TRANSNATIONAL EVASION OF UNITED STATES TAXATION

I. INTRODUCTION

Since the close of World War II, the rise in international commerce and investment has rendered evasion of United States taxes across national borders an increasingly acute problem.1 Evasion has succeeded in large part because of the inability of the United States to secure jurisdiction over the person and property of the evader.2 The generally followed doctrine that the courts of one country will not enforce the revenue laws of another makes it impossible to use foreign courts as forums in which to bring original actions to collect taxes or suits to enforce United States tax judgments.3 Neither reciprocal tax collection treaties 4 nor extradition treaties 5 have significantly liberalized United States access to foreign forums for tax-collection purposes. Thus the taxpayer, either individual or corporate, who liquidates his holdings and flees beyond the territorial limits of the United States, or the foreigner who has limited business dealings in the United States and then simply fails to file any tax return, might well frustrate enforcement of any judgment.

In response to this situation judicial and legislative attempts have been made to broaden United States jurisdiction over suspected or actual tax debtors and their property, and over parties controlling their assets. The United States interest in such expanded jurisdiction rests primarily, of course, upon the need for revenue to carry on the functions of government and concern for the successful enforcement of the social and economic policies underlying the tax laws. Though other states have similarly strong interests in the enforcement of their own tax laws, a foreign state will rarely have an active interest in the frustration of United States tax enforcement, as such.6 Significant foreign interests may exist when United States courts interfere with agreements in restraint of trade involving foreign entities, or attempt

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2 The aspect of the problem concerning the lack of cooperation among sovereign states in the exchange of information and the detection of concealed income will not be discussed. See Caplin, International Cooperation in the Field of Taxation, 14 TAX EXEC. 324 (1962); Eichel, supra note 1; Fox, Office of International Operations: What It Does and How It Functions, 22 J. TAXATION 162 (1965).
6 A credit is given for the payment of foreign taxes, so foreign governments need not fear exhaustion by the United States of available funds. INT. REV. CODE OF 1954, § 901.
to regulate the shipping rates of foreign carriers, but the collection of a tax debt will not usually involve such an intense conflict with a foreign government's policy. The nonenforcement doctrine itself seems to rest mainly on considerations of judicial administration—a reluctance to apply the complicated tax laws of another system or to expend judicial resources to benefit a country which might not reciprocate. The doctrine does not apparently embody any policy which would deter United States courts from attempting more thorough enforcement by means which do not rely on foreign courts. Delicate questions may, however, arise if a United States court orders performance of some action prohibited by the law of another state. But where such a possibility exists, judicial power has been used with restraint and the remedies fashioned have often been conditioned on proper compliance with foreign law. Such care may be required not only by notions of judicial propriety but by the defendant's rights to federal due process.

Assuming, therefore, that United States jurisdiction ought to be extended in cases of alleged tax evasion whenever possible, consistent with avoidance of specific conflicts with foreign law and respect for the rights of the defendant to due process of law, this Note will explore the methods which have been employed to achieve this end. These include the more effective use of personal jurisdiction; the redefinition of the concept of property rights; and the development of procedures, both summary and judicial, to seize and keep property within the country, to assert jurisdiction once it has left, and even to order its repatriation from a foreign country.

II. PERSONAL JURISDICTION OVER A TAXPAYER, HIS AGENT, OR HIS DEBTOR

A. Use of Personal Jurisdiction To Secure Records, Documents, or Property from Abroad

A court which has properly acquired personal jurisdiction over the taxpayer or one of his agents may nevertheless be unable to secure the return of property or records from abroad for two reasons: the defendant may have insufficient control over the material in question, or the court may find that its order if issued would be in violation of the laws of some foreign state. The problem of control usually arises in cases where documents are demanded from an agent.
necessary control factor is easily found in cases of individual taxpayers who have records located in foreign countries and relevant to potential tax liability. In the area of corporations, both foreign and domestic, with offices within and without the United States, the Ninth Circuit has established the power of a district court to order production of records located abroad provided that it has personal jurisdiction over an authorized agent who holds the documents within his control. The same rule has been applied to foreign branches of United States banks.

There are situations, however, where the taxpayer holds documents in a dual capacity, both as an individual and as agent, so that the courts have found it necessary to determine not only whether physical control exists, but the legal capacity in which the agent holds the documents. For example, In re Daniels involved a summons upon a United States citizen, president and sole shareholder of a Panamanian corporation which did not engage in business operations within the United States, to produce corporate records pursuant to an investigation into his personal tax liability. The court found it necessary, before determining whether Daniels could assert a fifth amendment defense, first to decide that the summons could not properly be addressed to Daniels in his corporate capacity since the corporation had no business connection with the United States. Use of such a conceptual approach may properly be restricted, however, to situations like Daniels itself, where the defenses available to the party summoned may differ depending on the capacity in which he is being investigated. Capacity may be seen not as a jurisdictional matter, but as a factor affecting a party's range of defenses. Thus had Daniels involved a demand on a corporate agent against whom no personal liability was asserted, disclosure could have been compelled under the statutory provisions relating to material held by third parties or under the doctrine of corporate custody. The desirability of maximizing the reach of investigative procedures makes it sensible to rely in the main on physical control and to explore legal capacity only when the availability of constitutional defenses is in issue.

Attempts to use personal jurisdiction to secure property or records or "any person having possession, custody or care" of such records. Sections and make the summons enforceable through a contempt proceeding in the district court for the district in which the person resides or can be found.

SEC v. Minas de Artemisa, 150 F.2d 215 (9th Cir. 1945). The case involved an SEC provision analogous to INT. REV. CODE OF 1954, § 7602.


In re Daniels, 140 F. Supp. 322 (S.D.N.Y. 1956).

But cf. Shapiro v. United States, 335 U.S. 1 (1948), where the Court held that records required to be maintained by laws were "public" and hence not subject to the privilege against self-incrimination. INT. REV. CODE OF 1954, § 6001, requires taxpayers to keep such records as the Regulations may require.


Production of documents held in a "corporate capacity" may not be resisted on the grounds of a constitutional freedom from self-incrimination. Hale v. Henkel, 201 U.S. 43, 74-75 (1906).
held abroad have also been resisted on the ground that action by the taxpayer or his agent would constitute a violation of some foreign law. In *United States v. Ross*,20 for example, the Second Circuit ordered a taxpayer, resident in the Bahamas but a United States citizen, to turn over his securities, located in the Bahamas, to a receiver appointed pursuant to a jeopardy assessment for unpaid income taxes. The court rejected the taxpayer's argument that it was improper for the court to order an act to be performed outside the United States, basing its decision in part upon the Supreme Court's opinion in *New Jersey v. City of New York*,21 upholding a court's jurisdiction to enjoin the city from dumping garbage in the ocean beyond the three-mile limit. In *Ross*, however, the act was to be done not only beyond the court's jurisdiction, but within the jurisdiction of another country. The possibility of actual conflict with the laws of a foreign state was, however, recognized by the court as a valid defense.

In determining whether a conflict with the laws of another state exists, the courts have established a presumption that an order does not per se involve an invasion of foreign sovereignty and have placed the burden on defendant to make a showing of conflict.22 The Second Circuit in *First National City Bank v. IRS*, for example, found that a summons to produce records in Panama involved no violation of article 29 of the Panamanian Constitution, prohibiting the examination of private documents except by legal formality;23 the court held that the constitution did not limit "legal formality" to Panamanian legal procedures, and that the United States procedure had been followed. The reluctance of the courts to find a conflict with foreign law is further exemplified by the manner in which the court then skirted a statute,24 which prohibited examination of books in the offices of merchants. It reasoned that in granting a license to a United States bank, knowing that the bank was subject to examination by the Federal Reserve Board at any time,25 Panama must not have intended its statutory provision to apply to authorized representatives of the United States Government.

The court's treatment of the Panamanian statute goes beyond any justifiable imposition of a burden of proof upon the defendant or any legitimate policy rationale based on the need for effective tax enforcement. Though a foreign state may have no desire to frustrate the enforcement of United States tax laws, it has an obvious and strong interest in the enforcement of its own laws with reference to property within its boundaries. Too ready a resolution of nice questions of foreign law may thus indicate not merely carelessness in United States

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20 302 F.2d 831 (2d Cir. 1962).
24 *Código de Comercio* art. 88 (1963) (Pan.).
courts, but also a disrespect for the laws of friendly foreign nations in violation of the principles of international comity. Moreover, the effect of the Second Circuit's decision in *First National City Bank* was to place an innocent third party, the bank, in the dilemma of either obeying the court's order and thereby subjecting itself to possible criminal liability in Panama, or disobeying and risking a contempt action in the United States. A better course of action for a court faced with a possible conflict between United States and foreign law would be to require that the defendant make a good faith attempt to obtain a waiver from the foreign government. *Ross* held, for example, that if the Bahamian foreign exchange rules prohibited the transfer of securities to persons outside the sterling area without the authorization of the Controller of Exchange, *Ross* would be ordered first to apply for the necessary permission. Should permission be denied, the court would vacate the order rather than subject the defendant to possible criminal action in a foreign state. When no provision for waiver exists, and the foreign statute under which the defendant is threatened is ambiguous, the defendant might be required to seek a declaratory judgment from a foreign court. If such a procedure is unavailable a United States court might nevertheless issue a conditional order, subject to rescission should an illegality subsequently develop. Only in the event that conflict with foreign law is unavoidable either through conditioning the summons or through reasonable interpretation of foreign law should a United States court refuse to issue an order because of alleged conflicts with foreign law.

**B. Measures To Preserve a Court's In Personam Jurisdiction**

The preceding uses of personal jurisdiction are, of course, impossible if the taxpayer has succeeded in fleeing the jurisdiction. Therefore Congress has provided the Internal Revenue Service with a number of procedures, both summary and judicial, to move effectively in situations where the Service must act immediately or lose any possible control over a taxpayer and his property. Should the IRS find that a tax debtor intends to flee the jurisdiction and thereby defeat any subsequent collection proceeding, it may terminate the current fiscal period, demand immediate payment, and have its findings that effective tax collection was jeopardized considered "presumptive evidence" in any subsequent enforcement proceeding. If the potential evader is an alien, he may not leave the United States, with certain exceptions, until a certificate of compliance with all revenue obligations is granted. While no similar statutory provision limits the departure of a United

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26 *In re Chase Manhattan Bank*, 297 F.2d 611, 613 (2d Cir. 1962).
28 302 F.2d at 834. The taxpayer was later held not in contempt for noncompliance where it was shown that the stock had been transferred six days before entry of the order. 243 F. Supp. 496 (S.D.N.Y. 1965). See also *In re Investigation of World Arrangements with Relation to the Production, Transportation, Refining & Distribution of Petroleum*, 13 F.R.D. 280, 286 (D.D.C. 1952).
30 INT. REV. CODE OF 1954, § 6851(a)(1).
31 Id. § 6851(d).
States citizen, section 7402(a) of the Internal Revenue Code of 1954 established jurisdiction in the district courts to issue in civil actions writs of ne exeat republica, prohibiting the removal of the taxpayer's person and property from the United States.32

A ne exeat writ, however, has been invoked in only one reported case, United States v. Robbins.33 Neither the Code section nor the Regulations define the circumstances under which the writ may be invoked, but the Robbins court concluded that the writ would issue only in circumstances proper under the general equity doctrines of the common law, that is, when a threatened departure from the jurisdiction, resulting in loss of control over the person and his property, would defeat the court's jurisdiction. A temporary order may properly issue on an ex parte showing of probable cause that jurisdiction may be lost. Since the writ imposes a restraint on defendant's freedom of movement,34 however, he is entitled to an immediate, full hearing before the order is made final. At the hearing the Government, as the party procuring the writ, has the burden of producing substantial evidence in its support; otherwise, the Robbins court held, there would be a denial of liberty without due process in violation of the fifth amendment.35 The writ in Robbins was dismissed for failure to produce sufficient evidence that defendant was liquidating his assets with the intent to flee the jurisdiction and avoid the revenue laws. While the Robbins court did not define what degree of substantiality was necessary to sustain a final order,36 it implied that the standard should be a strict one because of the constitutionally protected private interests involved.37 However, such a conclusion does not necessarily follow if one distinguishes the use of the writ at common law from its present purported use. While the common law cases cited by the court involve only private litigants, section 7402(a) presents the writ in light of important considerations of governmental policy. Thus the Government's interest in tax enforcement might lead a court to seek ways to increase the effective use of the writ by structuring the relief granted. For example, a court might separate the restraint on the taxpayer's person from that on his property, and require a lesser showing of substantiality to sustain a restraint on property. Such a benefit to the Government might be balanced by a requirement that the Government present its deficiency case within a specified time. Alternatively a court might deny the writ on condition that the taxpayer post a bond equal to the contested tax assessment. Neither of these procedures would assure the use of criminal penalties against a subsequently convicted taxpayer, but they would at least guarantee

32 Id. § 7402(a).
36 The court found that the Government had not established "any probability" at all, thus rendering any definition of the degree of substantiality required for the writ unnecessary. 235 F. Supp. at 357.
the existence of property within the United States for collection purposes.

C. Jurisdiction over a Debtor of the Taxpayer: United States v. First National City Bank

It is established that a court acquires jurisdiction to garnish a debt by securing personal jurisdiction over the debtor. The principle was applied in United States v. First National City Bank to uphold an order under section 7402(a) enjoining a New York bank from paying out a tax evader's deposits held in a branch office in Montevideo. The court had not yet acquired jurisdiction over the taxpayer, though it had prospects of doing so through application of the New York long-arm statute. A vigorous dissent by Justice Harlan questioned both the statutory authorization of the injunction and the propriety of the decision. Justice Harlan concluded that the advantage to be obtained by the Government from allowing such freeze orders was slight—knowledgeable tax avoiders would simply place their assets in foreign banks which had no American connections. On the other hand, the disadvantages were great—an innocent third party was threatened with administrative problems, loss of business, and possible double liability; the possibility of giving offense to a foreign state was substantial; and, finally, since the majority supposed reciprocity, United States courts would have to honor similar freeze orders issued by foreign courts at the request of foreign tax assessors. Thus, although there was clear jurisdiction in the sense of ability to compel compliance, a court of equity should properly forbear to exercise it.

The force of this criticism is mitigated somewhat by the fact, admitted even by Justice Harlan, that the United States parent exercised "actual, practical control" over its branches, thus making the branch, under traditional notions of jurisdiction, subject to United States courts. And here, as in the case of production of documents or property, double liability may be guarded against, to some extent, by shaping the decree. Moreover, the force of the weapon thus given the Government is, at least for taxpayers with funds in banks with United States branches, considerable. Although the district court had not yet obtained jurisdiction over the deposits, it prevented the taxpayer from reaching them. Production of such a stalemate is a strong inducement to the taxpayer either to appear in court to contest the merits of the

43 379 U.S. at 384, 387.
assessment or to reach a compromise on liability. So far, however, no attempt has been made by the Government to use the concept of jurisdiction developed by the Court to force actual transfers of funds, though the rationale of control would seem as applicable to direct transfers as to freeze orders. In a regulation promulgated while First National City Bank was still in the course of litigation the Government in effect limited itself to situations similar to that in First National.\textsuperscript{44} Such restraint is wise not only because any dramatic expansion of jurisdiction in the international sphere would rest on a slender statutory base,\textsuperscript{45} but also because the majority in First National carefully limited itself to validating a temporary freeze order where it seemed probable that personal jurisdiction would be acquired.\textsuperscript{46}

III. JURISDICTION: QUASI-IN-REM

A. Section 6321: The Automatic Lien Provision

1. Property Within the Territorial Limits of the United States.— Should any person liable to pay a tax neglect or refuse to do so after demand, a lien automatically attaches to "all property and rights to property, whether real or personal," of the taxpayer.\textsuperscript{47} The Commissioner may then employ the usual means of judicial foreclosure upon a lien, a quasi-in-rem action in the district court for the district in which the property or rights are located.\textsuperscript{48}

One of the major difficulties in applying section 6321 is that under the federal enactments the concept of "property" or "rights to property" to which liens attach remains undefined. The Supreme Court has declared that although state law creates legal rights and interests, federal law determines which rights or interests are subject to a federal tax lien.\textsuperscript{49} This approach was followed in United States v. Dallas National Bank.\textsuperscript{50} There an English resident failed to report income from securities transactions in New York; the Fifth Circuit upheld a Government lien on the taxpayer's right to receive income from a spendthrift trust established under Texas law, on the ground that once Texas had created a legal interest it was without power to immunize that interest from the operation of federal law.\textsuperscript{51} Thus it would seem that any beneficial interest created by state law is subject to a federal tax lien, whatever the rights of other creditors against that interest. In some cases, in fact, courts have made no inquiry into state law at all.

\textsuperscript{44}Treas. Reg. § 301.6332-1 (1964).
\textsuperscript{45}INT. REV. CODE OF 1954, § 7402(a).
\textsuperscript{46}379 U.S. at 385.
\textsuperscript{47}INT. REV. CODE OF 1954, § 6321. While filing is necessary to validate the lien against certain third parties, it is not essential to the lien's existence. \textit{Id.} § 6323. Furthermore, the lien attaches to after-acquired property immediately upon acquisition, Glass City Bank v. United States, 326 U.S. 265 (1945); and continues until the liability is satisfied. \textit{Int. Rev. Code of 1954}, § 6322.
\textsuperscript{48}INT. REV. CODE OF 1954, § 6321. While filing is necessary to validate the lien against certain third parties, it is not essential to the lien's existence. \textit{Id.} § 6323.
\textsuperscript{50}152 F.2d 582 (5th Cir. 1945).
\textsuperscript{51}See also Shambaugh v. Scofield, 132 F.2d 345, 346 (5th Cir. 1942).
In *United States v. Metropolitan Life Insurance Co.*, where a delinquent taxpayer fled to Canada, the Fourth Circuit held that the taxpayer’s right to surrender his United States insurance policies for cash was attachable under the statute, and, once attached, the right could be exercised by the Commissioner and the money used to satisfy a tax judgment. For its proposition that the cash surrender value of an insurance policy could be attached the court relied only on federal cases, and made no reference whatever to the law of West Virginia where the court sat and the insurance company was subject to service. Thus *Metropolitan Life* may be taken to mean either that a reference to state law is not required in cases where the existence of some beneficial interest seems clear, or that in certain cases a federal presumption supports the existence of a beneficial interest. Under this interpretation a defendant would still be able to assert that, under state law, there is no “interest or right” at all.

When reference is made to state law, however, either because the extent of the interest to be attached is uncertain or because of a need to determine the situs of the res for jurisdictional purposes, difficult problems in choice of law may arise. In the cases in which courts have turned to state law to determine situs, the state law which recognized the interest also established the situs of the res within the boundaries of that state. A far more difficult situation would exist, however, if the state recognizing the interest assumes the situs to exist in another state, a state which may itself not recognize such interests. Though the factors bearing on the choice of law in such cases are too complex for analysis here, it may at least be suggested that federal courts, which are already moving toward uniform definitions of property in some cases, might employ a uniform, federal rule in those cases where reference to state law would unnecessarily prejudice federal interests. Such a uniform rule would seem especially sensible in the context of effectuating a federal statute.

2. Property Outside the Territorial Limits of the United States.

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52 256 F.2d 17 (4th Cir. 1958); cf. United States v. Mitchell, 349 F.2d 94 (5th Cir. 1965).
53 Such a position was taken by defendant bank in United States v. First Nat’l City Bank, 379 U.S. 378 (1965). The bank argued that under New York law no right existed in New York until a wrongful refusal of payment by the bank’s branch in Montevideo. However, it is possible that a right might still be found to exist in New York through an application of *United States v. Metropolitan Life Ins. Co.*, 256 F.2d 17 (4th Cir. 1958). There the Second Circuit held that the Government was not precluded from reaching certain property rights because the taxpayer had not yet elected to exercise them. While it might appear the situations are distinguishable in that any right of the taxpayer in New York depends not only on his demand but as well on the bank’s refusal, a freeze order would in fact assure a refusal in Montevideo. Thus, the existence of a right in New York would at the moment of the decree be entirely within the taxpayer’s control, as in *Metropolitan Life*, and quasi-in-rem jurisdiction should therefore lie in the district court to foreclose the tax lien. The Supreme Court in *First National City Bank*, however, never reached the question of quasi-in-rem jurisdiction, but rested its decision instead on personal jurisdiction over the bank. See p. 882 supra.
While section 6321 states that the lien attaches to all property rights of the taxpayer, it is questionable whether a court would find that it reached property located in a foreign country. The Second Circuit in *First National City Bank v. United States* rejected the contention that section 6321 be given global application.57 The Supreme Court has displayed its reluctance, in the absence of a clear congressional mandate, to imply extraterritorial force into statutes and thus extend legislative jurisdiction beyond the territorial limits of the United States.58 This hesitation results from a fear of interference with the rights of other nations and the foreign affairs functions of the United States,59 and from the knowledge that without jurisdiction over a person in control of the property to order repatriation under section 7403, the Government has no enforcement mechanism to foreclose the lien. And should it attempt to reach property in a foreign state, *United States v. Harden*60 has made it clear that the foreign court would look to the real nature of the claim underlying the lien proceeding and refuse enforcement if it involves tax liabilities.

**B. Levy**

As an alternative procedure to judicial foreclosure, the Commissioner may resort to the statutory procedure of levy and distraint, a summary process similar to execution on a judgment, whereby the property can be seized and sold without resort to the courts.61 This administrative remedy is unavailable, however, when the property is located abroad. It would be highly improper for a United States revenue officer to seize property in a foreign nation since the state would view such an act as an official act of a foreign sovereign within its borders.62 However, should there be a person in control of the property within a district court's jurisdiction, section 6332(c) provides severe penalties for the refusal to surrender property subject to levy; the person is liable for a sum equal to the value of the property, up to the tax liability due, plus interest and a fifty percent penalty if no reasonable cause for non-surrender is proven. The Regulations state that if property subject to levy is held by a foreign office of a bank engaged in business in the United States, under certain conditions the Commissioner may enforce the levy.63 Thus the same considerations which should prompt judicial care in exerting jurisdiction 64 seem to have led to reticence on the

57 321 F.2d 14, 23 (1963).
60 [1964] 41 D.L.R.2d 721, 725 (Can. 1963). The court there refused to accept the Government's argument that the compromise tax judgment to which the taxpayer had agreed was an enforceable contract right.
61 INT. REV. CODE OF 1954, §§ 6331-44.
63 The Regulation establishes conditions similar to those which existed in *First National City Bank*. See p. 883 & note 44 supra.
64 See p. 882 supra.
part of the Commissioner. Such restraint is especially appropriate in administrative proceedings since an immediate hearing may be impossible and the danger of harm to third parties from conflicting liability is thereby increased, even if judicial penalties are not ultimately imposed.

IV. Conclusion

The willingness of the federal courts to exert their jurisdictional powers to the utmost in the area of international tax evasion has been criticized by several judges as an exercise of naked power without restraint, of jurisdiction without discretion. However, immense practical difficulties block effective enforcement of United States tax laws in the international context, and attempts to employ foreign assistance in the detection of income and the collection of taxes have foundered. Thus, unless the domestic courts render substantial aid to the Government, the volume of evasion is likely to increase, as more and more taxpayers recognize the chances for successful avoidance. Realizing the difficulties in reaching persons and property abroad, the courts have broadened the concept of property rights within the United States, and extended their power over persons within the jurisdiction to reach property situated abroad. Such assertions of jurisdiction by the courts have often been accompanied by considerable restraint when constitutional freedoms have been involved. As long as such care is exercised and until the executive manages to secure extensive investigatory and judicial rights for tax enforcement in foreign nations, similar uses of jurisdiction would seem thoroughly appropriate means of enforcing the revenue laws.
