's stock and is present in New York.
45. *Id.* at 165 (citing Int'l Shoe v. Washington, 326 U.S. 310 (1945)).
46. *Id.*
47. *Id.*
48. *Id.*

This case makes it clear that there are minimum U.S. connections necessary for a summons or subpoena to be enforced. However, incorporation in the United States may not be the necessary minimum connection where the records sought are held in the corporation's foreign operation, and there is a foreign law prohibiting the disclosure of the records.

2. *Domestic Corporation with Books and Records Held by Foreign Operation*

The U.S. tax authorities have had several occasions to issue administrative summonses or to request grand jury subpoenas to domestic corporations for books and records held by foreign branches and subsidiaries.[49] Two questions have arisen for the courts in their deliberations on the enforceability of a summons or subpoena served on the domestic corporation. First, did the domestic corporation have control of the books and records held by the foreign operation so that the subpoena or summons was enforceable? Second, did the existence of foreign banking and commercial secrecy laws prohibiting disclosure of the requested books and records preclude the courts from enforcing the subpoena or summons?

The question of control has been conclusively settled. *Societé Internationale Pour Participations Industrielles et Commerciales v. Rogers*[50] established that the domestic corporation has control over the books and records of its subsidiaries and a court may require production of those records even where they are held in a foreign jurisdiction so long as the domestic corporation is subject to U.S. jurisdiction.[51]

---

49. Six cases in which U.S. tax authorities have issued summonses or subpoenas to U.S. corporations for books and records held by a foreign operation are: *In re* Nat'l Pub. Util. Inv. Corp., 79 F.2d 302 (2d Cir. 1935); First City Nat'l City Bank of New York v. IRS, 271 F.2d 616 (2d Cir. 1959), *cert. denied*, 361 U.S. 948 (1960); *In re* Chase Manhattan Bank, 297 F.2d 611 (2d Cir. 1962); United States v. First Nat'l City Bank, 396 F.2d 897 (2d Cir. 1968); United States v. Vetco, 691 F.2d 1281 (9th Cir. 1981), *cert. denied*, 454 U.S. 1098 (1981); and United States v. First Nat'l Bank of Chicago, 699 F.2d 341 (7th Cir. 1983).

50. 357 U.S. 197 (1958).

51. In *Societé Internationale*, the Court held that a Swiss holding company controlled certain records held by its Swiss bank on the basis of a showing that the holding company and its bank were substantially identical. *Id.* at 200 and 204. The Swiss holding company was the petitioner in the court so there was no issue of U.S. jurisdiction over the holding company.

In First Nat'l City Bank of New York v. IRS, 271 F.2d 616 (2d Cir. 1959), *cert. denied*, 361 U.S. 948 (1960), the court held that there is a rebuttable presumption that a corporation is in control of its own books and records. Where an officer or agent of a branch has the authority to send the books to the parent for any corporate purpose, the parent has sufficient control over the books for the summons or subpoena to be enforceable. *See* United States v. First Nat'l City Bank, 396 F.2d 897, 898 n.2 (1968). The rule applies regardless of whether the controlled operation is a branch or subsidiary. *See* SEC v. Minas de Artemisa, 150 F.2d 215 (9th Cir. 1945) and, In re Nat'l Pub. Util. Inv. Corp., 79 F.2d 302 (2d Cir. 1935).

Similarly, there is little question that *Societé Internationale* will be applied in a corporation/branch relationship. U.S. courts have not distinguished between the foreign operation as a branch or subsidiary in determining the enforceability of a summons or subpoena.[52] Furthermore, a branch of a domestic corporation is merely an extension of the corporation, not a separate entity, and, as such, is controlled by the corporation.[53] Thus, so long as the corporation is subject to U.S. jurisdiction, a court may also require production of the books and records of its branches.

Whether the existence of a foreign banking and commercial secrecy law prohibiting disclosure of the requested information precludes enforcement of the summons or subpoena has not been uniformly answered. In *United States v. Vetco, Inc.*[54] the IRS issued administrative summonses to Vetco, a domestic corporation, and to its accountants requesting the books and records of Vetco and its Swiss subsidiary and the tax accounting reports prepared by Vetco's accountant and the accountant's Swiss subsidiary.[55] Vetco ordered its accountants not to disclose the information and then resisted the summonses[56] by asserting, in part, that compliance would require it to violate Swiss law.[57] The district court enforced the summonses and imposed contempt sanctions when Vetco failed to disclose the requested information.[58] The court of appeals affirmed, holding that the mere existence of a foreign law prohibiting the disclosure of certain information did not constitute an automatic bar to a U.S. court's ordering disclosure of that information.[59] Rather, each case must be decided on its facts.[60] When the taxpayer has made extensive good faith efforts to comply with the order, the court must first attempt to obtain compliance by imposing lesser sanctions against the taxpayer or drawing inferences unfavorable to the taxpayer.[61] In cases where there have been no good faith efforts at compliance, the court of appeals held that courts must use

52. See *infra* notes 56-118 and accompanying text.

53. Since the branch is not a separate entity, it falls under 28 U.S.C. § 7602(a)(2)(1982).

54. 691 F.2d 1281 (9th Cir. 1981), *cert. denied*, 454 U.S. 1098 (1981).

55. *Id.* at 1283-84.

56. The taxpayer has the right to quash a summons and this right extends to summonses issued on third parties holding books and records of the taxpayer. 26 U.S.C. § 7609(b)(2)(A) and § 7609(a)(1)(1982).

57. 691 F.2d at 1283.

58. *Id.*

59. *Id.* at 1287.

60. *Id.*

61. 691 F.2d at 1287. The court of appeals cited *Societé Internationale*, 357 U.S. 197, 213 (1958) where the Supreme Court refused to allow dismissal of the Swiss holding company's complaint upon the holding company's refusal to disclose requested information. The Court stated that the district court could allow the U.S. government additional opportunity to challenge the holding company's good faith, seek other methods of obtaining fuller compliance, or proceed immediately to trial on the merits.

a balancing test to determine whether to order disclosure or not.[62] After finding that Vetco had not made a good faith effort at compliance, the court went on to discuss various factors weighing in the balance. First, the court of appeals considered the vital national interests of each country and considered that Switzerland has a lesser interest in enforcing its secrecy laws than the United States has in enforcing its tax laws where the source of the information is a subsidiary of an American corporation and where the party seeking the records is the IRS which must maintain the confidentiality of the information.[63] Second, the court of appeals addressed the extent of hardship on the taxpayer. Disclosure of information pursuant to an IRS summons might be a defense to a violation of the foreign secrecy laws; Section 964(c) of the I.R.C.[64] requires American corporations to keep books and records of their controlled foreign corporations available for examination; and there was no evidence that unrelated third parties with an interest in the records would object to disclosure.[65] Third, in considering the location of the records, nationality of the taxpayer, and the expectation of taxpayer compliance, the court of appeals noted that the records sought were outside the United States, but that each of the parties was either a domestic firm or was controlled by a domestic firm.[66] Fourth, the court of appeals concluded that the documents were important since they were shown to be necessary to a determination of tax liability and there was no showing that the records were cumulative of records already produced.[67] Finally, considering whether alternate means of compliance with the summonses were available, the court of appeals found that obtaining consents to the disclosure, issuance of letters rogatory, use of treaty provisions, concealing the names of third parties, use of an independent expert on Swiss law to determine which records may be disclosed, and disclosure of the records in Switzerland are not substantially equal alternatives.[68] In this case, the balancing test weighed in favor of disclosure and the order enforcing disclosure was proper.[69]

62. 691 F.2d at 1288. The balancing test is derived from the factors set forth in RESTATEMENT (SECOND) FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965).

63. *Id.* at 1289.

64. 26 U.S.C. § 964(c)(1)(1982) and Treas. Reg. § 1.964-3 (1983), T.D. 7893, 1983-1 C.B. 132, 144.

65. 691 F.2d at 1289-90.

66. *Id.* at 1290.

67. *Id.*

68. *Id.* at 1290.

69. Two cases in which U.S. courts have applied the balancing test and required disclosure are SEC v. Banca della Svizzera Italiana, 92 F.R.D. 111 (S.D.N.Y. 1981) and United States v. First Nat'l City Bank, 396 F.2d 897 (2d Cir. 1968). Navickas, *supra* note 38 at 174-76, contains an analysis of the balancing test as applied in *Banca della Svizzera Italiana* and

An application of the balancing test in *United States v. First National Bank of Chicago*[70] resulted in the reversal of an order enforcing an IRS summons issued on a U.S. corporation for the books and records of its foreign branch. In 1979, the IRS issued a summons to First Chicago ordering the production of bank statements available only at its branch in Greece covering certain accounts in that branch.[71] The district court enforced the summons, but the court of appeals reversed. The court of appeals stated that a U.S. court is not precluded from enforcing a summons or subpoena even though disclosure of the information as required by the court would violate foreign law. Instead, in such cases, a court should balance the competing interests at stake.[72] The court of appeals applied the same balancing test as used in *Vetco,* but felt that on the facts available, the balancing weighed in favor of First Chicago. First, the court of appeals felt that the Greek national interest in enforcing its secrecy law outweighed the United States' interest in collecting taxes since the information sought in this case was relatively unimportant.[73] The court of appeals noted, in what the court of appeals in *Vetco* considered the fourth factor, that the amount of the asset was small, there were restrictions on the conversion and export of Greek funds, and the information sought was only to be used to levy and collect the tax, not to determine whether there was a tax liability.[74] Second, the court of appeals concluded that disclosure would impose a severe hardship on First Chicago and its employees because the sanction for violating the Greek bank secrecy law is imprisonment, not merely a fine, and its employees were not the taxpayers about whom the information was being sought.[75] Upon considering the third factor of location of the records, taxpayer nationality and expectation of taxpayer compliance, the court of appeals noted that the records were held in Greece, the disclosure would occur in Greece, persons of Greek nationality would make the disclosure, and First Chicago was reluctant to expose its Greek employees to criminal liability.[76] Finally, the court of appeals suggested that alternative means of compliance might

First Nat'l City Bank. Under slightly different facts not otherwise limiting the decision, the Eleventh Circuit Court of Appeals held in Grand Jury Proceedings, United States v. Bank of Nova Scotia, 691 F.2d 1384 (11th Cir. 1982), *cert. denied,* 103 S. Ct. 3086 (1983), discussed in detail at *infra,* notes 82-97 that *Societé Internationale* does not hold that a subpoena may be resisted on constitutional grounds where compliance would violate foreign law. *Id.* at 1388-89.

70. 699 F.2d 341 (7th Cir. 1983).
71. *Id.* at 342-43.
72. *Id.* at 345.
73. *Id.* at 346.
74. *Id.*
75. *Id.* at 345-46.
76. *Id.* at 342 and 345.

be available since there had been no attempt to obtain consent for the disclosure or to determine whether the Greek secrecy law contained an exception for the transfer of this information to the home office of First Chicago.[77] If such disclosure would not violate Greek law, the court of appeals stated that the result of the balancing test might then be different.[78]

The apparent conflict between the holdings in *First Chicago* and *Vetco* can be explained by the factual differences in the cases. In *Vetco*, the documents sought were important in determining whether there was a tax liability, the taxpayer was the subject of the disclosure request,[79] and there was no finding that disclosure would violate foreign law.[80] In *First Chicago*, on the other hand, the court of appeals suggested there might be an exception to the secrecy laws thereby allowing disclosure, the records were sought only for the purpose of collecting taxes not to levy taxes or determine a tax liability, and an unrelated third party, not the taxpayer, was the target of the summons.[81]

In summary, these cases make it clear that the IRS may successfully mandate the production of tax information held outside the United States on activities performed solely outside the United States. The one minimum requirement is that the information be under the control of a U.S. person or entity or an entity controlled by a U.S. person or entity. The cases do not completely agree, however, on whether the existence of a foreign law prohibiting disclosure of the information precludes enforcement of the summons or subpoena. It is suggested in the next section that a summons or subpoena requesting books and records held outside the United States by a non-U.S. corporation may be enforceable despite a foreign law prohibiting disclosure of the requested information when the information sought is necessary for a determination of a U.S. tax liability and the source of the information or a related party maintains a presence in the United States.

3. *Domestic Operation with Books and Records Held by Foreign Corporation*

The courts have ordered disclosure of requested information in cases involving books and records held by a foreign corporation with domestic operations, even though foreign law prohibits disclosure by the foreign corporation. In *Grand Jury Proceedings, United States v. Bank of Nova Scotia*,[82] the court of appeals reviewed a district court order compelling

77. *Id.* at 346.
78. *Id.*
79. 691 F.2d at 1284.
80. *Id.* at 1287.
81. 699 F.2d at 346.
82. 691 F.2d 1384 (11th Cir. 1982), *cert. denied*, 103 S. Ct. 3086-87 (1983).

the production of documents held by the foreign corporation in a federal grand jury investigation of tax and narcotics law violations.[83] The grand jury issued a subpoena to the Bank of Nova Scotia's Miami office ordering it to produce certain documents regarding third party transactions involving its branch in the Bahamas.[84] The district court held the bank in contempt when it refused to comply with the subpoena.[85] The court of appeals upheld the district court, holding, first, that the United States was not required to establish that the documents sought were relevant to the grand jury investigation and that imposing such a requirement would be an undue restriction on the grand jury.[86] Second, the court held that the mere showing that a foreign law prohibits disclosure of the information and that the information sought does not relate to the bank's tax liability does not prohibit enforcement of the subpoena.[87] The court of appeals cited *Societé Internationale*[88] and *Vetco*[89] and stated that the bank was not deprived of due process rights since it did not make a good faith effort to comply with the subpoena,[90] and because the Bahamian government had not prevented the bank from complying with the subpoena.[91] Finally, the court of appeals rejected the bank's arguments that comity between the U.S. and the Bahamas precluded enforcement of the subpoena and that the district court had improperly applied the Restatement balancing test.[92] The court of appeals stated, first, that although the bank was not the target of the investigation, this was not significant since the bank held records relating to an investigation.[93] Second, there was no reason to distinguish between requests for testimonial as compared to documentary evidence since the effect on the Bahamas would be the same.[94] Third, whether the information was located in the United States or the Bahamas was not significant to the court of appeals' decision since the disclosure would occur in the United States and because Bahamian interest in enforcing its secrecy laws would be compromised by the mere fact of the disclosure, not just by the substance of the disclosure.[95] Finally, the court of appeals opined that use of letters rogatory was not an alternate means

83. *Id.* at 1386.
84. *Id.*
85. *Id.* at 1387.
86. *Id.* at 1387-88.
87. *Id.* at 1388.
88. 357 U.S. 197 (1958). *See supra* note 51.
89. 691 F.2d 1281 (9th Cir. 1981). *See supra* notes 54-69 and accompanying text.
90. 691 F.2d at 1388-89.
91. *Id.* at 1389.
92. *Id.*
93. *Id.* at 1390.
94. *Id.*
95. *Id.*

of compliance.[96] In this case, the balancing weighed in favor of requiring disclosure.[97]

In re Marc Rich & Co., Marc Rich & Co. v. United States[98] similarly involved a subpoena requesting documents held by a foreign corporation with domestic operations. During a federal grand jury investigation of a tax evasion scheme allegedly involving Marc Rich & Co., the grand jury issued a subpoena to Marc Rich AG, a Swiss corporation, by serving it on Marc Rich International, Marc Rich AG's domestic operation. Marc Rich AG refused to disclose the requested books and records, claiming it was not subject to the jurisdiction of the court.[99] The court of appeals upheld the district court's order to disclose the books and records. The court stated that the mere fact that the subject of the subpoena was a foreign corporation was not significant.[100] The territorial principle of jurisdiction was applicable since Marc Rich AG allegedly violated U.S. tax law, and the violation would have occurred in cooperation with Marc Rich International, which did business in the United States.[101] Furthermore, two persons who were directors of both Marc Rich AG and Marc Rich International were residents of the United States, and at least one of them was alleged to have been involved in the tax law violation.[102] Therefore, had there been a violation of the tax laws, at least some of those violations would have occurred within the United States.[103] The court of appeals ordered Marc Rich AG to respond to the grand jury's inquiries.[104]

The Swiss government strongly objected to the U.S. court's order in *Marc Rich* to disclose the requested information.[105] Upon the district court's order imposing the contempt sanctions, the Swiss government filed a note of protest with the U.S. State Department.[106] Then, after Marc Rich AG agreed to produce the requested information, the Swiss government seized the records which were to be produced on the grounds

96. *Id.* at 1390. The bank stated that if the documents were being sought pursuant to a tax investigation, Bahamian judicial assistance would not be available. *Id.* at 1391, n.8. *See infra* notes 176-197 and accompanying text for a discussion on the use of letters rogatory by the U.S. tax authorities.

97. *Id.* at 1391.

98. 707 F.2d 663 (2d Cir. 1983), *cert. denied*, 103 S. Ct. 3555 (1983).

99. *Id.* at 665.

100. *Id.* at 667.

101. *Id.* at 668.

102. *Id.*

103. *Id.*

104. *Id.* at 670 (citing Int'l Shoe Co. v. Washington, 326 U.S. 310, 320 (1945)). For a detailed substantive analysis of the jurisdictional issue *see*, Note, *The Marc Rich Case: Extension of Grand Jury Subpoena Power to Nonresident Alien Corporation*, 18 GEO. WASH. J. INT'L L. & ECON. 97 (1984).

105. Wall St. J., Aug. 15, 1983, at 3, col. 2.

106. *Id.*

that the Swiss secrecy laws would be violated.[107] Marc Rich International eventually pleaded guilty to the tax violations, and the order to produce the documents was terminated.[108] Nonetheless, the Swiss protest against the United States' disregard of Swiss law was made clear.[109]

In both *Bank of Nova Scotia* and *Marc Rich*, United States courts upheld the validity of subpoenas issued to foreign corporations but served on domestic operations. Prior to these cases, however, the U.S. courts had already gone one step further in attempting to gather information on tax evasion in tax haven countries. The courts enforced a subpoena of a foreign corporation which was served on a non-resident alien employee of the corporation on business in the United States. The foreign corporation was not required to have any U.S. presence.

4. *Subpoena of a Non-Resident Alien Employee of a Foreign Corporation*

In re Grand Jury Proceedings, United States v. Field,[110] involved the validity of a subpoena issued to Anthony Field, a Canadian citizen residing in the Cayman Islands. During 1975 and 1976, a grand jury was investigating criminal tax evasion activities being conducted through the Castle Bank and Trust Company, a Cayman Islands corporation.[111] Field was a director of Castle Bank and, while in the transit hall of Miami International Airport, was served with a subpoena ordering his testimony before the grand jury.[112] Field refused to answer questions before the grand jury on the grounds that the subpoena was invalid. First, he claimed, the subpoena violated his Fifth Amendment right against self-incrimination because to require him to testify would subject him to prosecution under Cayman Islands law.[113] Second, the principle of comity between nations precluded requiring him to testify.[114] Third, the court lacked jurisdiction over him because he was a non-resident alien, the personal service on him while in the United States notwithstanding.[115] The court of appeals rejected each of Field's arguments and affirmed the district court's order holding

107. *Id.*
108. Wall St. J., Oct. 15, 1984, at 36, col. 1.
109. Wall St. J., Aug. 15, 1983, at 3, col. 2; Wall St. J., Oct. 22, 1984, at 30, col. 1; and, Egger, *U.S. Jurisdiction in Conflict with Swiss Sovereignty,* 1984 INT'L BUS. LAW. 225.
110. 532 F.2d 404 (5th Cir. 1976).
111. *Id.* at 405. *See generally, Oversight Hearings Into the Operations of the IRS (Operation Tradewinds, Project Haven and Narcotics Traffickers Tax Program): Hearings Before a Subcommittee of the House Committee on Government Operations,* 94th Cong., 1st Sess. (1983) [hereinafter referred to as *Oversight Hearings*].
112. 532 F.2d at 405.
113. *Id.* at 406.
114. *Id.* at 407.
115. *Id.* at 409.

Field in contempt. The court held that the Fifth Amendment protected only against the use of his compelled answers; it does not protect against situations where the mere act of testifying is an offense under foreign law.[116] In deciding the issue of comity between nations, the court referred to the Restatement (Second) of Foreign Relations Law of the United States and held that the United States' interest in obtaining information on the violation of its tax laws overcame the Cayman Islands' right of privacy incorporated into its bank secrecy laws.[117] Finally, the court conclusively settled the issue of Field's immunity because of his non-resident alien status stating that anyone within the jurisdiction of the court, whether resident or citizen or not, may be compelled to appear before a grand jury.[118] Field was within the jurisdiction of the court when he was served with the subpoena.

This analysis of the case law regarding the use of administrative summonses and subpoenas suggests that the summons and subpoena are an effective tool for the U.S. tax authorities in tax evasion investigations. U.S. courts have been willing to enforce these summonses and subpoenas so long as sufficient minimum U.S. connections are maintained. These cases indicate the low level to which the minimum connections standard has been reduced. Where summonses and subpoenas cannot be enforced, other information gathering tools, such as IRS paid informants, must be utilized.

B. IRS Paid Informants

Use of paid informants by IRS agents is specifically authorized by statute.[119] The U.S. tax authorities have commonly used paid informants to obtain information on tax evasion activities.[120] Informants have proven indispensable in certain international tax evasion investigations, primarily because the information sought could not be obtained in any other manner.[121] One such investigation was Project Haven, an investigation into tax evasion activities in the Bahamas and Cayman Islands centered around the Castle Bank and Trust Company.[122] Project Haven is more significant, however, as an indicator of the extent to which the U.S. tax

116. *Id.* at 406-07.

117. *Id.* at 407-08.

118. 532 F.2d at 409-10 (citing United States v. Germann, 370 F.2d 1019, 1022-23 (2d Cir. 1967, *vacated and remanded upon death of petitioner,* 389 U.S. 329 (1967)).

119. 26 U.S.C. § 7623 (1982).

120. Gordon Report, *supra* note 3 at 124-26.

121. *Id.* at 124.

122. *See generally, Oversight Hearings, supra* note 111. *In re* Grand Jury Proceedings, United States v. Field, 532 F.2d 404 (5th Cir. 1976) at notes 116-24, involved grand jury proceedings which arose out of the Project Haven investigations.

authorities will go to obtain information on tax evasion activities in tax haven countries.

In the mid 1960's, the IRS began an investigation into the alleged use of foreign trust accounts by U.S. taxpayers, including organized crime figures, for the purpose of evading U.S. income taxes.[123] The investigation was named Operation Tradewinds.[124] The IRS utilized two to three agents and thirty to thirty-five paid informants, operating in both the Bahamas and the United States.[125] The investigation ultimately evolved to the point of involving IRS resources nationwide with an informant network so highly developed that the IRS could request and receive detailed and specific information on short notice.[126]

In 1972, Project Haven was initiated to investigate the dealings of a narcotics trafficker with a Bahamian bank, the Castle Bank and Trust Company (Bahamas), which had been uncovered in the Operation Tradewinds investigation.[127] The IRS utilized an informant, Norman Casper, to supply information concerning the narcotic trafficker's accounts with Castle Bank.[128] Casper developed a close social relationship with Michael Wolstencroft, vice president of Castle Bank, which included arranging dates for Wolstencroft during trips to Miami.[129] On one occasion, Casper was informed by Wolstencroft that Wolstencroft would be traveling to Chicago via Miami with a list of bank clients to be taken to the law firm of Levenfeld, Kanter, Baskes & Lippitz, and that he wanted Casper to arrange a date for him in Miami.[130] Casper arranged the date with Sybil Kennedy, a former policewoman.[131] While Kennedy and Wolstencroft were dining out, Casper entered Kennedy's apartment with the key Kennedy had given him and located Wolstencroft's briefcase containing the account records.[132] Casper delivered the documents to an IRS agent who

123. *Oversight Hearings, supra* note 111 at 23 and 197.

124. *Id.*

125. *Id.* at 138-40.

126. *Id.* at 139.

127. *Id.* at 140-41 and GORDON REPORT, *supra* note 3 at 115.

128. GORDON REPORT, *supra* note 3 at 115.

129. *Oversight Hearings, supra* note 111 at 159-61; GORDON REPORT, *supra* note 3 at 115, and United States v. Baskes, 442 F. Supp. 322, 326 (N.D. Ill. 1977), *aff'd*, 649 F.2d 471 (1980).

130. *Oversight Hearings, supra* note 111 at 160; *Baskes*, 442 F. Supp. at 326; and United States v. Baskes, 433 F. Supp. 799, 801 (1977), *conviction upheld*, 442 F. Supp. 322 (N.D. Ill. 1977), *aff'd*, 649 F.2d 471 (1980).

131. *Oversight Hearings, supra* note 111 at 160. Kennedy received $1,000 from Casper for her services, which Casper asserted included only accompanying Wolstencroft. *Oversight Hearings, supra* note 111 at 160 and *Baskes*, 442 F. Supp. at 326. *But see, Baskes*, 433 F. Supp. at 801 where the court claimed Kennedy "engaged in sexual intercourse for compensation."

132. *Baskes*, 442 F. Supp. at 326; *Oversight Hearings, supra* note 111 at 143-44 and 177-78; and GORDON REPORT, *supra* note 3 at 115.

copied them and then returned them in the briefcase to Kennedy's apartment. Subsequently, Kennedy visited Wolstencroft at the Castle Bank and Trust offices and surreptitiously removed a card file containing the names and addresses of Castle Bank clients. This was delivered to the IRS investigators.[133]

The information obtained by these efforts proved extremely valuable. Over 300 names and account numbers were disclosed, and these names led to the development of sixty-three cases of recommended deficiencies totalling $27.5 million.[134] These names also lead to the criminal indictment of members of the Levenfeld, Kanter, Baskes & Lippitz law firm in Chicago which had assisted in the tax evasion activities conducted through the Castle Bank.[135] The method used to obtain the Castle Bank records posed no legal problem for the U.S. tax authorities. In *United States v. Payner,*[136] the Supreme Court discussed the issue of whether the evidence from the briefcase should be suppressed under the Fourth Amendment. The Court held that the defendant Payner, a subject of the Project Haven investigation, did not have standing to suppress the information since the Fourth Amendment prohibits the use of only that evidence obtained by conduct which invaded the defendant's expectation of privacy.[137] The Fourth Amendment does not apply where, as in *Payner,* the defendant had no privacy interest in Wolstencroft's briefcase.[138]

The IRS was the target of a great deal of public criticism for its conduct in the Project Haven investigation[139] and the subject of an extensive congressional committee hearing,[140] primarily because of the methods used to obtain the Castle Bank records. Nonetheless, the IRS continually asserted that its conduct was not improper[141] and its actions were supported by at least some members of Congress.[142] Furthermore, the IRS subsequently stated that it would continue disseminating information obtained in the Project Haven investigation to its field offices.[143] The IRS

133. *Baskes,* 433 F. Supp. at 802.

134. *Oversight Hearings, supra* note 111 at 31 and 45-47.

135. *See, United States v. Baskes,* 433 F. Supp. at 799, where the defendants Baskes, Kanter, and Hammerman were members of the Levenfeld, Kanter, Baskes & Lippitz law firm.

136. 447 U.S. 727 (1980).

137. *Id.* at 731.

138. *Id.* at 731-32.

139. *Netherlands Antilles Hearings, supra* note 1 at 33 (statement of William J. Anderson, General Government Division, General Accounting Office).

140. *Oversight Hearings, supra* note 111.

141. *Id.* at 27 (statement of Meade Whitaker, chief counsel, IRS).

142. *Id.* at 117 (statement of Congressman Garry Brown).

143. Letter from Donald C. Alexander, commissioner IRS, to Congressman Benjamin S. Rosenthal, chairman, Subcommittee on Commerce, Consumer and Monetary Affairs dated October 25, 1975. *Id.* at 81.

also intimated that it might continue the Project Haven investigation.[144] Thus, aggressive investigations of this character in future IRS investigations might well be expected.

Not all unilateral investigation tools used by the U.S. tax authorities are so intrusive. The IRS has also conducted investigations, sometimes involving other governmental agencies, where the investigation is highly visible or involves only information which is not subject to any secrecy laws.

C. Exclusive IRS Investigations

The IRS frequently engages in investigations using only IRS agents or in cooperation with other governmental agencies.

1. *The Swiss Mail Watch*

In 1967, the IRS formed a task force to obtain information on secret foreign bank accounts. One of the projects of this task force was to identify U.S. taxpayers receiving mail from Swiss banks.[145] The IRS microfilmed the exterior of all envelopes believed to originate from Swiss banks, using the postal meter stamp to identify the originating financial institution.[146] This activity was conducted from January to May 1968, from January to February 1969, and from December 1970 to February 1971.[147] The first mail watch provided information sufficient to initiate 168 audits which resulted in the assessment of about $2 million in taxes and penalties.[148] The 1969 and 1970-71 mail watches identified over 40,000 taxpayers having foreign bank accounts. No audits or assessments directly resulted.[149]

2. *Revenue Service Representatives*

The Revenue Service Representative assists the IRS in conducting audits and examinations outside the United States and in generally obtaining

144. *Id.*

145. *Netherlands Antilles Hearings*, *supra* note 1 at 31 (statement of William J. Anderson, director, General Government Division, General Accounting Office).

146. Gordon Report, *supra* note 3 at 113. The legality of the Swiss Mail Watch was upheld in United States v. Leonard, 524 F.2d 1076 (2d. Cir. 1975), *cert. denied*, 425 U.S. 958 (1976).

147. Gordon Report, *supra* note 3 at 113-14.

148. *Id.* at 113.

149. *Id.* at 114. The fact that no audits resulted does not mean that the Mail Watch was not productive. The Mail Watch was discontinued, in part, because of fears that use of the Mail Watch might jeopardize the negotiations then being conducted with Switzerland regarding the United States–Switzerland Mutual Assistance Treaty. *See infra* notes 240-49 and accompanying text.

public information on taxpayer activities in foreign countries.[150] With the exception of gathering public information, the RSR has typically proven successful only in obtaining specifically requested information.[151] First, foreign government permission is necessary to conduct an on-site examination, and the tax haven countries have not always been supportive of U.S. tax collection efforts.[152] Second, the taxpayer will obviously not provide the necessary consent under foreign law to the audit or examination if he or she has violated the U.S. tax laws.[153] Finally, the RSR is unable to order production of books and records with an administrative summons since the summons is enforceable only where a person resides or may be found in a U.S. district court jurisdiction.[154] The investigation must have been referred to a grand jury before the U.S. tax authorities can compel the production of books and records.[155]

3. *Public Information Gathering*

The IRS does not routinely examine public records as an information gathering tool. Typically, this is because public records are often unavailable, or if available, either the records do not contain useful information or the local government prevents the IRS from gathering the information.[156] The Cayman Islands prohibits the disclosure of any corporate information other than the name and registered office of the corporation and the date of incorporation.[157] Switzerland, on the other hand, maintains extensive public records.[158] A company must file its business charter, the names and nationalities of directors and managers, names of founders or partners and their contribution, liabilities and preferential rights, the amount of authorized and paid-in capital, names and powers of persons authorized to sign on behalf of the corporation, and the method of publishing official notices.[159] Despite the extensive disclosure requirements, the identity of owners of a Swiss entity can easily be concealed through the use of nominees or bearer shares.[160] Even where public information is available, both Switzerland and the Cayman Islands closely regulate information

150. GORDON REPORT, *supra* note 3 at 200. The Revenue Service Representative [hereinafter referred to as RSR] is an overseas employee of the IRS. *Id.*

151. *Id.*

152. *Id.*

153. *Id.*

154. *See supra* notes 31-39 and accompanying text.

155. The grand jury subpoena may be enforced against U.S. citizens outside the United States. 28 U.S.C. § 1783 (1982).

156. GORDON REPORT, *supra* note 3 at 198.

157. *Id.* at 199.

158. *Id.* at 198.

159. *Id.* at 199.

160. *Id.*

gathering by the U.S. tax authorities by requiring advance governmental approval for the investigation.[161] Swiss law also provides for imprisonment for unauthorized information gathering in that country.[162]

The preceeding discussion has examined the primary unilateral information gathering tools used by the U.S. tax authorities in tax evasion investigations. The next category of information gathering tools is the IRS' use of reporting requirements, both those imposed on the taxpayer and those imposed on financial institutions.

III. Internal Revenue Service Reporting Requirements

Despite broad authority in the Secretary of the Treasury to require the filing of tax returns and the maintaining of books and records,[163] the taxpayer has not proven a valuable source of information in tax evasion investigations. First, taxpayers will obviously not knowingly disclose information on their own tax evasion efforts.[164] Second, even when information is provided on IRS forms, the information is often of poor quality and the IRS has experienced difficulty in processing the information.[165] One effective source of reporting information is the Currency Transaction Report (CTR) filed by domestic financial institutions, which is useful in tracking international cash flows.[166] The Treasury Regulations provide that certain financial institutions and other entities must report each currency transaction exceeding $10,000.[167] There are certain limited exceptions.[168] The IRS then enters this information on its computer system which, in audit situations, is accessed and compared to the representations made on the taxpayer's return.[169]

---

161. *Id.*

162. *Id. See also* TAX HAVEN INFORMATION BOOK, *supra* note 6 for a general summary of the bank secrecy laws of several tax haven countries; *Oversight Hearings, supra* note 111 at 162-76 for a reprint of the Bahamian secrecy laws; and *supra* note 6, *generally.*

163. 26 U.S.C. § 6001 (1982).

164. *See,* GORDON REPORT, *supra* note 3 at 180-84.

165. *Id.* The U.S. tax authorities have, however, met with some success in their efforts to prosecute violations of the currency export reporting laws discussed in the GORDON REPORT, *supra* note 3 at 180-84. *See* Wall St. J., Jan. 3, 1986, at 23, col. 6.

166. *Id.* at 186-87. The Currency Transaction Report [hereinafter referred to as CTR] was created pursuant to the Bank Secrecy Act, Pub. L. No. 91-508, Titles I and II, 84 Stat. 1114-24 (1970).

167. 31 C.F.R. §§ 103.22-103.51 (1984).

168. *Id.* 31 C.F.R. § 103 was amended in 1980 by Financial Recordkeeping and Reporting of Currency and Foreign Transactions, 45 Fed. Reg. 37,818 (1980) (codified at 31 C.F.R. § 103 (1980)). The amendments reduced the available exceptions from the reporting requirements.

169. GORDON REPORT, *supra* note 3 at 187 and *see Senate Hearings, supra* note 2 at 33-35 (statement of John M. Walker, Jr., assistant secretary, enforcement, Department of the Treasury).

The purpose and value of the CTR became clear during the recent federal prosecution of First National Bank of Boston.[170] The Justice Department had been investigating a money laundering scheme at First National involving organized crime.[171] The Justice Department discovered that from 1980 through 1983 an individual allegedly involved in organized crime had exchanged paper bags full of cash for 163 cashier's checks totalling $2.2 million.[172] First National failed to report these transactions as required.[173] The Justice Department subsequently discovered that First National failed to report $1.22 billion in cash transactions with Swiss banks.[174] The Justice Department's use of CTRs in uncovering First National's failure to disclose these financial dealings should serve as a warning that the United States tax authorities are increasing their use of CTRs as a major information gathering tool and will be strictly enforcing the CTR reporting requirements.[175]

CTRs may prove effective information gathering tools in tax evasion investigations involving domestic financial institutions. But, CTRs cannot be used in investigations involving foreign financial institutions not obligated to file CTRs. In those investigations where charges or suit has been filed, the U.S. tax authorities may consider using letters rogatory to obtain information from foreign sources, including foreign financial institutions.

IV. Letters Rogatory

The Federal Rules of Civil Procedure provide for the gathering of evidence in a foreign country through the assistance of a foreign tribunal.[176] The U.S. court in which the matter is being heard[177] sends a written

170. Wall St. J., Mar. 7, 1985, at 1, col. 6.

171. *Id.*, and Wall St. J., Feb. 8, 1985, at 2, col. 2.

172. Wall St. J., Mar. 7, 1985, at 1, col. 6.

173. *Id.*

174. Wall St. J., Feb. 8, 1985, at 2, col. 2.

175. At the time, the $500,000 fine imposed on First National was the largest fine ever imposed on a financial institution for violating the currency reporting law. Wall St. J., Feb. 8, 1985, at 2, col. 2. This led a Wall Street Journal reporter to state that federal officials were making an example of First National in their attempt to stop money laundering activities. Wall St. J., Mar. 7, 1985, at 1, col. 6. Subsequently, several violations of CTR reporting requirements have been reported and even higher fines have been imposed. Wall St. J., Feb. 19, 1985, at 3, col. 2; Wall St. J., Mar. 12, 1985, at 1, col. 1 and at 3, col. 1; Wall St. J., Mar. 11, 1985, at 3, col. 1; Wall St. J., Mar. 29, 1985, at 5, col. 1; Wall St. J., Aug. 28, 1985, at 3, col. 2; Wall St. J., Aug. 29, 1985, at 3, col. 2; and Wall St. J., Jan. 3, 1986, at 3, col. 4. U.S. tax authorities have also conducted searches of offices of retail brokerage firms seeking records of cash transactions not reported to the IRS. Wall St. J., April 4, 1985, at 12, col. 2.

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

177. Letters rogatory may be used only in a judicial proceeding. BLACK'S LAW DICTIONARY 815 (5th ed. 1979) and *The Signe*, 37 F. Supp. 819, 820 (E.D. La. 1941), *action dismissed*, 39 F. Supp. 810 (E.D. La. 1941), *aff'd sub nom., The Florida*, 133 F.2d 719 (1943).

request, a "letter rogatory," on behalf of the party seeking the information asking for the assistance of the foreign tribunal.[178] The foreign tribunal will, if it decides to grant assistance, obtain the requested information through its own powers of investigation and convey it to the U.S. court.[179]

The U.S. tax authorities have rarely used the letter rogatory principally because not all foreign courts cooperate with the request[180] and because of the strict bank and commercial secrecy laws in those countries.[181] A major breakthrough in the use of letters rogatory occurred, however, in the case of *United States of America v. Carver, LeMire, et al.*[182] In 1982, criminal charges were pending in the U.S. against Roy Carver, Joseph LeMire, Lionel Achuck, Jon Stephens and Interconex, Inc.[183] The United States requested the assistance of the Cayman Islands Grand Court to order certain Cayman banks to disclose information on transactions involving the banks, the defendants, and Redcon Limited and International Resource Management Consultants, two Cayman Islands companies controlled by LeMire and Carver.[184] The banks refused to disclose the information voluntarily and the Cayman Grand Court refused to order the banks to disclose the information.[185] The United States appealed the Grand Court's decision to the Cayman Islands Court of Appeal.[186] The

178. *The Signe*, 37 F. Supp. at 820 and, Ings. v. Ferguson, 282 F.2d 149, 151 (2d Cir. 1960).

179. *Id.*

180. GORDON REPORT, *supra* note 3 at 205, and SENATE STAFF STUDY, *supra* note 1 at 18.

181. *Netherlands Antilles Hearings*, *supra* note 1 at 263-64 and 278 (statement of John E. Chapoton, assistant secretary for tax policy, Department of the Treasury). The IRS especially complained in the Netherlands Antilles Hearings about the lack of cooperation on the part of the Netherlands Antilles and provided the committee with a list of tax fraud cases involving the Netherlands Antilles. *Id.* at 356-66. The Netherlands Antilles government submitted a prepared statement at the hearings strongly defending its conduct and responding to the IRS' complaints. The Netherlands Antilles government asserted that it had gone beyond the requirements of the tax treaty in exchanging with the United States information on tax crimes. It also stated that it was not the only country which faced legal obstacles in its secrecy laws to providing information to its treaty partners. *Id.* at 798-817. *See id.* at 478-81 and *Current and Quotable*, 20 TAX NOTES 171-72 (1983) for copies of letters between Doug Barnard, Jr., chairman, Commerce, Consumer and Monetary Affairs Subcommittee, Richard C. Wassenaar, commissioner, Criminal Investigations, IRS and Harold Henriquez, minister plenipotentiary for Netherlands Antilles Affairs discussing the Netherlands Antilles Hearings.

182. Civil Appeal No. 5, *slip op.* (Cayman Islands Court of Appeal, Nov. 1982) (on file with the INTERNATIONAL LAWYER) *and see* Tax Havens in the Caribbean Basin, *supra* note 8 at 5; SENATE STAFF STUDY, *supra* note 1 at 125-26; and, *Senate Hearings*, *supra* note 2 at 52-53.

183. United States of America v. Carver, LeMire, et al, Civil Appeal No. 5, slip op. at 4 (Cayman Islands Court of Appeal, Nov. 1982).

184. *Id.* at 5-6.

185. *Id.* at 6.

186. *Id.* at 10.

Court of Appeal reversed the Grand Court and held that, in this case, Cayman law allows disclosure by the banks and that the disclosure should be made. The court stated that a Cayman court should give effect to foreign court requests for assistance in gathering evidence so long as the request is not frivolous, excessive, vexatious, or an abuse of process of the court.[187] The court also stated that the Cayman Islands secrecy laws do not suggest that it is the public policy of the Cayman Islands to allow a person to "launder the proceeds of a crime in the Cayman Islands, secure from detection and punishment."[188] The court held that there are only four conditions that must be met before a Cayman court can order disclosure of information requested by a foreign court: the request be for particular information;[189] the information be relevant to an ongoing prosecution;[190] there be special circumstances justifying an exception to the Cayman bank secrecy laws for disclosing the requested information;[191] and, in cases as this, when the evidence is sought from accounts not in the defendants' names, there be strong suspicion that the information sought will be used against the named defendants at trial.[192] The court found that each condition was met. The request was for particular information to the extent that it sought "all correspondence, ledgers, day books, [and] account books."[193] The information sought was certainly relevant to the defendants' ongoing prosecution in the United States for obtaining money under false pretenses and for interstate and foreign transfer of stolen property.[194] There were special circumstances justifying disclosure since the evidence was sought for use in a foreign court, the requesting party had no alternate method for obtaining the information, and the evidence obtained would be helpful only if the actual books were produced.[195] Finally, the strong suspicion requirement was met by the United States' allegations in its request to the Grand Court that International Resource Management Consultants (IRMC) was controlled by Carver and LeMire, that over $200,000 U.S. was transferred to IRMC's account through a Swiss account controlled by Carver and LeMire and through two checks payable to Carver's wife, that Redcon Limited was controlled by Carver and LeMire, and that Redcon received $500,000 U.S. from a Liechtenstein entity controlled by Carver and LeMire.[196]

187. *Id.* at 17.
188. *Id.* at 18.
189. *Id.* at 19.
190. *Id.* at 13-14.
191. *See supra* notes 187-89 and accompanying text.
192. Carver, slip op. at 14-15.
193. *Id.* at 7.
194. *Id.* at 4, and *see* 18 U.S.C. §§ 1343 and 2314 (1982).
195. *Carver,* slip op. at 13-14.
196. *Id.* at 15.

With this breakthrough, the use of letters rogatory, at least in the Cayman Islands, appears far more promising, although such requests had not proven fruitful in the past. *Carver* should not be read to suggest that tax evasion investigations in the Cayman Islands will be routine; the four conditions must still be met which, in turn, requires a significant knowledge of the facts behind the tax evasion activity. Nonetheless, the Justice Department has indicated its willingness to take every request for information to the Cayman Islands Court of Appeal if necessary.[197] Accordingly, in light of *Carver,* one might expect that more letters rogatory will be sent to the Cayman Islands and perhaps more cooperation will be rendered by the Cayman government.

Notwithstanding the decision in *Carver,* the usefulness of the letter rogatory still is generally limited by the willingness of the foreign courts to cooperate. The U.S. tax authorities have attempted to overcome this problem and to generally establish formal channels of communication in tax evasion investigations by negotiating bilateral agreements with other countries. There are several types of bilateral agreements presently in effect, but at minimum each requires the signatory countries to exchange tax information in certain circumstances.

A. Bilateral Tax Treaties

The United States presently has twenty-nine income tax treaties in force.[198] Because of extensions to territories and former colonies, the treaties cover almost forty territories and countries.[199] The tax treaties have two basic purposes: the avoidance of international double taxation and the prevention of international tax avoidance and evasion.[200]

An important provision of an income tax treaty which is intended to reduce tax avoidance and evasion is the exchange of information clause.[201] The exchange of information clause typically authorizes the taxing authority to request and exchange information relevant to the enforcement of tax laws with information on dividends, interest, rents and royalties being routinely exchanged.[202] The exchange of information provision may vary depending on whether the treaty is based on the U.S. Model Income

197. *Senate Hearings, supra* note 2 at 52.

198. *Income Tax Treaties: Hearing Before the Subcommittee on Oversight of the House Committee on Ways and Means,* 96th Cong., 2d Sess. 3 (1980) (statement of David Brockway, International Tax Counsel, Joint Committee on Taxation Staff). For a listing of the countries *see,* [II Audit] Internal Rev. Man. (CCH) Exhibit 42(10)0-1.

199. *see,* [II Audit] Internal Rev. Man. (CCH) exhibit 42(10)0-1.

200. *Income Tax Treaties, supra* note 198 at 3.

201. *Id.* at 24.

202. Irish, *supra* note 8 at 507.

Tax Treaty[203] or on the OECD Model Income Tax Treaty,[204] but the result should not vary significantly given the similarity of the clauses.[205] These treaties and the exchange of information clauses have generally proven effective only in circumstances involving the routine exchange of information.[206]

Not all income tax treaties have benefited U.S. information gathering efforts. First, the tax treaties do not require the information to be provided in a specific form, with the result that much of the information received from a foreign jurisdiction is not readily useable by the U.S. tax authorities.[207] Second, the tax treaties expressly provide that no disclosure of information is required if disclosure would violate local secrecy laws.[208] Thus, many tax havens do not provide the detailed information requested by the U.S. tax authorities[209] and, instead, provide only information that is often public knowledge and substantively insufficient to detect and prosecute tax evasion.[210] Finally, the income tax treaties have allowed treaty shopping by residents of non-signatory countries through the easily satisfied residence requirements.[211] These treaty shopping activities often lead to tax evasion efforts[212] that cannot be discovered since there is no tax treaty under which information can be exchanged.

These shortcomings of the bilateral tax treaties with tax haven countries have caused the U.S. tax authorities to reexamine all such tax treaties and either terminate or renegotiate those treaties that are being abused.[213] This renegotiation/termination policy is intended to eliminate treaty shopping and to obtain more favorable exchange of information agreements.[214]

The U.S. government has developed two different methods for encouraging countries to renegotiate their income tax treaties with the United

203. [*1 Tax Treaties*] FED. TAXES (P-H) para. 1022.

204. *Id.* para. 1017.

205. *Compare* art. 26, U.S. Model Income Tax Treaty, *id.* at 1022, *with* art. 26, OECD Model Income Tax Treaty, *id.* at 1017.

206. *See*, GORDON REPORT, *supra* note 3 at 208-09.

207. *Income Tax Treaties, supra* note 198, at 24.

208. *See, [1 Tax Treaties]* FED. TAXES (P-H) para. 1022, art. 26 and para. 1017, art. 26.

209. Letter from Doug Barnard, Jr., chairman, Commerce, Consumer and Monetary Affairs Subcommittee to Roscoe L. Egger, Jr., commissioner, IRS, dated June 7, 1983, *reprinted in Current and Quotable*, 20 TAX NOTES 171 (1983).

210. Letter from Richard C. Wassenaar, commissioner for Criminal Investigations, IRS to Doug Barnard, Jr., chairman, Subcommittee on Commerce, Consumer and Monetary Affairs, dated June 15, 1983, *reprinted in Netherlands Antilles Hearings, supra* note 1 at 478-79.

211. *Senate Hearings, supra* note 2 at 37 (statement of Alan W. Granwell, international tax counsel, Department of the Treasury) and *Netherlands Antilles Hearings, supra* note 1 at 261-62 (statement of John E. Chapoton, assistant secretary for tax policy, Department of the Treasury).

212. *Id.*

213. *Id.* at 262 and *see supra* notes 24-31 and accompanying text.

214. *Id.*

States. First, the recently enacted Caribbean Basin Initiative[215] limited the extension of certain tax benefits under the act to only those countries which have entered into a bilateral or multilateral exchange of information agreement with the United States.[216] Second, the Foreign Sales Corporation legislation[217] limits the approved host countries list to only those countries that are one of four qualifying U.S. possessions, have signed a CBI exchange of information agreement,[218] or have an approved bilateral income tax treaty with the United States.[219] For countries that do not desire to negotiate income tax treaties, Congress has suggested possible sanctions including treating loans from haven banks as U.S. income, prohibiting tax losses on transactions with haven banks, and curbing airline flights between the United States and these countries.[220]

The U.S. tax authorities' renegotiation/termination policy has met with some success as several countries are renegotiating their income tax treaties with the United States while others are negotiating or have adopted CBI exchange of information agreements with the United States.[221] The new CBI exchange of information agreement may prove an extremely valuable information gathering tool in future tax evasion investigations.

B. CBI Exchange of Information Agreements

The most recently developed information gathering tool is the CBI exchange of information agreement. Barbados was the first country to enter into a CBI agreement, having signed the agreement with the United States on November 3, 1984.[222] On November 8, 1984, the Treasury announced that the United States and Costa Rica agreed on the text of a CBI agreement and that signing would take place in the near future.[223] Similarly, a CBI exchange of information agreement was finalized with the Dominican Republic in August 1984.[224]

---

215. Caribbean Basin Economic Recovery Act, Title II Caribbean Basin Initiative, Pub. L. No. 98-67 (1983) [hereinafter referred to as CBI].

216. The Caribbean Basin Economic Recovery Act amended 26 U.S.C. § 274(h)6 (1982) to allow tax deductions for conventions in the beneficiary countries, as defined in section 212(b) of the CBI, if those countries entered into exchange of information agreements with the United States.

217. Deficit Reduction Act of 1984, Title VIII Foreign Sales Corporations, Pub. L. No. 98-369 (1984) [hereinafter referred to as FSC legislation].

218. *See supra* note 215 and *infra* notes 221-26 and accompanying text.

219. 26 U.S.C. §§ 922 and 927(e)(3)(1982). For a list of the approved FSC host countries *see*, Tax Notes Int'l, Dec. 1984 at 4 and 70 and *Treasury News*, 24 Tax Notes 833 (1984).

220. Wall St. J., Oct. 10, 1985, at 1, col. 5.

221. *See supra* notes 25-31 and accompanying text and *see Treasury News*, 24 Tax Notes 833 (1984) and Tax Notes Int'l, Dec. 1984 at 4 and 70.

222. Wall St. J., Feb. 20, 1985, at 1, col. 5 and Tax Notes Int'l, Dec. 1984 at 70.

223. Tax Notes Int'l, Dec. 1984 at 70.

224. *Treasury News*, 24 Tax Notes 833 (1984).

Although these agreements have not yet been tested in a tax evasion investigation, their information gathering value may well be significant. The CBI exchange of information agreement is to provide for:

> The exchange of such information . . . as may be necessary or appropriate to carry out and enforce the tax laws of the United States and the beneficiary country (whether criminal or civil proceedings), *including information which may otherwise be subject to nondisclosure provisions of the local law of the beneficiary country such as provisions respecting bank secrecy and bearer shares.* (emphasis added)[225]

The United States Model Income Tax Treaty provides that:

> In no case shall the obligation [to disclose information] be construed so as to impose on a Contracting State the obligation
> (a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
> (b) to supply information which is not obtainable under the laws or in the normal course of the administrative practice of that or of the other Contracting State;
> (c) to supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public).[226]

Thus, on their face the information disclosure provisions under the CBI exchange of information agreement are far more inclusive than the exchange of information provisions presently in force in the bilateral income tax treaties. Whether these agreements will, in fact, prove of value in tax evasion investigations remains to be seen. The first real test will probably occur in an investigation involving Costa Rica, the most significant tax haven of the three countries that have signed such an agreement.

Both the bilateral tax treaties and the CBI exchange of information agreements are generally used to exchange tax information upon the request of one party. These information exchanges cannot, however, provide a complete picture of the tax situation of a multinational taxpayer with transactions involving more than one country.[227] Thus, the U.S. tax authorities implemented a simultaneous examination program with some of the U.S. bilateral income tax treaty partners.

C. Simultaneous Examination Program

Under the authority of the information exchange provisions of the bilateral income tax treaties, the United States has implemented a simultaneous examination program with six countries: Canada, the United

225. 26 U.S.C. § 174(h)6(C)(i)(1982).

226. [*I Tax Treaties*] Fed. Taxes (P-H) para. 1022, art. 26.

227. Outline of address by Glenn Cagle, deputy assistant commissioner (Compliance), IRS, Tax Executives Institute, Vancouver, Canada (Sept. 29, 1980) at 6-7.

Kingdom, the Federal Republic of Germany, France, Norway, and Italy.[228] These procedures allow the tax authorities in each country to conduct concurrent examinations of the books and records of related taxpayers, typically a multinational corporation.[229] The rationale for the simultaneous examination is that the tax authorities may obtain and exchange information more efficiently and thoroughly and with greater specificity and speed.[230]

The IRS has activated the simultaneous examination procedure only rarely,[231] but the procedure has proven effective. One case involving a simultaneous audit with Canada resulted in income adjustments of $19 million, more than $6.5 million of which was directly attributable to the simultaneous examination.[232] Because of the general success of the program, the IRS is in the process of extending it to other treaty partners.[233] Furthermore, the bilateral simultaneous examination program has been expanded into a multilateral simultaneous examination program[234] and is conducted as a series of concurrent bilateral examinations.[235] The multilateral simultaneous examination covers the deficiencies in the bilateral simultaneous examination when the taxpayer is engaged in activities involving several foreign countries.[236] The U.S. tax authorities cannot, however, give to one party in a multilateral simultaneous examination information that was received from another party to the examination.[237] Nonetheless, bilateral information exchanges can be made.[238] The U.S. tax authorities anticipate increasing use of the multilateral and bilateral simultaneous examinations in tax evasion investigations.[239]

Considering each of the bilateral investigation tools discussed thus far, the United States has some type of bilateral exchange of information

228. [II AUDIT] INTERNAL REV. MAN. (CCH) para. 40(10)(10).7. These procedures are authorized under the exchange of information clause in the bilateral income tax treaty with each country. Cagle, *supra* note 227 at 1.

229. [II AUDIT] INTERNAL REV. MAN. (CCH) para. 42 (10)(10).7. Each country examines the books and records of only the related taxpayer within its jurisdiction. *Id.* at 42(10)(10).7(2).

230. Recent Developments, *Taxation: Implementation of Simultaneous Auditing Procedures*, 21 HARV. INT'L L.J. 798, 801-02 (1980).

231. As of Sept. 1980, the IRS had conducted only eleven simultaneous examinations. Cagle, *supra* note 228 at 4.

232. *Netherlands Antilles Hearings, supra* note 1 at 226 (statement of Roscoe L. Egger, commissioner, IRS).

233. Senate Hearings, *supra* note 2 at 39 (statement of Alan W. Granwell, international tax counsel, Department of the Treasury).

234. [II AUDIT] INTERNAL REV. MAN. (CCH) para. 42(10)(10).7(5)(a) and (b).

235. Cagle, *supra* note 228 at 5.

236. *Id.* at 6-7.

237. [II AUDIT] INTERNAL REV. MAN. (CCH) para. 42(10)(10).7(5)(c) and Cagle, *supra* note 228 at 8.

238. Cagle, *supra* note 228 at 7-8.

239. *Id.* at 5 and 9.

agreement with virtually every industrialized country. With Switzerland, however, the United States has relied upon a broader mutual assistance agreement in effect between the countries which provides for a variety of judicial assistance methods in several circumstances, including tax investigations. This agreement is the United States–Switzerland Mutual Assistance Treaty.

D. The United States–Switzerland Mutual Assistance Treaty

The United States and Switzerland entered into a mutual assistance treaty in 1977.[240] The agreement provides for a broad array of bilateral judicial assistance methods, primarily in the nature of information exchange procedures. The United States sought the agreement for the specific purpose of lifting the Swiss banking secrecy law, especially when tax violations, securities law offenses and organized crime activities were being prosecuted.[241]

While the United States and Switzerland agreed that the banking secrecy laws will be lifted in criminal investigations, this agreement does not provide authority for the disclosure of information in most U.S. tax evasion investigations. First, the treaty expressly states that it does not apply to violations with respect to taxes except for certain gambling crimes and drug and firearm crimes included within the tax laws.[242] Second, the Mutual Assistance Treaty provides for compulsory exchange of information only in criminal cases where the offense for which the information is sought is a crime in both Switzerland and the United States.[243] The treaty lists the criminal offenses for which compulsory measures are automatically available.[244] Tax evasion is not a covered offense. Third, even under the treaty section providing for the discretionary use of compulsory disclosure, tax evasion would not be a covered offense since tax evasion, as defined by Swiss law, is considered a minor offense in Switzerland, not a crime.[245] In tax evasion cases Swiss Cantonal law protects against

240. Mutual Assistance in Criminal Matters, Jan. 23, 1977, United States–Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302 [hereinafter referred to as Mutual Assistance Treaty].

241. Navickas, *supra* note 38 at 172 and Honegger, *supra* note 6 at 14.

242. Mutual Assistance Treaty, *supra* note 240 at art. 2, para. 5 and schedule, nos. 26 and 30.

243. *Id.* at art. 4, para. 2. Navickas, *supra* note 38 at 172 and Recent Developments, *International Agreements: United States–Switzerland Investigation of Insider Trading Through Swiss Banks*, 23 Harv. Int'l L.J. 437, 438 (1983).

244. Mutual Assistance Treaty, *supra* note 240 at schedule. *See*, Honegger, *supra* note 6 at 14.

245. In Switzerland, taxes are collected by the cantons in accordance with both federal and cantonal law. Meyer, *supra* note 6 at 32. The cantonal laws generally and the Swiss federal law define tax evasion as the mere non-reporting or the incomplete reporting of income without further manipulation; i.e., the failure to declare all income on the tax return. *Id.* at 33-34.

disclosure of tax information.[246] Only in those cases involving tax fraud, as defined in Swiss law, might the Mutual Assistance Treaty allow disclosure.[247] Most of the Cantons consider tax fraud a criminal offense, thus annulling the bank secrecy laws and bringing the offense within the scope of the Mutual Assistance Treaty.[248] For these reasons, the Mutual Assistance Treaty has not been of much value in tax evasion investigations.[249]

V. Future Information Gathering Methods

The previous discussion has considered a wide variety of information gathering tools presently used by the U.S. tax authorities in tax evasion investigations. The discussion indicated that the various tools were not equally effective. Furthermore, the discussion revealed several new developments in the information gathering area, including proposals by the U.S. tax authorities to implement new information gathering tools. Following are two information gathering methods not presently used by U.S. tax authorities nor discussed in the previous sections, but which are likely to be utilized in future information gathering activities.

A. The Switzerland–United States Memorandum of Understanding

The Switzerland–United States Memorandum of Understanding[250] was a result of SEC investigations of insider trading activities on United States

246. Honegger, *supra* note 6 at 7 and Meyer, *supra* note 6 at 33.

247. Tax fraud is generally described as overt acts, fraudulent practices, or falsification of documents in an attempt to mislead tax authorities. This includes more than merely filing an inaccurate tax return. Meyer, *supra* note 6 at 34.

248. Honegger, *supra* note 6 at 7 and Meyer, *supra* note 6 at 34.

249. Gordon Report, *supra* note 3 at 210 and *Senate Hearings, supra* note 2 at 27 (testimony of Richard C. Wassenaar, assistant commissioner for criminal enforcement, IRS). Some hope remains, however, for the Mutual Assistance Treaty in tax investigations. In the *Marc Rich* case the Swiss government expressly argued that the United States should utilize the Mutual Assistance Treaty to obtain the desired information instead of trying to coerce Marc Rich International into disclosing the information in violation of Swiss law. Wall St. J., Aug. 15, 1983, at 3, col. 2. This apparently has proven encouraging to the U.S. tax authorities in that they are attempting to negotiate similar agreements with other countries. Wall St. J., Oct. 31, 1985, at 32, col. 1.

As an outgrowth of the Mutual Assistance Treaty, Switzerland enacted the Federal Law of Judicial Assistance in Criminal Matters on Jan. 1, 1983. Honegger, *supra* note 6 at 9 and Wall St. J., May 31, 1983, at 3, col. 1. The law clarifies the Swiss disclosure requirements in criminal tax investigations. It does not, however, significantly expand the disclosure provisions, at least as far as the United States is concerned. Honegger, *supra* note 6 at 9.

250. Memorandum of Understanding, Aug. 31, 1982, United States–Switzerland *reprinted in* Legal Times, Oct. 4, 1982, at 18, col. 3. The Memorandum of Understanding was negotiated by representatives of the Swiss Department of Foreign Affairs, the Federal Banking Commission, and the Swiss National Bank on the one hand and by representatives of the SEC, Department of Justice, and State Department on the other.

stock exchanges occurring in the fall of 1981. In *Securities and Exchange Commission v. Banca della Svizzera Italiana*[251] the SEC began prosecution of Banca della Svizzera Italiana (BSI), a Swiss bank, for insider trading activities in St. Joe stock and options. The SEC attempted a variety of discovery methods to obtain the identity of the purchasers of the stock. BSI refused to disclose their identities claiming that disclosure would subject it to punishment under Swiss law.[252] Finally, the court ordered disclosure and imposed a $50,000 per day fine until the identities were disclosed.[253] Before the order was issued, however, BSI obtained waivers from its customers and identified the purchasers.[254] About the same time, the SEC filed a complaint against "Certain Unknown Purchasers of the Common Stock and Call Options for the Common Stock of Santa Fe International Corporation."[255] The SEC asserted violations of the insider trading rules and named a number of large Swiss banks as defendants.[256] The court imposed a temporary restraining order enjoining the defendants from further trading violations and from disposing of the proceeds from the stock transactions in question.[257]

These cases created several significant economic problems for both the United States and Switzerland. First, *Banca della Svizzera Italiana* was the first case involving such sanctions against a bank trading in its representative capacity, and the sanctions presented by the court were perhaps overly harsh given the bank's lack of scienter.[258] Second, the court's threat to block BSI's access to trading markets in the U.S. was especially threatening to the Swiss given the temporary restraining order imposed against several other Swiss banks only three weeks earlier by the same court in *Santa Fe International*.[259] The potential loss of trading rights was of major concern to the entire Swiss banking and securities industry.[260] Finally, the possibility of a ban on Swiss trading on U.S. exchanges posed a major concern to U.S. investors and authorities given the major volume of Swiss trading on those exchanges.[261] In this light,

251. 92 F.R.D. 111 (S.D.N.Y. 1981).

252. *Id.* at 112-13.

253. Honegger, *supra* note 6 at 22.

254. Comment, *Recent Developments in Insider Trading Through Swiss Bank Accounts: An End to the "Double Standard,"* 5 NW. U.J. INT'L L. & BUS. 658, 674 (1983).

255. [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) para. 98,323.

256. *Id.*

257. *Id.*

258. Navickas, *supra* note 38 at 177.

259. The decision in *Santa Fe International* was mandated on Oct. 26, 1981, while the decision in *Banca della Svizzera Italiana* was mandated on Nov. 16, 1981.

260. Navickas, *supra* note 38 at 177 and Comment, *supra* note 254 at 659.

261. As of 1981, Switzerland accounted for approximately 20 percent of all foreign trading in U.S. securities markets, or $14.8 million. *Id.*

Switzerland and the United States held meetings in March 1983 to discuss these issues.[262] The Memorandum of Understanding was the result of these discussions.[263]

The Memorandum of Understanding provides, in part, that the provisions of the Mutual Assistance Treaty[264] should be utilized to the extent feasible[265] and that in certain circumstances insider trading could be a criminal violation so that compulsory disclosure would be available.[266] The Memorandum of Understanding also provides, through the integrated Private Agreement Among Members of the Swiss Bankers' Association, that even when the investigation does not concern criminal violations of Swiss law, disclosure might be made upon U.S. compliance with certain standards and procedures.[267]

The Memorandum of Understanding provides no direct authority for Swiss disclosure of tax information to the United States, but the fact that the Swiss agreed to disclosure without a showing of a criminal act is significant. In that the Swiss were willing to exchange information in the absence of criminal acts, as in the instance of insider trading, the Swiss might be willing to exchange information in non-criminal tax evasion investigations.[268] This fact has encouraged the SEC to pursue negotiation of similar pacts with other countries.[269]

Despite the extensive network of agreements providing for bilateral information exchanges, the United States does not have any multilateral income tax treaties. Multilateral income tax treaties are valuable in that information gathering and tax collection procedures are enhanced and the exchange of information clause in the multilateral income tax treaty provides a basis for a complete sharing of information in multilateral simultaneous examinations.

---

262. Honegger, *supra* note 6 at 22 and nn. 194-96, therein.

263. *Id.* at 21-22; Comment, *supra* note 254 at 659; and Navickas, *supra* note 46 at 177.

264. *See supra* notes 240-49 and accompanying text.

265. Memorandum of Understanding, art. II, para. 3(a) and (b), Legal Times, *supra* note 250 at 18, col. 1. If the investigation relates to criminal activity and the prosecuted offense is a crime in both countries, the Mutual Assistance Treaty applies.

266. *Id.*

267. Honegger, *supra* note 6 at 23-27.

268. Certainly the United States authorities had a very considerable sanction in barring access to U.S. stock exchanges if the Swiss failed to exchange the requested information. This may have been a significant factor in the willingness of the Swiss to disclose the requested information despite the non-applicability of the Mutual Assistance Treaty and the Memorandum of Understanding. The Swiss argument that bank customers committed a Swiss crime in their insider trading activities by giving away business secrets may have been a way of appeasing the bank's interests in not disclosing the information. Wall St. J., Feb. 21, 1985, at 5, col. 1.

269. Wall St. J., Oct. 31, 1985, at 32, col. 1.

B. Multilateral Tax Treaties

At present, there are two multilateral treaties in effect dealing specifically with tax evasion. The first is the Agreement Concerning Reciprocal Administrative Assistance in Matters of Taxation signed by the five Scandinavian countries in 1972.[270] The treaty generally provides for multilateral service of documents, exchange of information, and collection of tax liabilities.[271] The second multilateral tax treaty is Directive 77/799 of the Council of the European Communities in which the Member States of the European Economic Community agreed to exchange tax information relating to the assessment and collection of taxes.[272] The Directive applies to all Member States[273] and provides that a Member State can refuse to exchange information that would disclose a business secret or that would violate public policy.[274]

A multilateral treaty would offer significant benefits to the U.S. tax authorities. First, information gathering and exchange would be facilitated since a larger group of countries would have an identical agreement and the countries may agree to more extensive information exchange and tax collection procedures. Second, a multilateral agreement could provide for mutual assistance in collecting taxes imposed by the other countries as well as for the enforceability of the tax claims of one country in each of the other countries. These provisions are contained in the Scandinavian multilateral treaty.[275] Finally, a multilateral treaty would cure the inability of the United States to share information obtained from other countries in a multilateral simultaneous examination. This is prohibited under existing treaties.[276] Thus far, the United States has not entered into even a firm agreement regarding the adoption of a multilateral income tax treaty. Nonetheless, with the occurrence of negotiations on a multilateral simultaneous examination program, adoption of a multilateral income tax treaty may occur in the not too distant future.

VI. Conclusion

The United States tax authorities have increasingly concentrated on attacking international tax evasion activities involving tax haven coun-

270. Agreement Concerning Reciprocal Administrative Assistance in Matters of Taxation, Nov. 9, 1972, Denmark, Finland, Iceland, Norway, and Sweden, 956 U.N.T.S. 61 (English translation at 97) [hereinafter referred to as Scandinavian Multilateral Treaty].

271. *Id.*

272. Council Directive 77/799/EEC, 20 O.J. Eur. Comm. (No. L 336) 15 (1977).

273. *Id.*

274. *Id.* at ninth recital, 20 O.J. Eur. Comm. (No. L 336) at 16.

275. Scandinavian Multilateral Treaty, *supra* note 270 at art. 13, para. 1, 956 U.N.T.S. at 100 (English translation).

276. *See supra* note 237 and accompanying text.

tries. The principal problem faced by the U.S. tax authorities is obtaining information on the tax evasion activities.

The United States tax authorities have utilized several methods of gathering information on transactions in tax haven countries. Most of these efforts have proven quite successful. Unilateral efforts of the U.S. tax authorities have proven the most successful when specific instances of tax evasion are suspected. The use of an administrative summons or grand jury subpoena has proven effective when there is an entity or person within U.S. jurisdiction who can be threatened with contempt sanctions. The IRS' use of paid informants in tax evasion investigations has proven highly successful, albeit highly intrusive. Because these investigations have proven so successful, the increasing use of paid informants should not be unexpected.

Increasing emphasis is being given to bilateral information gathering efforts as well. The recent termination/renegotiation policy towards income tax treaties with certain countries together with the U.S. tax authorities' use of economic incentives to encourage new information exchange agreements has not yet been tested. The information exchange provisions are, however, far more strict in requiring disclosure and so have the potential to be very effective.

Finally, the U.S. tax authorities have utilized existing reporting requirements imposed on financial institutions to obtain information on tax evasion. While this is a passive information gathering method, it could prove extremely valuable in detecting the original transaction upon which subsequent tax evasion activities are based. Increased enforcement of IRS reporting requirements should be expected.

The U.S. tax authorities are continuing to develop new means to continue past successes. Multilateral income tax treaties and simultaneous examination programs will likely be adopted, and further inroads into the Swiss banking secrecy laws will likely result from the Switzerland–United States Memorandum of Understanding.