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Enforcing United States Tax Laws Where the Information or the Taxpayer is Overseas

Joseph H. Guttentag

income of the entire affiliated group to the extent allocated to California. A substantial case can be made that this is extraterritorial taxation, and that it violates the U.S. Constitution.

Conclusion

I have often wondered whether there is such a thing as international law. The name of the Section of International Law suggests that there is such a thing. It would be nice if there were. I tend to think that we would sleep more soundly at night if there were an international legal order. Unfortunately, however, we seem to have a lot more international transactions, relations, ramifications and problems than we have international law. The U.S. tax laws do have an extraterritorial effect. Some aspects of U.S. tax laws may in fact violate international law, if it does exist. DISC may violate GATT. The California unitary tax may violate the U.S. Constitution or the California Constitution on certain aspects. The antiboycott legislation has resulted in serious diplomatic protests. It is clear that, as the title of this talk suggests, we do export U.S. tax policy.

ROBERT COLE: Thank you, Dave. One of the things that we have to keep in mind as we make all of these rules taxing people who are abroad on U.S. income and taxing activities of Americans overseas is how we are to enforce our rules on a worldwide basis. Joe Guttentag will discuss enforcement.

Remarks by Joseph H. Guttentag

Enforcing United States Tax Laws Where the Information or the Taxpayer is Overseas

Thank you, Bob.

We have now heard from distinguished and well-qualified legal scholars. We are now going to turn to something less scholarly which we might clarify under the general rubric: What are the chances that the IRS is going to find out about your Swiss bank account?

First, I am going to mention very briefly the problem of collecting taxes internationally. We have already discussed this subject but I wish to mention it in the context of my presentation. We can divide the problem into several categories: first, the foreigners who have income from U.S. sources; they usually have their assets here in the United States. How do we collect tax revenue from these persons located outside the United States? The second category consists of U.S. persons living in the United States, either an individual or a U.S. company, and they earn income or have assets outside the United States. How do we go about making sure that the tax collector has access to those assets and income?

Then, we will turn to information. What kind of information is overseas and how do we get it? I am also going to mention very briefly some additional collection problems involving foreigners.

In summary, the approach is that when we have some jurisdiction *in personam* over the foreigners, such as aliens residing in the United States, we follow the same rules as with U.S. citizens. That is, we follow our usual self-assessment tax system. The taxpayer is expected to file a return and pay taxes as so determined. When we do not have that type of jurisdiction over the taxpayer such as in the case of foreigners overseas earning investment-type income or any other income that we think should be taxed here in the United States, the Internal Revenue Code puts the burden on the U.S. person who is paying the income. The Code shifts the tax collection burden from the IRS to that U.S. person and gives him the responsibility of actually withholding the tax at the time the payments are made and remitting the tax to the Treasury. This is a very broad type of jurisdiction and severe penalites are imposed if the U.S. payor does not withhold the required amount of tax.

Now, before we turn to the problem of income outside the United States, let's deal with the problem of a foreigner crossing the border and leaving the country. We are dealing with a foreigner subject to the self-assessment system or within U.S. jurisdiction who leaves before satisfying his tax liability. We have a requirement in the law that most foreigners who are leaving the country have to obtain what is known as a "sailing permit" from the IRS. It is my experience that most foreigners are not aware of this requirement. I have never seen it enforced. I think the only time it is enforced involves actual ship sailings, though most international travel is now done by air. Every once in a while an IRS agent shows up on one of the few ships that still travels on the ocean and asks the aliens for their sailing permit showing that they have satisfied their U.S. tax liabilities.

FROM ANOTHER SPEAKER: That is a sailing permit, not a flying permit.

JOSEPH GUTTENTAG: Right. It seems to be.

The United States has a right to make what is known as a jeopardy assessment—to terminate the taxable year of an alien who is leaving the United States and make all the taxes for the prior periods immediately due. And the most vicious type of power available to the government is a writ of *ne exeat* (normally we do not use Latin terms in the Tax Section). The writ of *ne exeat* can be issued on request of the government to prevent an alien from leaving the country until his tax liability is settled to keep him within the U.S. jurisdiction.

ROBERT COLE: Is there any special place the alien under one of these writs has to stay?

JOSEPH GUTTENTAG: No. The only experience I have had with a writ resulted in

the judge taking and holding the alien's passport. I'm not satisfied that the procedure was correct or the only one available.

Who are the people and entities from whom the United States tries to collect taxes overseas? We have U.S. citizens living overseas, some of whom are permanent expatriates. All of their assets may be overseas and all of the information concerning their tax liability is overseas. Former U.S. citizens under our Code can be subject to U.S. taxes for up to ten years on all U.S.-source income if they give up their U.S. citizenship in order to avoid U.S. taxes. In other cases, the withholding taxes may not have been collected from the alien or foreign corporation, and, of course, the obligation is still on the foreign taxpayer to pay the required taxes.

What type of information is overseas? In the case of an expatriot U.S. citizen, all of the information relating to the determination of his tax liability may be over there. United States persons may have all their assets overseas and receive only foreign income. The United States wants to know all about the taxpayer, regardless of the source of his income.

Another category of information overseas involves U.S. persons who have transactions with related foreign parties, which have to be tested to determine whether those transactions were at arm's length in order to determine whether the United States is collecting its appropriate share of the income tax. In order to do that, the Internal Revenue Service may want to know more about the transaction and get information from the related party.

This field of transactions with related parties is also of great interest to foreign countries. These countries may limit their taxing jurisdiction much more than the United States, but they are still concerned about taxing their net local income and the only way they can tell if they are collecting their fair share of that income is that they have to worry about such things as pricing of goods, fees, and commissions that are paid overseas. Foreign governments are therefore interested in obtaining information on the United States and other countries.

Let me give you an example in another area. We talked about the foreign tax credit and you heard that in order to determine whether the tax credit should be given, we have to know all about the foreign tax. We have to know whether it was paid. We have to make sure that the tax wasn't paid and then a refund given. Under the tax systems of some foreign countries, foreign income is not taxed and a credit given. These countries exempt such income from tax completely. So long as the revenue officials of such countries are satisfied that the proper amount of income has been reported as being earned in their country and the proper amount overseas, they don't care whether any foreign taxes were paid.

How does the United States obtain this information that is overseas? In several ways. First, we get it from U.S. persons right here, that is through ex-

tensive reporting requirements on their overseas transactions. Second, the IRS can pick it up overseas through public records and through voluntary cooperation. In some cases, unfortunately, the information is also obtained by the IRS through bribery, theft of foreign records and the like. I hope that doesn't continue. And we also obtain information, which might not otherwise be available, through the information exchange provisions of the tax treaties. Those are the three principal ways.

Looking at the first one under the U.S. tax law, the Internal Revenue Service has a right to summon any person within the jurisdiction of the court, and he can be required to testify and produce documents. The procedure is in addition to regular reporting and record-keeping requirements. You have noticed a question on your Form 1040 dealing with foreign bank accounts. You have all seen that. You all answered it. Well maybe not all of you. In 1974, the last time for which I have any information, over 60 percent of the taxpayers who filed a 1040 failed to answer the question: Do you have a foreign bank account? Now what is the IRS doing in this case? Commissioner Alexander testified the IRS was doing nothing about the 38 million people who failed to answer the question.

Other recordkeeping requirements require reports as to the organization and reorganization of foreign corporations by shareholders, directors and officers of such corporations. Annual financial statements and other information must be furnished by U.S. shareholders of certain foreign corporations.

ROBERT COLE: Joe, you might take a second and just mention Form 959, because this is a group of international lawyers whose bread and butter is forming foreign corporations for their clients.

JOSEPH GUTTENTAG: Yes, Form 959 is the one that I just mentioned which requires that organization and reorganization of foreign corporations must be reported by the shareholders of that corporation and the officers and directors so long as there is a U.S. person with a five percent or greater interest. If another U.S. person becomes a shareholder, the officers and directors again are required to report to the IRS. The reporting requirement is triggered by the acquisitions or dispositions of stock and there is no annual filing requirement. The law used to require that not only were officers and directors required to report, but lawyers who organize foreign corporations were required to advise the IRS that they had organized such corporations in which U.S. persons were shareholders. That provision was eliminated in 1962.

In the case of IRS reporting requirements as well as in connection with furnishing tax information generally, lawyers and others can get involved in conflicts between the laws of foreign jurisdictions which prohibit disclosure of certain information under so-called bank secrecy or economic security laws. In

general, U.S. laws interpreted by the courts and as under international law, require the information to be furnished in response to a summons, for example, even though the disclosure may subject the party to civil or criminal sanctions imposed by a foreign jurisdictions.

For example, Citibank was required to produce records even though it claimed that to do so would violate German secrecy laws. Tony Field, who was and still is, an official of a Cayman Islands bank, was required to testify before a Grand Jury, even though the court found (though erroneously) that his testimony would subject him to criminal prosecution in the Cayman Islands for disclosing information. I would like to mention and revert to these problems later, and also ask Mr. Joelson if he may wish to comment on these same kinds of problems as they arise in the antitrust area.

How is information obtained which is overseas and outside the U.S. jurisdiction in cases in which the IRS doesn't have taxpayers or others in the United States who can be required to furnish the information? The Office of International Operations of the Internal Revenue Service was created to help get such information. It now has fourteen overseas posts and about thirty-two technical personnel in addition to clerical personnel. It operates under the jurisdiction of the U.S. Ambassador and the Department of State, as well, of course, of the IRS. What does it do? Its personnel assist taxpayers overseas, they collect taxes, and they secure information. How do they get this information? Some is very easy to find. They read the newspapers. They look at court records. They check on the value of land for U.S. estate tax purposes. They look at vital statistics records. If the information is not public, or it is not available, voluntarily from private parties, or if a foreign government official is not willing to give it to O.I.O., it cannot be obtained. An IRS O.I.O. official said several years ago, "we carry no more weight in a foreign country than any other American citizen." So remember that if you are overseas and an IRS agent comes and knocks on your door and says I have a bill here, you owe the Internal Revenue Service X-dollars, they have no more power over there than any other American citizen. When they go overseas, if they are special agents, they leave their badges, and their guns at home. Our special agents investigating fraud cases, as well as international tax examiners, do also go overseas in attempts to get information in connection with fraud cases, multinational corporation investigations and other types of audit.

These rules apply absent any tax treaties. Under U.S. tax treaties, there is provision for the foreign governments to give information to the Internal Revenue Service, and vice versa, which otherwise would not be available. Recent cases disclose the operation of these treaties. These cases involve Switzerland, a country which has stringent economic laws. The cases are the *Ryan* case in the United States, and the *X* and *Y Bank* cases in Switzerland.

For those cases the United States sought information under the treaty in connection with a U.S. tax investigation. The Swiss Government tried to help by attempting to obtain it from the Swiss bank. The bank refused to give the information, went to court in Switzerland, and the court ordered the bank to furnish the information under the terms of the U.S.-Swiss treaty. Otherwise, it would not have been available. The information was summarized and delivered to the Internal Revenue Service. The United States then went back and asked the Swiss to present the evidence in a form which would be admissible in the Tax Court. That issue went to court and the Swiss Supreme Court ruled that under the treaty, the Swiss were not required to furnish the information in admissible form. However, as it turned out in the case, the Tax Court under its new discovery rules required the taxpayer to make an admission as to the facts set forth in the summary. However, the general problem of admissible evidence was not solved under the Swiss treaty. Our new U.S. treaties are designed to overcome that problem by specifically providing that the information should be furnished in a form which is admissible in court.

What kind of information do we get? Most of the information obtained under tax treaties consists of routine exchanges of forms filed by taxpayers regarding transactions with residents of another treaty country. We get about 50,000 pieces of information a year from nineteen treaty countries. A recent congressional investigation disclosed that those 50,000 documents received by the IRS were stamped and put in a file and no one has ever looked at them to the best of the knowledge of the IRS. This, it seems to me, requires some closer coordination between the Treasury, which bothers to negotiate treaty provisions requiring disclosure, and the IRS. The IRS is now attempting to use this information and is presently reviewing it. The absence of identification numbers to which our computers are tied does create problems. This look of use by the IRS relates only to routine information received from treaty countries. Where the IRS makes a specific request, it, of course, uses the information received.

In addition to this routine type of information, the United States does make specific requests for information through the foreign governments. In many cases, the foreign government does not have the information in its files. In some cases, it won't try to get it from third parties because there is no such procedure under the local law.

The United States provides about 400,000 pieces of information to our treaty partners, another 200,000 pieces of information are filed by U.S. withholding agents, but since they are payments made to non-treaty countries, we do not send that information overseas. In fact, we are prohibited from providing it under the Code. We get about 150 requests from foreign governments with respect to specific cases. Fishing expeditions are not allowed. The foreign

government must show specifically why they need the information, why they think we have it and that they have exhausted their attempts to get it over here, or in their home country. A lot of these inquires relate to taxation of foreign entertainers who come over here, report no income back home, and the foreign country would like to know how much money they made while they were here in the United States.

Just a word on collection, including the so-called "Omar" cases involving Citibank, which has been very litigious in this area. Those cases held that the U.S. courts had jurisdiction over foreign branches of U.S. banks to enjoin them from disbursing money to foreigners while the United States tried to collect these taxes against the foreigners. The bank was not the taxpayer. The bank held money which belonged to a taxpayer and the IRS was trying to enforce its collection authority. Tax treaties do provide for some collection. Generally, they are limited to collection of taxes which have been reduced under the treaty. The collection effort is designed to take back improperly granted treaty benefits. As far as general or broader provisions of collection, they have received a rather negative response from the Senate Foreign Relations Committee which holds hearings and reports on the treaties for the benefit of the full Senate. It appears that the Congress is not in favor of collection activities, certainly not by foreign governments against U.S. persons here in the United States. The reciprocal carries with it an indication that the United States is not about, at this time anyway, to enter into a treaty with broad collection assistance authority.

Robert Cole: Is there some recent activity in this area? I think the OECD at one time was considering the problem.

Joseph Guttentag: Yes, there is a draft treaty prepared by the Fiscal Committee of the OECD which is under consideration to provide for broader assistance in collection. There are very difficult problems, particularly the verification of the tax, the fact that "due process" has been provided, whether the collection assistance should be limited to proceedings against nationals of the Foreign Treaty country, and not applied to nationals of the collecting treaty country. These are very difficult questions. The OECD is just getting into them.

With respect to the determination of proper taxes and other audit activity, there have been recent developments of interest. The United States and Canada have now announced that there are going to be auditing companies which operate in both countries on a simultaneous basis. The auditors from both countries are going to get together and decide the issues they are going to look at, each of them will go back then and audit the records, and then they will get together and see how they stand, what questions remain and what questions can be answered from each other's audit. Discussion, I understand have been going on with France and Germany and possibly other European