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Claude L. Eichel

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ADMINISTRATIVE ASPECTS OF THE PREVENTION AND CONTROL OF INTERNATIONAL TAX EVASION

CLAUDE L. EICHEL*

The employment of technical methods to deal with fraud in matters of taxation is no doubt wholly to be recommended, both for the good of the communities reaping the benefit of such taxation, and in the interests of the taxpayers themselves, since any fraud which goes unpunished leads to an unfair distribution of the burden of public expenditure and to the payment by one set of persons of sums properly due by others.

League of Nations¹

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INTRODUCTION

The problem of international tax evasion is not new, but it has become increasingly significant since the end of World War II.

Income taxation became a permanent part of American life little more than half a century ago.² At the time, evasion across international boundaries was given slight thought by both taxpayers and the government, for several reasons. First, high tariffs restricted international trade,

2. Although an income tax existed during the Civil War, it was repealed soon afterwards. In 1894, the income tax was reintroduced, only to be held unconstitutional by the United States Supreme Court. *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895). However, the passage of the sixteenth amendment to the United States Constitution in 1913, reestablished its validity, and since March 1, 1913, the income tax has been in continuous existence.

and therefore few people participated in it. Second, international travel and communications were both costly and time consuming, making the conduct of international transactions somewhat of a chore. Third, and perhaps most important, comparatively low tax rates³ did not provide sufficient incentive to the evader to justify the effort.

Since World War II, however, changes in these factors have stimulated the ingenuity of the international tax evader. International trade and investment have increased enormously,⁴ partly as a result of the lowering of international tariffs.⁵ Communications are virtually instantaneous, and travel is swift.⁶ And, of course, high tax rates have rendered international evasion very profitable.

As recently as 1961, the then Commissioner of Internal Revenue, Mortimer M. Caplin, remarked that "our workload overseas has increased to such an extent that we are concerned over our ability to assure a satisfactory level of voluntary compliance among United States taxpayers in all parts of the world."⁷

Although international tax evasion has been a concern of tax officials for more than twenty years, only recently has any large-scale effort been made by the United States Internal Revenue Service to curb it. This has been no simple task, since the administrative problems inherent in worldwide enforcement are both technically complex and fraught with political and diplomatic ramifications. To place in proper perspective the scope of the difficulties inherent in a worldwide enforcement program, as compared to its domestic counterpart, one might well envisage the complexities of a game of three-dimensional chess, as contrasted with its less formidable ancestor.

It is the purpose of this article to discuss the administrative aspects of controlling international tax evasion. In general, we will discuss the

3. In 1913, rates were one percent to six percent, and, but for a brief period around World War I, it was not until 1938, that the top rates reached seventy-five percent.

4. United States assets and investment abroad have increased from 12,275,000,000 dollars in 1940 to 80,126,000,000 dollars in 1961. *International Investment Position: 1940 to 1962, Statistical Abstract of the United States 1964-1965* 853. (U.S. Dep't of Com. 1964).

5. On the multi-national level, the most significant factor in the reduction of tariffs has been the GATT (General Agreement on Tariffs and Trade) to which most of the countries of the free world, including the United States, are party. In the United States, the Trade Agreements Act of 1934, the Trade Agreements Extension Act of 1958, and the Trade Expansion Act of 1962 have each contributed to the lowering of tariffs.

For a discussion of customs, tariffs, and reciprocal trade agreements, see *Report to Committee on Ways and Means on United States Customs, Tariffs, and Trade Agreement Laws and Their Administration*, (Boggs Report) (U.S. Gov't Printing Office 1957). For a discussion of the GATT see Catudal, *The General Agreement on Tariffs and Trade: An Article-by-Article Analysis in Layman's Language*, 44 DEP'T STATE BULL. 1010 (1961); 45 DEP'T STATE BULL. 35 (1961).

6. "It may be due to jet planes. It may be due to Common Markets. Whatever the reasons, more and more U.S. Corporations are doing business in more and more foreign countries." 4 COOPERS & LYBRAND, INT'L REP. No. 3 (July, 1961).

7. Caplin, *A Status Report from the Commissioner*, 14 TAX EXEC. 9, 17 (1961).

scope of the problem, comparing international versus domestic considerations; indicate the type and nature of the enforcement tools presently available, and how they are being wielded; and consider the directions in which efforts to prevent international tax evasion should proceed. As a caveat, it should be noted that we are here concerned with the administrative aspects of evasion rather than the substantive means employed by evaders to achieve their ends.

Our approach will be to view the problem primarily from the standpoint of the United States tax system, rather than from a general multinational level. The reasons for favoring this type of analysis are several: first, the concept of international cooperation in tax matters is in its infancy,⁸ and at its present stage of development, lends itself more readily to bilateral rather than multilateral solution; second, the principles involved in international tax administration are common to most systems; and third, no exhaustive analysis of the area is intended.

The use of the term "taxpayer" will include any person or entity subject to taxation under our internal revenue laws, be he a citizen, resident or nonresident alien. Our basic quest will be to seek out the barriers which result from the crossing of international boundaries and stand between the taxpayer and the government to which he owes taxes; to analyze those barriers; and to determine how they can best be removed.⁹

I. THE PROBLEM

The two basic cornerstones of an effective tax enforcement system are intelligence and collection. The function of intelligence is necessary to determine the extent to which taxpayer compliance is being achieved. By means of it (from an overall standpoint), it is possible to compare the amount of income being earned by the taxpaying public with the amount reported by them on their tax returns. Thus, it is possible to judge effectively how the tax system is functioning as a whole. The collection function is a logical corollary to that of intelligence, and on a policy planning level, is easily and more accurately employed. Through it the amount of income tax assessed can accurately be compared with the amount actually collected.

But no tax system can function on generalities. It is when applied to specific cases that the vital necessity of both intelligence and collection become readily apparent. Through an efficient intelligence network, tax officials can ascertain which individuals are engaged in activities that result in tax liability, and what the extent of that liability is. Through

8. King, *Tax Assistance from the International Tax Relations Division of the U.S. Treasury Dept.* 2 *DOING BUS. ABROAD* 582, 584 (1962).

9. It should further be noted that our discussion will be limited to income taxes, since such taxes are the major source of tax revenue in the United States.

effective collection procedures, the tax liabilities of taxpayers are liquidated, and the mission of the tax official has been accomplished.

We will now take a closer look at these two functions, both from their domestic and international aspects.

A. *Intelligence*

1. GENERAL CONSIDERATIONS

The intelligence function is comprised of two principal facets. The first facet is not directed primarily toward any specific evader, but merely assures a systematic flow of information to the tax authorities. This flow of information serves an important indirect compliance purpose in that those who might otherwise evade the revenue laws refrain from doing so because they are aware that the government is receiving information as to their income. The second facet is specifically directed toward the suspected evader, and provides a means of accurately ascertaining his tax liability, notwithstanding his hostility or lack of cooperation.

2. DOMESTIC ASPECTS

a. General Intelligence

The first facet of intelligence described above may be referred to as "general intelligence"—the systematic receipt of information by the government. In the United States, there are several sources for such information. The most familiar example of this type is the statement of annual earnings that must be furnished by all employers to both employees and the government.¹⁰ Since wages constitute the single greatest source of income, this is a most significant contribution to the efficacy of the intelligence function. Information reports are also required from payors of interest or dividends of ten dollars or more,¹¹ and from those engaged in trade or business who make payments of income in excess of six hundred dollars per year to any individual.¹² Such information has a high degree of reliability in that it is obtained from third parties who ordinarily would have no reason to furnish false information.¹³ Although cross-checking the information received against the income tax returns filed by taxpayers appears to be a monumental task, the advent of Automatic Data Processing (ADP), with its high speed computers, is making this task technically feasible.¹⁴

10. Such statements are required in connection with all employees who have earnings subject to withholding tax. Treas. Reg. § 31.6011(a)-4(b) (1960).

11. INT. REV. CODE OF 1954, § 6042. (All further references to sections will be to the INT. REV. CODE OF 1954, as amended, unless otherwise indicated.)

12. Section 6041(a).

13. Returns are also required under § 6044 for patronage dividends.

14. Use of automatic data processing on a massive scale began on January 2, 1962, and is expected to encompass the entire nation by January, 1967. Taylor, *Automatic Data Processing in the Internal Revenue Service* 119 J. Accountancy 53 (1965).

b. Specific Intelligence

The second facet of intelligence, which is directed toward accumulating information in individual cases under investigation, may be referred to as "specific intelligence." The first and most obvious such source of information as to a taxpayer's income is the taxpayer himself. Our system is basically one of self-assessment, and depends primarily on the individual taxpayer to make a full account of his income.¹⁵

In the United States, this system has functioned well, and most taxpayers file accurate returns. However, even the well-intentioned taxpayer may make errors in preparing his return; he may misinterpret a provision of the Internal Revenue Code so as to wrongly exclude certain items of income, or claim deductions or exemptions to which he is not entitled. Therefore, the second source of specific information consists of examination of the taxpayer's books and records for the purpose of verifying the correctness of his return, or to determine the correct amount of income where no return has been filed. Where, however, the taxpayer under examination either has failed to keep accurate records, or refuses to cooperate with the examining agent; or where the agent suspects fraud, recourse must be had to other sources of information.

The third such source would be third parties with whom the taxpayer has had dealings. In the United States, revenue agents have the power to compel testimony by third parties as to their transactions with the taxpayer under investigation.¹⁶ They also have power to examine a third party's records,¹⁷ including bank records. Third parties are usually cooperative, both from a desire to keep on good terms with the Internal Revenue Service, and because the law compels their assistance.¹⁸ A fourth source of information, and a primary aid to fraud investigation, is the informant. The informer may be motivated by the prospect of a reward,¹⁹ a desire for revenge against the person evading, or perhaps just an aversion to seeing someone else pay less than his share of the tax burden.

Acquisition of specific information is further facilitated by the closeness of investigators to sources of information, the readiness of other

15. [W]e cannot forget that over 97% of our total revenue collections comes from self-assessment or voluntary compliance, with only 3% from direct enforcement—although the significant impact of enforcement on compliance must definitely be taken into account. Caplin, *A Status Report from the Commissioner*, 14 TAX EXEC. 9, 12 (1961).

Of course, our system is not totally one of self-assessment, since taxes withheld from salaries constitute a large portion of the personal income tax revenue.

16. Section 7602(3).

17. Section 7602(1).

18. Revenue agents may compel persons to appear before them for questioning (§ 7602(2)); they may enter any building or other place for purposes of examining articles or objects subject to tax (§ 7606).

19. Rewards are paid to informers under § 7623. The amount paid varies with the value of the information given, but rarely exceeds ten percent of the tax recovered. See Treas. Reg. § 301.7623-1(c) (1959).

law enforcement agencies to cooperate, and the ability of government agents to keep a close watch over a suspected evader's activities by personal surveillance.

Although general intelligence may appear to be less dramatic as a source of information than specific intelligence, and greater accuracy can be obtained through the conduct of individual investigations, general reliance on investigation as a primary source of intelligence would be very costly, and might necessitate the commitment of a large segment of our population to the enforcement of the tax laws.²⁰

3. INTERNATIONAL ASPECTS

a. Activities of Aliens in the United States

For purposes of United States taxation, resident aliens are generally treated in the same manner as United States citizens,²¹ and they file the same tax returns. In relation to their activities in the United States, the same sources of both general and specific intelligence are available to the government, and function in the same manner.

Intelligence procedures as applied to nonresident aliens deriving income from United States sources require special adaptation, however. Information reports at the source are similar to those obtained as to domestic taxpayers, but with the addition of a collection feature, which will be discussed elsewhere.²² Application of specific intelligence techniques is rendered more difficult when a nonresident alien is concerned, however, for several reasons. First, the nonresident alien, almost by definition, is not physically present within the United States, and is therefore rendered less accessible to our investigative agents. Second, being beyond our borders, he may also feel himself beyond the jurisdiction of our tax authorities. Third, he might feel no desire to cooperate in contributing to the revenue of a government to which he owes no allegiance. These factors do not vitiate the intelligence function completely, however, because the nonresident alien is subject to tax only on his United States source income,²³ and the information is generally available to our agents at the source of payment.

20. For the 1962 fiscal year, the Internal Revenue Service had the following authorized enforcement personnel:

Revenue Agents	11,848
Special Agents	1,616
Office Auditors	3,034
Revenue Officers	5,789
Tax Examiners	4,695

Caplin, *A Status Report from the Commissioner*, 14 TAX EXEC. 9 (1961).

21. A minor exception exists in that the entitlement of the alien resident in the United States to the benefits of the foreign tax credit is dependent on whether the country of which he is a citizen allows a similar credit to United States citizens residing in that country. Section 901(b)(3).

22. See text accompanying note 60 *infra*.

23. See §§ 871-895.

b. Activities of Resident Aliens Overseas

As mentioned previously, resident aliens are generally treated on a par with United States citizens for tax purposes. In other words, both are taxable in the United States on their worldwide income. However, the problems of obtaining intelligence as to the overseas activities of resident taxpayers are infinitely greater when an alien is involved than when the taxpayer is a United States citizen. This is especially true when information is sought from the country of which the alien is a citizen.

The basic problem is that laws generally do not have extraterritorial effect, and the United States does not have access to the same type of information that it would have in this country. In the absence of a treaty, it is virtually impossible to obtain any general intelligence from a foreign country, since no country will undertake systematically to inform another government as to the domestic activities of its own citizens. Moreover, even when a treaty does exist, there is usually an express reservation against any "informing" as to the signatory's own citizens.²⁴ This, of course, imposes a great administrative burden on the country seeking the information, since it must rely on specific forms of intelligence, necessitating individual investigation for each taxpayer involved. Since this is impractical, great reliance must be placed on the taxpayer's own declarations.²⁵

One method of encouraging compliance is to spot-check taxpayers' financial affairs, as well as to make specific investigations where there is reason to suspect noncompliance or fraud. Unfortunately, the ability of a country even to make a specific investigation of an alien's foreign activities is severely restricted.

The resident alien is less likely to report his foreign source income

24. See text *infra* at p. 54, *et seq.*

25. France, in taxing individuals, places great emphasis on tangible signs of wealth. There are eight classes of such items taken into consideration in the income determination:

1. Principal residence of taxpayer
2. Additional residences
3. Servants employed
4. Automobiles
5. Yachts
6. Power Boats
7. Private airplanes
8. Race horses

Each item is given an income equivalent. For instance, if the taxpayer employs a single servant in his home, it is presumed that his annual income cannot be less than 1,215 dollars. Each additional servant indicates an additional income of 1,822 dollars. Automobiles have an income equivalent of about 30 dollars per United States brake horsepower. Residences are given an income equivalent of the annual rental value multiplied by a factor of three to six.

In addition, if the taxpayer owns property in more than three of the above classes, his taxable income is increased further from twenty five percent (four classes) to one hundred percent (more than six classes). 2 COOPERS & LYBRAND, INTERNATIONAL TAX NEWSLETTER 10 (1959).

to the United States than is his citizen counterpart. There are several reasons for this. First, many resident aliens are not aware that their non-United States source income is subject to United States income taxation. Many of them are also unaware of the United States foreign tax credit,²⁶ and feel that it is unfair to have to report the same income to more than one country. Second, even when the resident alien is aware that this income is required to be reported, he may feel that there is little chance of discovery by the United States of his foreign source income.²⁷ The third possible reason is that the alien, not having primary allegiance to the United States, may feel no great moral obligation to cooperate with the United States tax authorities.

The second method of obtaining specific intelligence—examination of the taxpayer's books and records—is also much more difficult to use effectively outside of the United States. As the internal revenue agent has no powers available to him that would authorize him to compel the production overseas of the books and records,²⁸ he must rely to a great extent on the alien's cooperation. But here also, too much reliance cannot be placed on this procedure.²⁹

The next source of specific intelligence—recourse to third parties having dealings with the taxpayer—also leaves a great deal to be desired. As mentioned, United States revenue agents have no official authority in a foreign jurisdiction,³⁰ and third parties may well prove uncooperative. Third parties have no particular motivation to assist the United States in enforcing its tax laws against one of their fellow countrymen.³¹ Moreover, hostility or indifference may also be encountered on the part of the foreign country's government officials.³² Thus, the absence of power to

26. See § 901.

27. "Psychologically, if a United States taxpayer knows information on his income from (abroad) is not beyond the reach of the Internal Revenue Service, he is likely to be stimulated to report correctly in the first place." Caplin, *International Cooperation in the Field of Taxation*, 14 TAX EXEC. 324, 326 (1962).

28. *Id.* at 327; See Newman, *Tax Administration in Striped Trousers: The International Operations Program of the Internal Revenue Service*, 12 TAX. L. REV. 171 (1957); In Europe, accounting data constitute only one factor considered in the determination of taxes. See note 25 *supra*. McCULLOUGH, *THE FINANCIAL EXECUTIVE, THE COMMON MARKET, AND TAXES* 45 (1960).

29. "[Enforcement] has presented formidable problems in countries where business has not installed adequate accounting or bookkeeping systems, where more transactions are carried out in cash than by check, where there is a high proportion of small farmers or small businessmen who keep only meager records of their operations." PATCH, *EUROPEAN TAXES AND TAX EVASION* 672 (1952).

30. Caplin, *supra* note 27, at 327; Newman, *supra* note 28, at 202.

31. Tax Enforcement in many countries presents formidable problems because of the absence of voluntary compliance, and the general feeling that out-witting the tax collector is a fine sport. See PATCH, *supra* note 29; According to a survey by the United States Mutual Security Agency, tax enforcement in Europe has not presented serious problems in Belgium, the Netherlands, the Scandinavian countries, or West Germany. *Tax Receipts of Selected European Countries Participating in the Mutual Security Program*. (Mimeographed publication March 31, 1952).

32. For instance, in Latin America, there is a traditional reluctance on the part of

compel testimony, the lack of access to the records of third parties, and the reluctance of third parties to assist a foreign government's tax officials, combine to make the gathering of this kind of information very difficult. On the other hand, quite often the foreign government will assist our government in obtaining the information on an informal basis.

Because of the severe restrictions on the obtaining of information outlined above, a measure of reliance must be placed on paid informers. This source of information is not entirely satisfactory, however, since it is often difficult to verify the information received. Moreover, some countries have laws prohibiting "economic espionage,"³³ and the Internal Revenue Service would not be party to the violation of a foreign law. However, when the informer offers information to the United States authorities, the government will not overly concern itself with the means employed to obtain the information.

c. Activities of United States Citizens Overseas

The United States is not nearly as impotent in obtaining information as to the income of its citizens abroad as it is in obtaining information as to aliens. Of course, the basic problem still exists—the absence of extra-territorial effect of our laws.

There are a few sources of general intelligence available to United States tax authorities concerning the overseas activities of United States citizens. One type of information received from third parties stems from the requirement that United States citizen or resident officers and directors of foreign corporations must notify the Internal Revenue Service upon formation of the corporation, when any United States person³⁴ owns five percent or more in value of the stock.³⁵

Another "third party" type of general information is obtained through some of our tax treaties which provide for the automatic exchange of information regarding dividends, interest, and other fixed and determinable income paid to persons with addresses in the other country, but these provisions appear only in a few treaties.³⁶

governments to take rigorous enforcement action against tax evaders. But some countries have instituted criminal penalties for evasion, and others have given their tax officials greater authority. Caplin, *supra* note 27, at 331.

33. *E.g.*, Switzerland.

34. "Person" includes both citizens and resident aliens. See § 7701(a)(30).

35. Section 6046(a); Treas. Reg. § 1.6046-1(j) (1962). The return is due within either ninety days after the formation of the corporation, or after the five percent requirement is first met. See text, p. 51, *infra*.

36. Treaty with Canada, Art. XX; Treaty with France, Art. 9; Treaty with Netherlands, Art. XXI; Treaty with Norway, Art. XVI; Treaty with Sweden, Art. XVI. For treaty citations, see note 45, *infra*.

Under the treaty with Canada, for instance, the United States in 1961, furnished Canada with more than 150,000 information returns, which represented income of about one hundred and fifty million dollars. Caplin, *supra* note 27, at 327.

There are several instances where information returns (in addition to the usual tax returns) are required to be filed by the United States taxpayer himself.³⁷ The obligation to notify the Internal Revenue Service upon the formation of a foreign corporation³⁸ is also imposed on the five percent shareholder himself.³⁹ A second instance in which an information return is required is when a United States taxpayer forms, or makes a transfer to, a foreign trust.⁴⁰ These, however, are basically onetime requirements. As long as there is no change in status, no further information returns are required. On the other hand, annual information reports are required⁴¹ from persons "controlling"⁴² foreign corporations. These reports furnish the government with a great amount of information which it can use to determine whether any transactions taxable in the United States have occurred.⁴³

While the information gleaned from these reports has given the Internal Revenue Service a more accurate picture of the foreign activities of United States taxpayers, reliance must necessarily be placed on the veracity of the taxpayer himself. Fortunately, the United States citizen, overseas or not, will usually file accurate returns, and will cooperate fully with his government. However, when the taxpayer fails to give correct information, or fails to file the return required, penalties⁴⁴ are imposed. But here, as in other instances where dependence for information is placed on the taxpayer, it is difficult to detect violations without information from independent sources.

Of course, while there are defects inherent in a system which relies on the taxpayer himself for the furnishing of information, few alternatives exist. For instance, it would be useless to require a report from the foreign trustee of a foreign trust established by a United States taxpayer, since there is no way of enforcing this requirement. One other solution that might be proposed would be to impose the annual foreign corporation report requirement on the corporation's officers and directors, instead of on those "controlling" the corporation. But since the officers and directors are chosen by those controlling the corporation, their independence is questionable.

37. This applies to both resident aliens and citizens.

38. See note 35 *supra*. See also text, p. 51, *infra*, for a discussion of the statutory provision.

39. Section 6046(a); Treas. Reg. § 1.6038-2(k) (1962) provides that where two or more persons are required to furnish the same information, they may file a joint information return (Form 2952).

40. Section 6048.

41. Section 6038(a).

42. With minor variations, the attribution rules of § 318(a) apply; see § 6038(d)(1).

43. For instance, the annual information returns required under § 6038 provide for eleven different categories of information, both as to financial position and detailed summaries of transactions. See Treas. Reg. § 1.6038-2(f) (1962).

44. Both civil and criminal.

Specific intelligence is also less difficult to obtain when a United States citizen is involved, although the handicaps are still formidable. The absence of official investigative authority is still the major impediment, but the revenue agent is less likely to encounter the same reluctance of persons to give information when our nationals are involved. By the same token, foreign governments will often be more cooperative in assisting our agents in obtaining information as to our citizens' activities in their country.

Most of the tax treaties to which the United States is a party contain provisions providing for exchange of information upon specific request,⁴⁵ but some of these treaties restrict this power to situations where taxpayers might wrongfully seek to take advantage of treaty provisions providing for lower rates of tax.⁴⁶

B. Collection

1. GENERAL CONSIDERATIONS

Intelligence is a vital function, but in a sense it is only a preliminary one. For once the identity of the taxpayer and the extent of his liability are determined, the taxes must then be collected. A government may have established a most efficient and effective intelligence operation, and even have identified all possible taxable transactions; it may have accurately determined the actual tax liability of each one of its taxpayers, only to find that all its efforts were for naught. For the ultimate success or failure of a program of tax administration depends on the amount of taxes ultimately reaching the coffers of the nation's treasury.

45. Treaty with Australia, Art. XVIII(1), 4 U.S.T. & O.I.A. 2274, T.I.A.S. 2880; Treaty with Austria, Art. XVI(1), 8 U.S.T. & O.I.A. 1699, T.I.A.S. 3923; Treaty with Belgium, Art. XV(1), 4 U.S.T. & O.I.A. 1647, T.I.A.S. 2833; Treaty with Canada, Arts. XIX, XXI, 50 Stat. 1399, T.S. 920; Treaty with Denmark, Art. XVII, 62 Stat. 1730, T.I.A.S. 1854; Treaty with Finland, Art. XVII, 3 U.S.T. & O.I.A. 4485, T.I.A.S. 2596; Treaty with France, Arts. 8(1), 11, 59 Stat. 893, T.S. 988; Treaty with Germany, Art. XVI(1), 5 U.S.T. & O.I.A. 2768, T.I.A.S. 3133; Treaty with Greece, Art. XVIII, 5 U.S.T. & O.I.A. 47, T.I.A.S. 2902; Treaty with Honduras, Art. XVIII(1), 8 U.S.T. & O.I.A. 219, T.I.A.S. 3766; Treaty with Ireland, Art. XX(1), 2 U.S.T. & O.I.A. 2303, T.I.A.S. 2356; Treaty with Italy, Art. XVII, 7 U.S.T. & O.I.A. 2999, T.I.A.S. 3679; see Rado, *The Tax Convention Between the United States and Italy*, 14 TAX L. REV. 203, 220 (1959); Treaty with Japan, Art. XVII(1), 6 U.S.T. & O.I.A. 149, T.I.A.S. 3176; Treaty with Luxembourg, Art. XVIII(1),—U.S.T. & O.I.A.—, T.I.A.S.—, CCH TAX TREATIES ¶ 5302 (Feb. 1965); Treaty with the Netherlands, Art. XXI, 62 Stat. 1757, T.I.A.S. 1855; Treaty with New Zealand, Art. XVI(1), 2 U.S.T. & O.I.A. 2378, T.I.A.S. 2360; Treaty with Norway, Art. XV, 2 U.S.T. & O.I.A. 2323, T.I.A.S. 2357; Treaty with Pakistan, Art. XVI(1), 10 U.S.T. & O.I.A. 984, T.I.A.S. 4232; Treaty with South Africa, Art. XIV, 3 U.S.T. & O.I.A. 3821, T.I.A.S. 2510; Treaty with Sweden, Arts. XV, XVIII, 54 Stat. 1759, T.S. 958; Treaty with Switzerland, Art. XVI(1), 2 U.S.T. & O.I.A. 1751, T.I.A.S. 2316; Treaty with the United Kingdom, Art. XX(1), 60 Stat. 1377, T.I.A.S. 1546.

46. However, there are fewer such restrictions in those treaties merely providing for exchange of information than there are in treaties providing for collection assistance.

2. DOMESTIC ASPECTS

a. Pay-As-You-Go

The most effective way of collecting taxes is to have the tax withheld at the source of the income, and to have the withholding party remit it directly to the government. Psychologically, there is probably less of a traumatic shock to the taxpayer when he never sees the money as compared to when he has to physically part with it after receiving it.

In the United States, taxes applicable to wages earned by employees are required to be withheld by all employers,⁴⁷ and remitted by them directly to the government⁴⁸ at least quarterly.⁴⁹ Although the tax withheld may not exactly equal the actual tax liability, any required adjustment is made when the employee files his annual income tax return. As mentioned previously, the withholding system also provides an important intelligence feature in that the government is simultaneously informed of the wage earner's salary income.

Another feature of our domestic tax system that also serves to spread the tax burden evenly over the tax year is the system of estimated tax payments.⁵⁰ This is an extension of the pay-as-you-go feature to all other types of income. By this method, the government is able to collect a large portion of its taxes even before any tax returns are filed. Of course, the estimated tax system is based upon a taxpayer's own declarations, and the tax is paid by the taxpayer himself, rather than by any third party.

b. Payment with Return

The second method of tax collection in the United States is accomplished through payment submitted by the taxpayer with his return,⁵¹ or by payment made voluntarily after assessment by the government.⁵² Apart from income tax withheld from the wages of employees, this is by far the most typical method of collection. Once it has been determined that a deficiency exists, most taxpayers proceed to liquidate that deficiency voluntarily, either by remitting payment with the return, or, when the deficiency arises subsequent to an examination by the Internal Revenue Service, after a formal request for payment is made.

47. Section 3402(a).

48. Payment is made to a government depository if so required under Treas. Reg. § 31.6302(c)-1 (1960).

49. Treas. Reg. § 31.6011(a)-4 (1959); the Commissioner of Internal Revenue may require monthly payments if the withholding agent is remiss in his duties. See § 7512(b).

50. Section 6153(a).

51. Section 6151.

52. Section 6155.

c. Enforcement Procedures

When the taxpayer does not meet his tax obligations voluntarily, the Internal Revenue Service has broad powers to resort to self-help by seizing the taxpayer's property and using it to satisfy the taxpayer's indebtedness.

Each district director's office contains a collection division, whose revenue officers have the duty to liquidate taxpayers' liabilities for income (and other) taxes. They not only have the power to seize a taxpayer's physical property,⁵³ but may also levy against sums to which the taxpayer is entitled from third parties.⁵⁴ When the taxpayer has transferred his property to others in order to avoid payment of his taxes, the government may still levy against this property in the hands of the transferee.⁵⁵

When the government has reason to believe that its taxes are in jeopardy, either because of the imminent expiration of the limitations period, or the suspected flight of either the taxpayer or his property from the United States, the Internal Revenue Service has the power to institute jeopardy proceedings.⁵⁶ This consists of the termination by the government of the taxpayer's taxable year,⁵⁷ the making of an immediate assessment of an amount at least equal to the taxes which may be owed,⁵⁸ and proceeding to levy upon the taxpayer's property in satisfaction of the assessment.⁵⁹

One aid to the collection process that stems from the intelligence function, is that in the process of determining the taxpayer's income, it is also possible to determine the nature, extent, and location of the taxpayer's property. As a result, both time and duplication of effort can be spared in satisfying the taxpayer's liability.

3. INTERNATIONAL ASPECTS

a. Collection at the Source

When payments of periodic income are made to nonresident aliens, the payor is generally obligated to withhold thirty percent of the payment,⁶⁰ and remit the withheld amount to the Internal Revenue Service. Income subject to withholding includes compensation for services, fees,

53. Section 6331.

54. *Ibid.*

55. Section 6901.

56. Section 6851(a)(1).

57. *Ibid.*

58. Section 6861.

59. Section 6331.

60. Section 1441(a); Where a tax treaty exists with the country of which the non-resident alien is a citizen, this rate is often reduced. Section 1442 provides for similar withholding on payments to foreign corporations not engaged in trade or business in the United States.

commissions, salaries, remunerations, emoluments, dividends, rentals, royalties, and interest.⁶¹ This periodic income is generally subject to a flat thirty percent tax rate, and the withholding usually satisfies in full the tax liability of the nonresident alien attributable to this income.⁶² Since a large proportion of United States source income derived by nonresident aliens is periodic income, collection from this class of taxpayers is greatly facilitated.

b. Payment with Return

When the taxpayer resides outside of the United States, and incurs liability for United States income tax that is not satisfied by withholding at the source, he is required to make full payment with his tax return. The motivation for making payment is greater in cases when the taxpayer has property in the United States because of an awareness that the government can use his property to satisfy his tax liability should he fail to do so. When the income is derived from the conduct of a trade or business in the United States, business property may exist which can be used to satisfy the tax claims of the government.

When the taxpayer has no property in the United States which can be levied upon to satisfy his tax obligations, his motivation to pay his taxes may not be great, and collection is accordingly rendered quite difficult. However, an errant taxpayer, if an alien, should realize that he may have difficulty in reentering the United States in the future, especially if he failed to obtain a tax clearance when he left.⁶³ However, when the taxpayer has no property in the United States, and does not intend to return, the taxes owed will generally prove uncollectible.

c. Enforcement Procedures

Several alternatives are open to the Internal Revenue Service when it seeks to collect taxes from a taxpayer who resides outside of the United States. First, of course, if the taxpayer has property of any kind in this country, it may be levied upon to satisfy his liability. There is little difficulty in accomplishing this, since the government has statutory authority to do so, and our courts will recognize any action taken pursuant to this authority.

The second alternative is to attempt to collect the taxes in the foreign country in which the taxpayer has resided. Unfortunately, under the present state of international law, legal efforts to enforce the claim will fail, for a country will generally refuse to enforce any claim by another

61. Section 1441(b); T.I.R. 706 (March 11, 1965).

62. Section 871(a).

63. The Office of International Operations entered into an informal agreement with the State Department in September, 1963, whereby the Internal Revenue Service is to supply the names of delinquent aliens to the State Department. The departing alien might therefore encounter difficulty upon his re-entry to the United States.

country arising from a liability for taxes.⁶⁴ The third alternative is for the government to wait until the taxpayer or some of his property reenters the United States, and then attempt to levy upon any assets in our jurisdiction.⁶⁵

d. Tax Treaties

Several of our tax treaties provide that one country will assist the other in collecting taxes from persons in the other country.⁶⁶ Some treaties have denied the application of these provisions to the collection of taxes owed by citizens of the country whose collection aid is sought.⁶⁷ Other treaties have restricted application of the collection provisions to the collection of taxes evaded through wrongful use of treaty benefits.⁶⁸ For reasons to be discussed later, not much use has been made of these collection provisions, and, as used, these provisions have not proved of much assistance in facilitating collection of taxes.⁶⁹

II. CURRENT ENFORCEMENT TOOLS

A. General Considerations

Thus far we have endeavored to indicate some of the problems that arise from the international application of the functions of intelligence and collection. It should be evident at this point that serious limitations are imposed upon a government's power to enforce its revenue laws outside of the confines of its borders. But some enforcement tools are available to the tax administrator, and the difficulties or complexities of

64. See Part III *infra*, p. 66 *et seq.*

65. Generally, after an assessment is made, the government has six years within which to either levy on the taxpayer's property, or to collect via a court proceeding (Section 6502(a)). However, where collection is hindered or delayed because the taxpayer's property is situated or held outside the United States, the six-year period is suspended for the period collection is so hindered or delayed. This suspension cannot continue for more than six additional years (making a maximum total of twelve years). Section 6503(c).

66. Treaty with France, Art. 12 (restricted effective Jan. 1, 1950); Treaty with the Netherlands, Art. XXII(1),(2),(3) (but does not apply as to citizens of state to which application is made. See note 67 *infra*); Treaty with Sweden, Art. XVII; *op. cit. supra*, note 45.

67. *E.g.*, Treaty with France, Art. 12(5) (added by Art. I(1) of Supplementary Protocol effective Jan. 1, 1950).

68. Treaty with Australia, Art. XVI; Treaty with Finland, Art. XVIII; Treaty with Germany, Art. XVI(2); Treaty with Greece, Art. XIX and protocol, Jan. 1, 1953; Treaty with Honduras, Art. XVIII(2); Treaty with Italy, Art. XVIII; Treaty with Japan, Art. XVII(2); Treaty with the Netherlands, Art. XXII(4) (This restricted provision applies only where a request is made regarding a citizen of the state to which application is made. Otherwise, the general collection provisions apply); Treaty with New Zealand, Art. XVII; Treaty with Norway, Art. XVII (the treaty as originally signed provided for general reciprocal collection, but the United States Senate conditioned its approval on its modification); Treaty with South Africa, Art. XV (broad collection provisions modified by United States Senate in protocol signed July 14, 1950); Treaty with Switzerland, Art. XVI(2); *op. cit. supra*, note 45.

69. See "Tax Treaties," p. 00 *infra*.

enforcement should not justify making the evader's lot any easier than is necessitated by present limitations.

In the United States, the recognition of abuses in the international area led to mobilization against the international evader. This mobilization took the form of organizing the Office of International Operations within the Internal Revenue Service in order to better cope with international problems administratively; enactment of statutory aids to international enforcement; and an attempt at international cooperation through the negotiation of bilateral tax treaties. These have been comparatively recent developments.⁷⁰

In order to determine where even greater improvements might be made in combatting international evasion, it is necessary to analyze these enforcement tools, and to examine the manner in which they are being wielded.

B. *Office of International Operations*

1. BACKGROUND

Prior to 1955, the Internal Revenue Service was poorly equipped to deal efficiently with international problems. Responsibility for handling cases with international aspects was distributed among the many district directors' offices throughout the United States. In each office, cases with international aspects represented a small portion of the annual volume, but usually contained complexities out of proportion to their number. No one district could afford to allocate sufficient personnel or resources to this area without sacrificing other district office functions considered of greater importance.⁷¹

In 1955, a survey was made by the Treasury Department, and several investigators were sent to Europe to check on the level of compliance by our overseas taxpayers. Their findings established that compliance was at a low level,⁷² and this was attributed to two principal factors.

The first was the unfamiliarity of taxpayers abroad with our worldwide source rules, and their lack of knowledge that the exclusion of overseas earned income⁷³ does not eliminate the need for filing a tax return.⁷⁴

70. Caplin, *International Cooperation in the Field of Taxation*, 14 TAX EXEC. 324, 327 (1962); "For long centuries, national boundaries have served as the door to sanctuary for fugitives from justice, including the evader. It is only within our lifetime that inroads have been made on the tax evader's safe retreat."

71. *Office of International Operations of the Internal Revenue Service, Machinery and Allied Products Institute* 11 (1964).

72. Newman, *supra* note 28, at 171.

73. Section 911(a).

74. Prior to 1958, a return was still required where the taxpayer had other than "earned income." Since 1958, § 6012(c) has required a return, even when the exclusion of income under § 911(a) was being claimed.

Of course, unfamiliarity with our laws does not constitute a valid excuse for noncompliance, but it must be remembered that educational and informational facilities for taxpayers are not as readily available overseas. For instance, in the United States, help is often only a telephone call away, since Internal Revenue Service offices, attorneys and accountants are readily accessible to all taxpayers.⁷⁵

The second reason found by the investigators was the lack of any coherent government audit function, and the absence of any front-line enforcement procedures.⁷⁶ After all, it is difficult to check on a taxpayer's activities from thousands of miles away.

On August 22, 1955, the International Operations Division of the Internal Revenue Service was established. Organizationally, it was a part of the Baltimore district director's office, with headquarters in Washington. In the IOD were concentrated all international enforcement functions which previously had been the province of the many district directors.

At the time of its organization, its stated mission⁷⁷ was to "provide for the centralization of responsibility for the international operations of the Internal Revenue Service, and to obtain better administration of Service affairs abroad." It was given primary responsibility for the administration of the United States internal revenue laws in all areas of the world outside of the geographical jurisdiction of the United States.

Among the functions assigned to the International Operations Division were:

1. The taking of appropriate and necessary action to maintain a satisfactory level of voluntary compliance among United States taxpayers residing, located or doing business in the geographical areas assigned; and
2. The audit of returns of nonresident taxpayers, the collection of delinquent accounts of such nonresidents, . . . the conduct of surveys and investigations concerning delinquency and evasion in the assigned areas, the conduct of military and other taxpayer education and assistance programs abroad, the maintenance of close liaison with the military services concerning Federal tax matters, the executive direction of Service personnel temporarily detailed or permanently stationed in the assigned areas, and other responsibilities necessary or incident to the proper administration and enforcement of the tax laws with respect to taxpayers residing, located or doing business in the assigned areas of responsibility.⁷⁸

75. Newman, *supra* note 28, at 172.

76. *Id.* at 176.

77. Rev. Proc. 55-2, CB 1955-2, at 898.

78. *Ibid.* See *Office of International Operations*, *supra* note 71, at 11.

In 1960, the International Operations Division became the Office of International Operations, and was made a part of the National Office of the Internal Revenue Service as part of the Office of Assistant Commissioner (Compliance). The Assistant Commissioner (Compliance) is charged with directing, coordinating and evaluating the work of the OIO.⁷⁹

2. FUNCTIONS⁸⁰

The Office of International Operations is headed by a "Director of International Operations," whose mission is to:

Encourage and achieve the highest possible degree of voluntary compliance with the Internal Revenue Code and related statutes on the part of citizens residing or doing business abroad, foreign taxpayers deriving income from sources within the United States, and taxpayers required to withhold tax on certain payments to nonresident aliens and foreign corporations.⁸¹

The Director accomplishes his mission by:

1. Administering and enforcing the provisions of the Internal Revenue Code and related statutes in all areas of the world outside the United States;
2. Administering the provisions of tax conventions with foreign governments concerning the exchange of information, reciprocity in tax collection, consideration and processing of claims alleging double taxation, preparation and issuing of determination letters, and all other provisions of tax conventions (except those relating to the preparation of regulations and rulings concerning the interpretation of tax conventions);
3. Administering the law relating to the withholding of tax on certain payments to nonresident aliens and foreign corporations;
4. Coordinating for the Service all foreign tax investigations and requests for information (other than those relating to regulations or rulings or in the area of general assistance in the field of administration) from foreign countries or United States possessions;
- ...
7. Coordinates foreign travel of Service personnel, and maintains foreign posts.⁸²

79. *Id.* at 12.

80. CCH 1965 STAND. FED. TAX REP. ¶ 5983, reprinted from *Statement of Reorganization and Functions*, TREAS. DEPT. PUBL. No. 383 (Rev. 7-62).

81. *Id.* Treas. Reg. § 113.56 (1962).

82. *Ibid.*

It is readily apparent from the above that the missions of the Office of International Operations and its director are comprehensive in the international enforcement area. By centralizing all international functions in one office, a well-coordinated enforcement program is thereby facilitated.

3. ADMINISTRATION AND ENFORCEMENT

In less than ten years, the Office of International Operations has grown from a four-man unit into a substantial branch of the Internal Revenue Service with approximately five hundred employees.⁸³ Generally, the OIO operates like any district director's office, with collection, audit, and intelligence divisions. But in addition, the OIO has two units peculiar to its specialized operation. The first is the Executive Assistant to the Director, who in addition to assisting the Director in the carrying out of his duties, is charged with the conduct of foreign posts, and general intra and inter-agency liaison and coordination. The second unit is the Operational Research Staff, which, among other duties, is charged with devising methods of detecting international tax evasion, and devising procedures for minimizing tax avoidance.⁸⁴

In addition to its national office functions, the OIO also has agents assigned to various district directors' offices to assist local revenue agents in any cases with international aspects. These agents work directly through the local district directors, although general international policy originates at the national office level. As a result of the availability of OIO agents at the local level, cases originating in district directors' offices may be processed on a local level, without the necessity of referring them to Washington each time an international aspect appears. It apparently is hoped also that the easier accessibility to OIO experts will encourage local revenue agents to seek their assistance more often.

4. FOREIGN POSTS

The OIO operates abroad primarily through its foreign posts. These "posts" consist of agents permanently stationed overseas, and attached to various United States embassies.⁸⁵ The OIO now has, or expects to have shortly, seventeen agents stationed in nine different countries.⁸⁶ These agents have diplomatic status, and while operationally under the direction of the OIO, are primarily responsible for their activities to the United States ambassador of the country in which they are stationed or operate.

83. Fox, *Functioning of the Office of International Operations*, 22 N.Y.U. TAX INST. 735, 736 (1964).

84. *Id.* at 739.

85. These agents are officially entitled "Revenue Service Representatives."

86. Ottawa, Canada 2; Sao Paulo, Brazil 2; Paris, France 3; London, England 2; Manila, Phillipines 4; Tokyo, Japan 1; Rome, Italy 1; Bonn, West Germany 1; Mexico City, Mexico 1.

These agents constitute the "front-line troops" whose absence was thought to account for the low measure of compliance by United States taxpayers overseas. They represent the Internal Revenue Service abroad, and serve varied functions, including assistance of taxpayers in the preparation of their United States income tax returns.⁸⁷

It is, however, the enforcement functions performed by these agents that are of primary interest to our discussion. First, there is the intelligence function.

When a revenue agent or a special agent (intelligence division) is investigating a case in the United States, and finds that information is required that can only be obtained in a foreign country, the agent will request that the information be secured by the OIO agent in the country concerned. From an administrative point of view, this policy seems preferable to one where our domestic agents would be constantly traveling back and forth. Because of diplomatic ramifications, it seems more desirable that an agent who has intimate knowledge of conditions in the country concerned be charged with responsibility for the acquisition of the required information.

One problem in attempting to procure information in a foreign country is that even the local tax officials may not have the legal power to compel their own citizens to come forward with information in tax matters.⁸⁸ But when the cooperation of the foreign tax official is an important factor in obtaining information, the personal contact that the overseas agent has with these officials often is a determining factor in achieving success.

Even though the Revenue Service Representative has no official investigative authority abroad, he is often able to obtain information on an informal basis in the same manner, for instance, as a private detective would in this country. In addition, the fact that he is unable to compel production of information does not necessarily mean that he is unable to obtain voluntary cooperation, especially from other United States taxpayers. Very often, the mere fact of personal contact with United States taxpayers overseas is sufficient to prod "voluntary" compliance.

Personal contact is often sufficient to insure collection of delinquent

87. *Office of International Operations*, *supra* note 71, at 16.

88. Fox, *supra* note 83, at 737; Caplin, *International Cooperation in the Field of Taxation*, 14 TAX EXEC. 324, 326 (1962); One solution to this problem lies in the field of tax treaties. For instance, for the implementation of the double taxation convention of March 30, 1949, between Sweden and the United Kingdom, England enacted § 353(2) of the Income Tax Act of 1952, which provides that the obligation to secrecy imposed by any United Kingdom enactment shall not prevent the United Kingdom Revenue authorities from disclosing to any officer of the Swedish government such information as is required to be disclosed under the treaty. See KOCH & EKENBERG, *TAX RELATIONS BETWEEN THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND AND THE KINGDOM OF SWEDEN* (International Bureau of Fiscal Documentation 1956).

taxes. Overseas taxpayers sometimes lose their sense of insulation from our tax laws when the presence of the Internal Revenue Service is felt close at hand. Even when the United States taxpayer refuses to pay his delinquent taxes, the Revenue Service Representative may be able to peruse his activities so as possibly to detect the contemplated transfer of property to the United States which might then be levied upon to satisfy the taxpayer's liability.

In addition to obtaining information and attempting to collect taxes, the overseas agent also performs some audit functions,⁸⁹ although the successful performance of this function, as noted, depends on taxpayer cooperation.

5. OPERATIONAL RESEARCH STAFF

The need to learn more about the expanding overseas activities of United States taxpayers, and the tax implications of those activities, led in 1960, to the creation of the Operational Research Staff.⁹⁰ This unit is comprised of some of the most experienced OIO agents, and includes several attorneys. Among its assigned functions are the preparation of analytical studies of technical problems and tax avoidance schemes in the international area for the purpose of disclosing Internal Revenue Code provisions that are weak, ineffective, inconsistent, or unjust.⁹¹ It also prepares plans and programs to combat tax avoidance and evasion in the international area. The efforts of the Operational Research Staff spotlighted patterns of tax avoidance which were helpful to the Treasury Department in the formulation of its legislative recommendations which were enacted in the Revenue Act of 1962.⁹² The Staff now is composed of a number of two-man attorney-agent teams, which can be deployed on projects independently as problems arise. Part of the staff's effectiveness is a result of its liaison with the International Operations Branch of the Chief Counsel's office, for coordination of the legal aspects of cases, and with the Treasury Department's International Tax Affairs section for coordination of policy.

6. EFFECTIVENESS

Through the activities of the OIO, relative chaos has been replaced by a systematic, coordinated, and large-scale enforcement effort in the international area. Although the OIO is severely handicapped by extraterritorial impotence, it is probably doing the best that can be expected under present conditions. The key to future effectiveness lies in the area of international cooperation among tax authorities. But many foreign gov-

89. Fox, *supra* note 83, at 739.

90. *Ibid.*

91. Treas. Reg. § 113.562 (1962); *Statement of Organizational Functions*, *supra* note 80.

92. *Ibid.*

ernments do not share our concern over tax evasion, and it will probably take time until fullscale international cooperation can be achieved.

Probably the greatest significance of the OIO has been that its establishment as a permanent enforcement agency manifests the determination of the Internal Revenue Service to do all within its power to control international tax evasion.

C. Statutory Aids

While many of the powers conferred on the Internal Revenue Service by statute are available for use in cases with international aspects, these powers can generally only be exercised within the jurisdictional limits of the United States. There are, however, several statutory provisions that primarily apply to the international area, and they are exercised at the point where the overseas taxpayer comes into contact with the United States, either by his physical presence, the presence of his income-producing property, or the presence of his agents.

1. SAILING PERMITS

Generally, the United States citizen may travel abroad freely, without any necessity of settling his accounts with the Internal Revenue Service before departing from the United States. However, if the Service determines that the imminent departure of the citizen or of his property is motivated by a desire to evade payment of his taxes, the Commissioner of Internal Revenue has the power to terminate the citizen's taxable year, make immediate demand for payment of all taxes due, and proceed to collect such taxes if not immediately paid.⁹³ But this provision is exercised against the United States citizen only in extraordinary circumstances when the Internal Revenue Service has good reason to suspect foul play.⁹⁴ Ordinarily, a United States citizen will return, and not attempt to use his departure as a means of evasion.⁹⁵ In any event, the relatively few instances when a United States citizen will be involved in evasion by permanently removing himself from the jurisdiction of the United States apparently do not justify the imposition of an additional tax reporting or payment burden because of his travel abroad.

This is not true when the departing traveler is an alien, whether resident or nonresident. An alien is not bound to our country by the same ties of loyalty as is a citizen, and is not subject to the same suasion overseas as would be an American citizen. Congress therefore believed that aliens should be required to settle their tax liabilities with the Internal Revenue Service before being permitted to leave our jurisdiction, and

93. Section 6851(a).

94. Section 6851(c).

95. Newman, *Tax Administration in Striped Trousers: The International Operations Program of the Internal Revenue Service*, 12 TAX L. REV. 171, 208 (1957).

accordingly enacted a provision of the Internal Revenue Code requiring aliens to obtain certificates of compliance (Sailing Permits) from their local district director prior to each departure.⁹⁶ Exceptions are made, however, for employees of foreign governments or international organizations, certain alien students and industrial trainees, and other aliens only temporarily present in the United States.⁹⁷

Generally, the departing alien will have to satisfy the examining agent that taxes for all prior years have been paid, and will have to pay any taxes that are due for the period up to his departure, notwithstanding the fact that his taxable year would not have been terminated but for his departure, or that his taxes for the preceding taxable year would otherwise not yet be due.⁹⁸

The internal revenue agent may, however, waive the requirement of payment of taxes if he is satisfied that the taxpayer's departure will not jeopardize the payment of taxes due at a later date.⁹⁹ When however, the agent is not willing to waive the immediate payment of taxes, the taxpayer must either pay them, or post a bond for the full amount of taxes due.¹⁰⁰

We have spoken of the duties imposed on departing aliens by the sailing permit provisions. Now we turn to how effectively these provisions are being enforced. The regulations state that:

An alien who presents himself at the point of departure without a certificate of compliance, or evidence establishing that such a certificate is not required, will be subject at such departure point to examination by an internal revenue officer or employee and to the completion of returns and statements and payment of taxes¹⁰¹

A literal reading of this provision would seem to envision the presence of internal revenue agents at all airports, steamship terminals, railway stations, and border crossing stations, at points of departure from the United States. If this were the case, this provision would indeed be an effective enforcement tool, and would prevent a great deal of tax revenue from permanently being diverted from our treasury.

Unfortunately, this is not the case in practice. While merely being "subject to" examination at the point of departure might induce the departing alien to obtain his sailing permit, there presently is little done by the Internal Revenue Service to enforce this provision on a regular

96. Section 6851(d).

97. Treas. Reg. § 1.6851-2(a)(2)(ii) (1961).

98. Treas. Reg. § 1.6851-2(b) (1961).

99. Section 6851(d)(2).

100. Section 6851(e).

101. Treas. Reg. § 1.6851-2(a)(1) (1961).

basis. In specific instances, of course, if the Internal Revenue Service has reason to suspect that an alien is about to depart without obtaining the required clearance, an agent may be sent from the district director's office to inform the alien that he may not leave without obtaining this clearance.

The Internal Revenue Service has chosen to rely for enforcement of the sailing permit provisions on ticket clerks employed by the transportation companies at the various airline and steamship terminals. In other words, when an alien presents his ticket and passport at the time of departure, the clerk is supposed to ask him for his sailing permit, and refuse him passage when he fails to exhibit it.

If this procedure were followed in all instances, it would indeed result in a savings of manpower for the Internal Revenue Service, without a corresponding decrease in enforcement efficiency. Reliance on ticket clerks has proven to be completely unrealistic, however, since in practice enforcement is at best sporadic.

While the failure of the transportation companies to enforce the sailing permit provisions enthusiastically is not to be looked upon with favor, several factors may explain their attitude:

1. No statute or regulation obligates the transportation companies to enforce the sailing permit provisions.
2. No sanctions, monetary or otherwise, are available to compel the companies to enforce the provisions.
3. The companies might well feel that enforcement of the revenue laws is the function of the Internal Revenue Service, and not of the carrier.
4. Competitive considerations discourage the carriers from running the risk of antagonizing passengers.
5. Loss of revenue might result from denying passage to a non-complying alien.
6. Fear of being subject to legal action when their conduct (resulting in a passenger missing his flight, for instance) is not required by law.

One other factor contributing to poor enforcement in this area, is the lack of centralized responsibility for enforcing the sailing permit provisions. Each district director is charged with enforcement of the provisions, and there is a resulting lack of coordination on a national level.

Reform in this area is seriously needed, both legislatively and administratively. If effectively wielded, the sailing permit provisions could

be a formidable weapon in the arsenal against the international tax evader.¹⁰²

2. INFORMATION RETURNS

With the advent of the International Operations Division in 1955, the Internal Revenue Service was able to obtain a clearer understanding of the overseas activities of our taxpayers. However, in its efforts to make an accurate analysis, the Service was hampered by the lack of reliable information as to the precise machinations employed by taxpayers to minimize taxes. In any event, even on the basis of the limited information available to it, it was apparent that abuses were widespread, and that reform was needed, both in strengthening substantive tax provisions, and in increasing the flow of information reaching the Service.

a. Section 6038¹⁰³

Prior to 1960, the Internal Revenue Service received no systematic reports concerning the activities of foreign corporations controlled by United States taxpayers. As a result, many questionable transactions were escaping Service scrutiny. Senator Gore, in 1960, was quoted as saying:

The Treasury and the Internal Revenue Service never know under which shell, if any, certain transactions may be found.¹⁰⁴

In order to enable the Service to police this area more closely, Congress added Section 6038 to the Internal Revenue Code of 1954.¹⁰⁵ As originally enacted, the section required domestic corporations to give detailed information as to both corporate structure and activities of foreign corporations in which they owned more than fifty percent of the voting stock. The penalty for failing to comply with the reporting requirement was a reduction of the "indirect" foreign tax credit.¹⁰⁶

In 1962, these reporting requirements were tightened to extend the definition of "control" to ownership of more than fifty percent in value, as well as voting power, of stock;¹⁰⁷ to extend the application of the requirements to any "United States person,"¹⁰⁸ with attribution rules;¹⁰⁹

102. See Part IV, text, *infra*, p. 74, for suggestions as to possible improvement in our sailing permit procedures. One aspect of the sailing permit requirements that has not been mentioned is the desire of the government to simplify travel for tourists from foreign countries. However, this desire must be weighed against the need to protect our revenue, and an effective education program should avoid any ill will that might result from stricter enforcement.

103. See generally, Cohen, *Reporting Requirements with Respect to Foreign Subsidiaries and Affiliates*, 21 N.Y.U. TAX INST. 793 (1963).

104. *Id.* at 793; CONG. REC. May 31, 1960.

105. Int. Rev. News Release IR-485, April 25, 1962; see Treumann, *Recent IRS Audits of Foreign Operations*, 40 TAXES 788, 789 (1962).

106. Section 902.

107. Section 6038(d)(1).

108. Section 6038(a)(1).

109. Section 6038(d)(1).

and to extend the penalty to loss¹¹⁰ of the direct foreign tax credit.¹¹¹ The return required by this section must be filed annually.¹¹²

b. Section 6046¹¹³

In contrast to the annual returns due under Section 6038, which are a comparatively recent innovation,¹¹⁴ information returns were required even under the Internal Revenue Code of 1939 upon the formation of a foreign corporation.¹¹⁵ However, compliance with the notification requirements was at a low level. This may be attributed to the fact that prior to 1960, the requirement for filing the information was imposed on attorneys and other financial advisors who assisted in the organization of the foreign corporation, and compliance was successfully resisted through the claim of the attorney-client privilege.

In 1960, the section was amended to shift the responsibility for compliance to United States officers, directors, and owners of more than five percent of the stock of a foreign corporation, who had such status within sixty days of the formation. However, this provision also proved ineffective, because it was easily avoided by delaying transfer of ownership and control to United States persons until the expiration of the sixty day period.

Finally, in 1962, Congress tightened the requirements¹¹⁶ to include reporting by persons who acquire the status more than sixty days after the formation of the corporation. Unless good cause is shown for failure to comply with this section, a one thousand dollar civil penalty is imposed.¹¹⁷

Although the Internal Revenue Service was assured of more faithful compliance with Section 6046 in regard to foreign corporations formed after the passage of the Revenue Act of 1962, it was believed that there were more foreign corporations controlled by United States taxpayers than was indicated by the some 4800 returns filed up to 1962. Congress therefore also agreed in 1962, to extend the stiffened requirements to all controlled foreign corporations *in existence* on January 1, 1963.¹¹⁸ This provision resulted in the filing of more than 24,000 information reports,

110. Section 6038(b)(1)(A).

111. Section 901.

112. Section 6038(a)(2).

113. See generally Cohen, *supra* note 103, at 795 *et seq.*

114. Since 1960.

115. INT. REV. CODE OF 1939, § 3604(a).

116. The Revenue Act of 1962 has been criticized as being against the international interests of the United States, but one can question whether policy considerations should favor increased international trade motivated by tax avoidance motives. See Cohen, *Common Market Operations of Controlled Foreign Corporations Under the Revenue Act of 1962*, 15 TAX EXEC. 253 (1963).

117. Section 6679(a).

118. Section 6046(a).

thus giving the Internal Revenue Service a clearer picture of "shells" under which taxable transactions might be found.¹¹⁹

c. Section 6048

United States taxpayers have made use of foreign trusts for purposes of substantive tax avoidance. Although the tax advantages of using these trusts were reduced through the Revenue Act of 1962,¹²⁰ the Internal Revenue Service received little information about the activities of these trusts, rendering the area difficult to police.

Congress therefore, in the Revenue Act of 1962, also imposed reporting requirements on the grantor (if an inter vivos trust), the fiduciary (if a testamentary trust), or any transferor, in respect to a trust.¹²¹ A report is required upon the creation of, or any transfer of money or property to a foreign trust. The civil penalty for failure to comply with this provision is five percent of the amount transferred, or 1,000 dollars, whichever is less.¹²²

The broadening of the disclosure requirements by the Revenue Act of 1962 may be a significant contribution to the prevention of international tax evasion in that United States taxpayers are less likely to engage in questionable activities when they are aware that the Internal Revenue Service is scrutinizing their foreign transactions.¹²³

3. WITHHOLDING AT THE SOURCE

Payors of fixed or determinable income are generally required to withhold a portion of any payments made to nonresident aliens¹²⁴ or foreign corporations not engaged in trade or business in the United

119. The Treasury Department has not yet (November 22, 1965) completed tabulation of the results of the strengthened reporting requirements. However, preliminary figures indicate the following:

1. In over fifty percent of the cases in which a United States investor owns five percent or more of a foreign corporation, his ownership exceeds ninety-five percent of the stock of that corporation, and approximately seventy-five percent of the time it is fifty percent or more. These figures are reasonably constant for all geographical areas.

2. United States investments abroad in which the investor owns over five percent of the stock are concentrated in Canada and Europe (about sixty five percent). The bulk of the remaining investment is in Central and Latin America. This is true of both debt and equity investments in these corporations, and applies to undistributed profits as well as to original investment.

These figures represent data collected as of January 1, 1963.

120. See, e.g., § 643(a)(6).

121. Section 6048(a). The return is due within ninety days after liability for filing accrues; Treas. Reg. § 16.3-1(e)(1) (1963). Temporary regulations incorporated into Treas. Reg. § 301.6048-1 (1963).

122. Section 6677(a); In addition, willful failure to file the return may result in criminal penalties under § 7203.

123. Kanter, *Congress Expands Information Reporting Requirements for Foreign Corporate Operations*, 42 TAXES 84, 113 (1964).

124. Section 1441(a). Such "fixed or determinable income" includes interest, dividends, rents, salaries, annuities, and other payments specified in § 1441(b).

States.¹²⁵ The withholding payor then remits the tax withheld to the Internal Revenue Service,¹²⁶ together with a return showing the amount of income paid, the name and address of the recipient, and the amount of tax withheld.¹²⁷ This process accomplishes both an intelligence function (informing the government of the existence of taxable income, and identifying the taxpayer), and a collection function.

Withholding of tax at the source of income is perhaps the single most efficient enforcement tool in international tax administration. This is true for several reasons. The first and most obvious one is that the taxes practically collect themselves. By imposing liability and responsibility for collection on persons within the jurisdiction of the United States, a high degree of compliance is attained, and the legal and administrative problems engendered by extraterritorial enforcement are avoided. Similarly, by shifting the responsibility for payment to a country's domestic subjects, in personam jurisdiction is maintained over them, and all collection and attachment proceedings available in domestic cases may be employed. The other major reason for the high degree of effectiveness is the relatively low cost of enforcement. Withholding at the source can be policed by domestic Internal Revenue Service agents in the course of routine tax audits.

The withholding rate is usually thirty percent,¹²⁸ and ordinarily equals the total tax due on such periodic income. An exception exists in the area of personal service income, where the rates are identical for citizens, resident and nonresident aliens, alike, except that for nonresident aliens, the minimum tax is thirty percent.¹²⁹ However, when the tax liability on this income exceeds thirty percent, a collection problem is presented for the excess. Since relatively few nonresident aliens earn more than would be taxed at thirty percent, it has been questioned whether the cost of enforcing the progressive rates is warranted.¹³⁰ Legislation recently introduced in Congress on behalf of the Treasury Department¹³¹ would eliminate the progressive rates on income earned by nonresident aliens.

The Treasury Department has indicated that we now place great reliance on our withholding system to collect taxes on foreigners, and may place even greater reliance on the system in the future. But closer scrutiny of the withholding system is contemplated to ensure that it is performing as it should.¹³²

125. Section 1442.

126. Section 1461.

127. Treas. Reg. § 1.1461-2(c)(2) (1956).

128. Section 871(a). Many of the tax treaties have provided for a lower rate.

129. Section 871(b); Under 1965 rates, the point at which the effective graduated rates would exceed thirty percent is 21,200 dollars.

130. Remarks by Stanley S. Surrey, Assistant Secretary of the Treasury, before the Tax Executives Institute, Montreal, Canada, September 21, 1964, p. 37.

131. H.R. REP. NO. 11297, 89th Cong., 1st Sess. (1965).

132. Surrey, *supra* note 130, at 39. Some other statutory enforcement aids are § 6531

D. Tax Treaties

In Part I, an attempt was made to indicate some of the problems facing the international tax administrator. The difficulties experienced in the exercise of the intelligence and collection functions have led the tax administrator to seek methods of operating more efficiently overseas, for no matter how effectively enforcement tools are applied within the domestic jurisdiction, a tax authority's inability to achieve effective enforcement overseas is conducive to widespread evasion.

Attempts to enforce tax claims in foreign countries by judicial means have proved generally futile,¹³³ while efforts to achieve compliance through informal agreements with foreign tax officials have proved relatively successful, but depend for their efficacy on personal relationships. The quest for greater strength and stability in our international tax relationships led to the enactment of bilateral tax treaties with foreign governments.

While the primary reason for the enactment of tax treaties has been to eliminate double taxation of the foreign income of domestic taxpayers, all treaties have some provision for the prevention of evasion.¹³⁴ These provisions were enacted to ensure that the income should be taxed at least once.¹³⁵

Our first treaties were entered into shortly before World War II. These early treaties had relatively strong provisions for reciprocal exchange of information and enforcement of claims. Most of the treaties executed after the war, however, have severely restricted the scope of these provisions. In several instances, treaties were actually signed containing strong provisions, only to have the Senate condition its approval on their restriction.¹³⁶

1. INFORMATION PROVISIONS

There are three basic types of provisions contained in tax treaties that apply to the exchange of information. The first allows this exchange

(extending statute of limitations in criminal prosecutions to six years for evasion, etc.); § 7001 (requiring license and extending information return requirements to banks or agents collecting foreign payments of interest or dividends by means of coupons, checks, or bill of exchange); § 7231 (providing criminal penalties for failure to obtain a license for the collection of foreign items); § 7456(b) (providing for the production of records in Tax Court proceedings by foreign corporations, foreign trusts or estates, or nonresident aliens); and 28 U.S.C. § 1655 (1964) (providing procedural rules for enforcement of liens where the defendants are absent).

133. See Part III, text, *infra* at p. 66 *et seq.*

134. See generally, Note, *International Enforcement of Tax Claims*, 50 COLUM. L. REV. 490 (1950); Cf. OECD Draft Model Income Tax Convention, text, *infra* p. 78.

135. "That international incomes be prevented from escaping taxation altogether is as desirable as that the same income shall not be taxed by several different countries." Committee of Technical Experts on Double Taxation and Tax Evasion, *Double Taxation and Tax Evasion*, 23, (League of Nations 1927); See Norr, *Jurisdiction to Tax and International Income*, 17 TAX L. REV. 431, 445 (1962).

136. See note 68 *supra*.

only to insure that the beneficial substantive provisions of the treaties are not availed of by those not entitled to them. This is a rather restrictive provision, and has limited application.¹³⁷ The second type of provision provides for this exchange only in specific cases, where one country requests the information from the other. This is the most common type of provision. The third type of provision provides for the automatic and systematic exchange of information as to all payments of fixed or determinable income paid to persons in the other country.¹³⁸

Generally, exchange is not required under the treaties when submission of the information would disclose a trade secret, or would result in a violation of the country's public policy. Several of the treaties also provide that the information requested must be available under the laws of the country to which the request is directed.

With most countries, the United States gives more information than it receives.¹³⁹ Although this may impose a slightly greater administrative burden on our Internal Revenue Service than on the foreign government, it would be short sighted to set any quota on the exchange of information.

In addition to increasing the flow of information, treaties have also helped to reduce much red tape. This is true since under the treaties, exchange of information is conducted directly between the tax administrators of both countries, rather than necessitating processing through diplomatic channels.¹⁴⁰

2. COLLECTION PROVISIONS

In those of our tax treaties that contain collection provisions, these provisions take one of two forms. The more restricted type is limited to the collection of taxes resulting from wrongful use of the lower rates obtained under the treaties. For instance, while the regular rate of taxation by the United States on dividends received by nonresident aliens is thirty percent, the treaty with Luxembourg reduces this rate to fifteen percent.¹⁴¹ If a nonresident alien wrongfully claims to be a Luxembourg subject, and takes advantage of the treaty with Luxembourg to pay a rate of fifteen percent, the Luxembourg authorities will collect the extra fifteen percent and remit it to our government.¹⁴²

137. This type of provision was only contained in the treaty with India (Art. XIV), which was withdrawn by the President on June 8, 1964.

138. *E.g.*, Treaty with Canada, Art. XX; see MCENTYRE, *PROCEDURE UNDER THE CANADA-UNITED STATES TAX CONVENTION* (1947); Treaty with France, Art. 9; Treaty with the Netherlands, Art. XXI; Treaty with Norway, Art. XVI; Treaty with Sweden, Art. XVI; *op. cit. supra* note 45.

139. Caplin, *International Cooperation in the Field of Taxation*, 14 *TAX EXEC.* 324, 326 (1962).

140. *E.g.*, Treaty with Switzerland, Art. XIX(2), *op. cit. supra* note 45: "The competent authorities of the two Contracting States may communicate with each other directly for the purpose of giving effect to the provisions of this Convention."

141. Treaty with Luxembourg, Art. IX(1)(a), *op. cit. supra* note 45. The rate is five percent for certain corporations. (Art. IX(1)(b)).

142. *Id.* Art. XVIII(2).

The second type of provision, which is found primarily in our earlier treaties, provides for collection of any tax assessment that has been "finally determined."¹⁴³ From the standpoint of effective enforcement, this is by far the preferable type of provision. However, not many treaties have these collection provisions, and even some of the ones that do, further restrict their applicability to noncitizens of the country whose aid in collection is sought.¹⁴⁴

Even when collection provisions exist, they have not been availed of to any extent by our government, for several reasons. First, in enacting our postwar treaties, Congress affirmatively rejected the insertion of any liberal collection provisions. Second, in view of the Congressional attitude thus expressed, the Internal Revenue Service has understandably been reluctant to take the initiative in exploiting these older provisions.

In several instances, however, the Internal Revenue Service, pursuant to a request from a country having a treaty with us containing a provision for collection, has sent a letter to the foreign taxpayer in this country, indicating the presence of the provision under the treaty, and demanding, on behalf of the foreign government, payment of the taxes requested. In almost all instances, the taxpayers in question complied with this request, and only once did our government almost file suit. However, even in that case, the taxpayer paid the sum requested before the suit was filed.^{144a}

3. LEGISLATIVE RESTRICTIONS ON TREATIES

We have briefly indicated that only the early treaties contained really effective enforcement provisions. Since the United States has so much to gain from an effective worldwide enforcement system, it seems surprising that any serious reasons exist for Congressional opposition to these measures.

We can gain a good insight into Congressional attitudes by studying the circumstances surrounding the enactment of a Supplementary Protocol in 1948 to the second treaty with France.

a. The Arguments

At the Senate Finance Committee hearings, spokesmen for several organizations, including the Foreign Trade Council, the International

143. *E.g.*, Treaty with Sweden, Art. XVII, *op. cit. supra* note 45.

144. *E.g.*, Treaty with France, Art. 12(5) (added by Art. I(1) of Supplementary Protocol of 1948, effective January 1, 1950).

144a. The author has been informed by the Internal Revenue Service that a demand was made by the United States in 1945 upon Signe Hasso, a Swedish citizen for payment of her Swedish tax liability. On December 28, 1945, a complaint had been dictated by telephone by the Department of Justice to the United States Attorney in Los Angeles, California, and had directed that it be filed and served immediately. It was then learned that Miss Hasso had paid her tax to the Swedish Vice Consul that morning, and the complaint was not filed.

Chamber of Commerce, and the United States Chamber of Commerce vigorously opposed the ratification of strong enforcement provisions. Among the arguments advanced were:

1. Other countries have discriminatory tax rates on foreign investment.¹⁴⁵
2. Some of the other tax treaties have no broad enforcement provisions, so why should this one?¹⁴⁶
3. Where measures of conservancy are authorized, property might be taken without due process.¹⁴⁷
4. Other countries have different concepts of due process.¹⁴⁸
5. Americans working abroad for American interests should not be denounced to a foreign power by our government.¹⁴⁹
6. The people of the United States never intended that the proceeds of their taxes should be used to enforce foreign tax claims. Congress never intended that the Internal Revenue Service should have its officers spending their time, or the time of our courts, or our revenues, in enforcing the revenue claims of foreign governments.¹⁵⁰
7. The likelihood of United States citizens evading their taxes is remote.¹⁵¹ We should not subject everyone to the jeopardy of the application of the enforcement provisions just because there might someday be a tax evader.¹⁵²
8. To use the governmental machinery of one country to enforce the public policy of another is fundamentally objectionable.¹⁵³
9. The use of "oppressive procedures" might hamper the free movement of capital and deflect it into countries with simple tax systems which do not require outside assistance for their effective administration.¹⁵⁴
10. Existing treaty provisions for mutual assistance with Sweden and France have never been implemented by regulations, and it has evidently not been considered necessary to have any provisions in the treaties with Canada and Great Britain. Therefore, there is obviously no need for it in our current treaties.¹⁵⁵

145. I LEGISLATIVE HISTORY OF UNITED STATES TAX TREATIES 974 (1961).

146. *Id.* at 977.

147. *Id.* at 977.

148. *Id.* at 1010.

149. *Id.* at 1047.

150. *Id.* at 1073.

151. *Id.* at 1073, 1075, 1103.

152. *Id.* at 979.

153. *Id.* at 1105.

154. *Id.* at 1063.

155. *Id.* at 1072.

11. Other treaties draw the line at applying the enforcement provisions to United States citizens, so why should not this one?¹⁵⁶

In defense of the provisions for reciprocal enforcement of tax claims, spokesmen for the United States Treasury Department argued that:

1. The United States should not shield its citizens against the legitimate tax claims of the other contracting party.¹⁵⁷
2. The reason that lines of nationality were drawn in previous collection provisions was primarily because of discriminatory Nazi taxes.¹⁵⁸
3. Provisions of the treaties relating to the prevention of double taxation eradicate most problems concerning possible discrimination in regard to foreign investment.¹⁵⁹
4. Collection provisions were not inserted in the treaty with Canada because Canadian tax authorities have no power to levy and enforce; they have to go into a Province court for this action. England was not "quite ready" for the insertion of collection provisions in their treaty.¹⁶⁰

b. The Result

The Senate Finance Committee agreed with the opponents of the collection provisions, and on its recommendation, the Senate refused to approve the treaty unless the collection provisions were removed. In the face of this Congressional attitude, these broad provisions have not been inserted in any of our more recent treaties.

c. A Time for Reappraisal

The Senate rejected the insertion of effective enforcement provisions in treaties principally because it felt that international evasion was not a serious problem, or at least not serious enough to warrant the subjection of American citizens to the enforcement of foreign revenue laws in this country.

At the time of the hearings on the French treaty, the Treasury Department was unable to refute the contention that international evasion was not a serious problem, primarily because it had no reliable statistics to present. No coordinated effort to check on overseas taxpayer activity had yet been launched. However, even if it can be assumed *arguendo* that in fact little evasion did take place in the late 1940's, the picture has changed in the course of the last two decades.

156. *Id.* at 1072.

157. *Id.* at 1095.

158. *Id.* at 1087.

159. *Id.* at 1024.

160. *Id.* at 978.

The subsequent increase in taxpayer activity overseas heightened the evasion problem, and the subsequent investigative activities of the Office of International Operations highlighted the low level of compliance. As of February, 1965, the Delinquent Accounts Branch of the OIO had on its books unpaid assessments totaling over 108 million dollars, which under present handicaps, pose serious collection problems. The major argument of the opponents of strong collection provisions has therefore withered.

The other arguments of the opponents of strict collection provisions in our tax treaties can be refuted:

1. When collection of another country's taxes would violate our public policy because these taxes are discriminatory, our government would justifiably refuse to comply with a request for collection. In fact, a common treaty provision allows a country to refuse to assist the other in the collection of these taxes, or the exchange of information.¹⁶¹ With this safeguard, it seems implausible for a government to refuse to assist in the collection of taxes which are not discriminatory (and most taxes fall into this class).
2. A related argument is that a finding by our Treasury Department that another country's taxes are discriminatory might lead to diplomatic embarrassment. In answer, one can well ask whether it is not even more embarrassing to refuse to collect nondiscriminatory taxes from a miscreant who is evading his just obligations.¹⁶²
3. A strong argument can be made for refusal to collect taxes when the taxpayer is denied due process. This would occur, for instance, when a tax is assessed by administrative fiat, with no rights of appeal. In fact, however, almost all countries have some provision for appeal of assessments; and even if no right of appeal exists, this is one of the risks assumed in transacting business in such a country. When the United States taxpayer in a country is treated no worse than any other taxpayer in that country, one can question whether there should be cause for complaint. Of course, when the violation to due process is serious enough, or is discriminatory, the escape valve of "public policy" may always be resorted to.
4. It is also argued that these provisions subject honest taxpayers

161. *E.g.*, the Treaty with Belgium, Art. XVIII(2), *op. cit. supra* note 45, provides that: "The State to which application is made for information or assistance shall comply as soon as possible with the request addressed to it. Nevertheless, such State may refuse to comply with the request for reasons of public policy, or if compliance would involve violation of a business, industrial or trade secret."

162. See also text, *infra* p. 72 *et seq.*

to enforcement provisions aimed at the evader.¹⁶³ This argument can be answered by the statement that as long as the taxpayer remains honest, he has nothing to fear from the enforcement powers, and their existence may well serve to keep him honest.

5. The use of our collection facilities and personnel to collect money for another country has also been criticized.¹⁶⁴ This argument approaches the problem from a strictly economic view, and is easily refuted by the fact that the amount of delinquent taxes that would be collected for our government by foreign tax administrations would more than offset the additional cost. This argument might have greater merit if raised by a country whose international enforcement problem is minimal, and whose leaders might object to the high cost of collecting our taxes for us, without any concurrent benefits to them.

One might then suggest the payment of a "collection allowance" to any country that collects our delinquent taxes for us. This would motivate the country to sign a treaty containing collection provisions, as well as stimulate it to undertake an active enforcement role on our behalf. And, of course, in the present situation, a resultant windfall might accrue to the Treasury.¹⁶⁵

There are also indications that Congress would be receptive to the insertion of effective enforcement provisions in our new treaties. Beginning with the Revenue Act of 1960, and most certainly with the Revenue Act of 1962, Congress showed its determination to take strong measures to eliminate abuses in the international area. This was partly brought about by the ability of the Office of International Operations to show the nature and extent of these abuses. There seems to be no reason why this enlightened attitude of Congress should not be capitalized upon to achieve a most significant strengthening of our enforcement capability.¹⁶⁶

4. ADMINISTRATIVE RESTRICTION OF TREATY ENFORCEMENT

One of the arguments raised by the opponents of strong treaty enforcement provisions was that the earlier treaties contained broad provisions, but that these were obviously not considered important by the Treasury Department and were not used.

The principal reason these provisions were not used is that no regulations were ever issued by the Treasury Department to implement them. At first blush, this appears inexcusable. However, the myriad of conflict-

163. *Ibid.*

164. *Ibid.*

165. See "incentives" *infra*, at note 85.

166. The Treasury Department has indicated that it is presently not attempting to incorporate collection provisions in its current treaties.

of-laws problems posed by these provisions are formidable, and there may have been a certain administrative reluctance to chart a new course. Then too, the Congressional displeasure that was manifested in the Senate hearings in the late 1940's may make it understandable why these provisions in the older treaties were not pursued with much vitality.

Some of the problems that are raised by the enforcement of another country's revenue laws pursuant to a treaty are:¹⁶⁷

1. If, for instance, a treaty provides for the collection of revenue claims "finally determined,"¹⁶⁸ what standard would be used for definition of this term? Would the foreign revenue claim have to be reduced to judgment, or would mere assessment be sufficient? Would the determination have to be made by a court, or merely by administrative officials?
2. Could the taxpayer contest the basis for the assessment in our courts, or would the determination by the foreign country be given comity, leaving the taxpayer to seek his remedy in the foreign country?
3. When a collection provision provides that the foreign revenue claim will be collected in the same manner in which we collect our own taxes, would our powers of levy and distraint under the Internal Revenue Code be applicable? When additional powers of enforcement and collection are given to the Internal Revenue Service by legislation enacted subsequent to the signing of a treaty, would these subsequent powers also be available for the collection of taxes pursuant to this treaty? Would Congress have intended the full use of the powers contained in the Internal Revenue Code for collection of another country's taxes?
4. Would the jeopardy assessment provisions apply to cases involving another country's taxes? Does a lien arise? If so, when? Does it arise at the time the request is made by the foreign country for collection assistance? In whose favor does the lien arise—the foreign country, or the United States on behalf of the foreign country? Would the foreign tax lien have priority over a United States tax lien? Would priority be established by time of filing? Would the claim for foreign taxes be dischargeable by the bankruptcy of the taxpayer?
5. When suit is brought, should it be in the name of the United States, or of the foreign government? Who is to bear the costs of the suit?

167. See Note, *Procedures for Enforcement of Claims under the Treaties*, 50 COLUM. L. REV. 490, 500 *et seq.* (1950).

168. *E.g.*, Treaty with Sweden, Art. XVII.

6. Which country's Statute of Limitations applies? What triggers it? What tolls it?

The above list is by no means exhaustive, but it should give some indication of the difficult problems that must be coped with before the enforcement provisions, especially those dealing with the collection of taxes, are effectively put in motion. One can sympathize with a revenue official who might be reluctant to embark on a collection program for another country's taxes with no guidelines to resolve the many difficult problems posed.

It is questionable whether some of these problems can be resolved unilaterally, without the agreement of the other party to the treaty. Perhaps the answer would lie in a supplementary agreement with other countries which would spell out the answers to these problems. On the other hand, perhaps the Treasury Department should promulgate proposed regulations advancing its solutions, and seek suggestions and comments from all interested parties.

One other alternative is to put detailed provisions in the tax treaties themselves. This might lead to unwieldy documents, but unless these provisions are spelled out, much confusion and disagreement may result.

Assistant Secretary of the Treasury Stanley S. Surrey, in discussing the need for a comprehensive examination of treaty drafting practices, said recently:

(T)his is likely of course to lead to greater technical complexity, and those with a nostalgia for a simpler era of international tax relationships will shake their heads. But as national tax systems grow more complex, and as the expertise of those engaged in domestic tax matters spreads to those, in Government and out, dealing with international tax matters, one cannot expect to retain simple international bridges between intricate national systems.¹⁶⁹

Although Mr. Surrey was not speaking specifically about the enforcement provisions in treaties, his words are especially applicable to this complex area.

Because of the factors indicated, our treaties have not lived up to the expectations of those who expected full-scale reciprocal tax enforcement. However, they still offer the one great hope for the eventual control and prevention of international tax evasion.¹⁷⁰

169. Surrey, *supra* note 130, at 12.

170. In addition to the treaties presently in force, new protocols with Belgium and Germany have been ratified; treaties with the Philippines, Israel and Thailand are awaiting ratification; tentative agreements have been reached with the Netherlands and India, and new treaties are being negotiated with the United Kingdom, France, Portugal, Honduras, Trinidad and Tobago, and Taiwan. Surrey, *Remarks at the Tax Institute of America Symposium*, New York, N.Y., December 2, 1965.

E. *Extent of Territorial Enforcement Power—
United States v. First National City Bank*¹⁷¹

A recent Supreme Court decision both highlights the ease with which international evasion can be accomplished, and indicates one of the few judicial remedies available once the evader's property has left the country.

Omar, S.A., a Uruguayan corporation, was engaged in stock market activities in the United States from 1955 to 1961. It filed its only federal income tax return in 1959, the incompleteness of which led to an examination by the Internal Revenue Service. This examination resulted in findings that Omar owed large sums of money to the United States for unpaid taxes. Omar apparently was unhappy with these findings, and proceeded to liquidate its United States holdings, and to transfer them out of the country. The transfer was generally accomplished by having the brokerage firms it did business with transfer, by wire or otherwise, funds to banks with offices in Uruguay.

On October 31, 1962, the Internal Revenue Service discovered that Omar's assets were leaving the country, and made jeopardy assessments¹⁷² totalling approximately 19,300,000 dollars. The First National City Bank of New York has a branch in Montevideo, Uruguay where Omar had monies in deposit at the time the assessments were made. The same day, the United States obtained an order in a federal district court which restrained the bank from transferring out of its Montevideo branch any monies owed to Omar.¹⁷³

On appeal, the United States Court of Appeals for the Second Circuit reversed the district court, and held that Omar had no rights against the bank that could be enforced in the United States; there was, therefore, no property within the United States over which a court could exercise its jurisdiction on behalf of the government.¹⁷⁴ This result was reached primarily on the ground that under New York law, each branch of a bank is a separate entity, and the depositor has no rights against the main office unless the branch refuses payment.¹⁷⁵ The court further felt that it would be treading on sensitive ground were it to attempt to extend its jurisdiction to property located in a foreign country:

The Supreme Court has made manifest its reluctance to read an extraterritorial force into statutes when to do so would extend coverage beyond places over which the United States has

171. 379 U.S. 378 (1965).

172. Under § 6851(a)(1).

173. *United States v. First Nat'l City Bank*, 210 F. Supp. 773 (S.D.N.Y. 1962).

174. *United States v. First Nat'l City Bank*, 321 F.2d 14 (2d Cir. 1963), *aff'd en banc*, 325 F.2d 1020 (2d Cir. 1964).

175. See *Sokoloff v. Nat'l City Bank*, 239 N.Y. 158, 145 N.E. 917 (1924); *Chrzanowska v. Corn Exchange Bank*, 173 App. Div. 285, 159 N.Y.S. 385 (1st. Dept. 1916), *aff'd*, 225 N.Y. 728, 122 N.E. 877 (1919).

legislative control . . . or would interfere with the rights of other nations¹⁷⁶;

and again:

The nations of the world have only recently begun to deal with the problem of extraterritorial collection of tax revenues through the medium of negotiated tax treaties providing for mutual cooperation. Absent an explicit indication to the contrary, there should not be attributed to Congress an intent to give the courts of this nation, in this highly sensitive area of intergovernmental relations, the power to affect the rights to property wherever located in the world. The apparent necessity of tax treaties underscores the conclusion that Congress has seen fit to handle this problem in another manner.¹⁷⁷

The banks were understandably concerned because, first, they feared that the Uruguayan courts might not recognize the order of the district court, and might order the Uruguayan branch of the bank to pay the funds to Omar. (However, the district court had indicated that it would modify its order in that event.) The second reason for concern was that they feared that foreigners would not put their money in United States branch banks overseas for fear of having the money subject to levy in the United States. The Second Circuit agreed that allowing the injunction to stand would lead to "harmful consequences for our banking system abroad without any concomitant benefits here at home."¹⁷⁸

The United States Supreme Court granted the government's petition for writ of certiorari,¹⁷⁹ and subsequently reversed the Court of Appeals by a seven to two margin.

In his opinion written for the majority, Mr. Justice Douglas saw the issue merely as whether the court had the power to issue an injunction against a party before it (in this case National City). In answering this question in the affirmative, the Court said that:

Whether the Montevideo branch is a 'separate entity' is not germane to the present narrow issue Respondent has actual, practical control over its branches; it is organized under a federal statute, which authorizes it 'to sue and be sued . . .' as one entity, not branch by branch.¹⁸⁰

Answering the charge that it might be treading on sensitive ground involving our international relationships, the Court said: "[If] litigation

176. 321 F.2d at 23.

177. 321 F.2d at 24.

178. *Ibid.* The decision of the Second Circuit was favorably reviewed in Note, 64 COLUM. L. REV. 774 (1964); Note, 62 MICH. L. REV. 1084 (1964); and Note, 9 VILL. L. REV. 339 (1964), primarily on the basis of the validity of the "separate entity" principle.

179. *United States v. First Nat'l City Bank*, 377 U.S. 951 (1964).

180. 379 U.S. 378, 384.

might in time be embarrassing to United States diplomacy, the District Court remains open to the Executive Branch"¹⁸¹

In a vigorous dissent, Justices Harlan and Goldberg expressed shock at the majority opinion, stating that under the decision, only a taxpayer stupid enough to have funds in a branch of a United States bank overseas would be caught, and that "In order to provide the government with this toy pistol, the Court flexes its muscles in a manner never before imagined."¹⁸²

It is interesting to note the manner in which the government hopes to recover the money in the Montevideo branch (remembering that the instant action only served to "freeze" the account):¹⁸³

First, in order to obtain in personam jurisdiction over Omar (which it did not have in the above action), the government would mail a letter to Omar in Uruguay, pursuant to the New York substituted service statute.¹⁸⁴ Then the United States would obtain a judgment against Omar (in the United States), and order Omar to transfer its funds in its Montevideo account to the United States government. Under the logical assumption that Omar would not comply with the request, the United States will then have a court officer appointed under Rule 70, Federal Rules of Civil Procedure,¹⁸⁵ who will go to Montevideo to make a demand on the bank branch in the name of the United States.

If the branch refuses payment, it will breach its contract to Omar to "pay on demand." Since the breach would enable Omar to maintain an action for breach of contract against the main office of the branch in New York, this right of cause of action would constitute "property" that the government could garnish to satisfy its judgment.

Terming this maneuver "procedural cake-walking,"¹⁸⁶ the Dissent found it "startling" that "a District Court, aware that a foreign country would not enforce its judgment, would nonetheless dispatch a court officer

181. *Ibid.*

182. *Id.* at 401.

183. *Id.* at 394.

184. Under the N. Y. CIV. PRAC. L. & R. § 302(a), the transaction of any business within the state by a non-domiciliary gives the court in personam jurisdiction over such person.

Section 313 of the N. Y. CIV. PRAC. L. & R. provides that service may be made outside of the state "by any person authorized to make service within the state who is a resident of the state or by any person authorized to make service by the laws of the state, territory, possession or country in which service is made or by any duly qualified attorney, solicitory barrister, or equivalent, in such jurisdiction."

185. "If a judgment directs a party to execute a conveyance of land or to deliver deeds or other documents or to perform any other specified act and the party fails to comply within the time specified, the court may direct the act to be done at the cost of the disobedient party by some other person appointed by the court and the act when so done has like effect as if done by the party. . . ." FED. R. CIV. P. 70.

186. 379 U.S. at 395.

to the foreign jurisdiction to accomplish that end by self-help."¹⁸⁷ It further doubted that such a "novel international adventure"¹⁸⁸ would be looked upon with favor by the foreign country.¹⁸⁹

The rationale of the majority in the Supreme Court opinion appears to be sound. A court *does* have the power to enjoin acts which a party before it has the means of performing or controlling. Any supposed detriment to foreign branch banking cannot be given priority over the enforcement power of a court to deal effectively with the parties before it. Although American banks may seek to avoid the effect of the decision in future cases by operating abroad through foreign subsidiaries instead of branches, this seems preferable as a matter of principle to imposing an unnecessary restraint on a court's ability to exercise its equitable powers.

III. JUDICIAL BARRIERS TO INTERNATIONAL ENFORCEMENT

A. *General Considerations*

In a democratic society, principal reliance is placed on the courts to effectuate enforcement of the laws; all actions of administrators, as well as all laws passed by legislators, are subject to the ultimate scrutiny of the courts. It should therefore be apparent that even if able administrators apply effective laws, all these efforts can be vitiated by judicial refusal to give effect to the results of the enforcement activities.

In the United States, few federal laws (especially those dealing with the enforcement of taxes) are held unconstitutional, and the courts generally lend the full weight of their power to the enforcement of our revenue laws. Although courts of one state of the union have generally refused to enforce tax claims of another state, this attitude has been changing, primarily under the impetus of the full faith and credit provision of the United States constitution.¹⁹⁰

International enforcement of revenue claims by judicial means has proved to be virtually impossible, because of the refusal of courts to lend their aid to the enforcement of revenue laws of other countries. This has served to create the single greatest obstacle to the prevention of international tax evasion.

What are the reasons for this judicial attitude? Should this attitude change, and if so, what are the chances of this change occurring? These are the questions that will be considered in this part of our discussion.¹⁹¹

187. *Id.* at 396.

188. *Id.* at 397.

189. *Id.* at 396.

190. Article IV, § 1: "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State."

191. For a more detailed analysis of the problem, see Castel, *Foreign Tax Claims and Judgments in Canadian Courts*, 42 CAN. B. REV. 277 (1964).

1. COMITY

Generally, courts of one nation will give recognition to laws, executive or judicial acts of another nation, so long as to do so would not prejudice its rights, or the rights of its citizens.¹⁹²

[T]he recognition of foreign laws cannot be claimed as a right, but only as a favor or courtesy. It is permitted and accepted by all civilized communities from mutual interest and convenience, from a sense of the inconvenience which would otherwise result, and from moral necessity to do justice in order that justice may be done in return.¹⁹³

In the absence of comity, international trade or transactions would be stifled, since no country would recognize the decision of a foreign court, or the acts of a foreign government in its own territory. However, comity is not universally applied. For instance, courts generally refuse to enforce laws that are penal in character, or which violate the public policy of the forum.

2. PUBLIC POLICY

A court will generally refuse to extend the privilege of comity where to do so would violate some strong policy of the forum, whether expressed by statute or not.¹⁹⁴ However, in order for a foreign law to contravene public policy, it must "violate some fundamental principle of justice, some prevalent conception of good morals, or some deep-rooted tradition of the common weal."¹⁹⁵

Courts have refused to enforce a foreign country's tax laws on the grounds they are in their nature penal,¹⁹⁶ although it is difficult to see where the purpose of a revenue law would be ordinarily to "punish an offense against the public justice of the state."¹⁹⁷ On the other hand, the ground of public policy may well be used to refuse enforcement of a tax law that is by its nature discriminatory. An example of this type of law would be the discriminatory income tax laws passed against the Jews by the Nazis.¹⁹⁸ But the refusal of courts to enforce foreign revenue laws

192. *Hilton v. Guyot*, 159 U.S. 113, 163 (1895); 11 AM. JUR., *Conflict of Laws* § 6 (1937).

193. *Id.* at § 5; *Olmsted v. Olmsted*, 216 U.S. 386 (1910); *Disconto Gesellschaft v. Umbreit*, 208 U.S. 570 (1908).

194. 16 AM. JUR. 2D, *Conflict of Laws* § 6 (1964).

195. *Coster v. Coster*, 289 N.Y. 438, 46 N.E.2d 509 (1943).

196. *Maryland v. Turner*, 75 Misc. 9 (N.Y. 1911); Other cases have not held tax laws to be penal, but have held them to be of a similar nature in that they both operate *in invitum*; see Hand (concurring opinion) *Moore v. Mitchell*, 30 F.2d 600 (2d Cir. 1929). Although the writer disagrees with the view that revenue laws are by their nature penal, one can sympathize with the view of G. K. Chesterton, who complained that "a citizen can hardly distinguish between a tax and a fine, except that the fine is generally much lighter." *New York Times Magazine*, April 4, 1965.

197. *Huntington v. Attrill*, 146 U.S. 657 (1892).

198. Examples of the use of the revenue laws of Nazi Germany to discriminate against

stems more from a reluctance to break tradition with the past than from a rational, functional analysis of the problem.

B. *Lord Mansfield and his Dictum*

The traditional unwillingness of one country to allow another country to use its courts for enforcement of revenue laws can be traced directly to a doctrine propounded by Lord Mansfield in two English cases decided in the eighteenth century. In *Holman v. Johnson*,¹⁹⁹ a contract for the sale of tea was made in Dunkirk, and delivery was made there. The defendant resisted payment in England on the grounds that the plaintiff knew that the tea would be smuggled into England, and that since the contract was founded on an intention to make an illicit use of the tea, the plaintiff was not entitled to the assistance of an English court to recover the price. Thereupon the court held that since the contract and delivery were both legal at the place made, the subsequent smuggling could have no effect. Lord Mansfield then said "For no country ever takes notice of the revenue laws of another."²⁰⁰ This was added as "pure dictum."²⁰¹

Lord Mansfield reiterated his dictum in *Planche v. Fletcher*.²⁰² This case involved the shipment of goods from England to France, the ship being captured by France, which was at war with England. The underwriter refused payment of insurance on the grounds that the ship was cleared for Belgium, when there was no intention of going there. The court held that it was commercial practice to do this, probably because customs rates were lower in Belgium. Lord Mansfield then added that motive did not matter, because "one nation does not take notice of the revenue laws of another."

In a case decided less than half a century later,²⁰³ the issue was whether a receipt that did not bear the French stamp tax could be admitted in an English court. The court held the receipt admissible, saying

Jews ranged from denial of "children's allowance" for parents with Jewish children (§§ 27, 39(3)3, 32(3) Einkommensteuergesetz (Income Tax Law) (EStG. 1938) (1938) Reichsgesetzblatt I, p. 121 (Ger.)); denial of deductions for medical, etc., expenses attributable to children or other relatives who were Jewish (§§ 10(2)1, 21(3), and (33) Durchführungsbestimmungen zum Einkommensteuergesetz (Income Tax Regulations) (ESt.DB) Law of March 17, 1939, (1939) Reichsgesetzblatt I, p. 503 (Ger.); application of "social-equalization" 15 percent surtax to Jews (Zweite Verordnung zur Durchführung der Verordnung über die Erhebung Eines Sozialausgleichs, Law of December 24, 1940, (1940) Reichsgesetzblatt I, p. 1666 (Ger.)).

199. 1 Cowp. 341, 343, 98 Eng. Rep. 1120, 1121 (K.B. 1775).

200. One writer credits the existence of international tax evasion as stemming in large part from this statement. Note, *International Enforcement of Tax Claims*, 50 COLUM. L. REV. 490 (1950).

201. See State *ex rel.* Oklahoma Tax Comm. v. Rodgers, 238 Mo. App. 1115, 193 S.W.2d 919 (1946).

202. 1 Dougl. 251, 99 Eng. Rep. 164 (K.B. 1779).

203. James v. Catherwood, 3 Dow & Ry. 190 (K.B. 1823).

"It has been settled, or at least considered as settled, ever since the time of Lord Hardwicke,²⁰⁴ that in a British court, we cannot take notice of the revenue laws of a foreign state . . ." Then in *Sharp v. Taylor*,²⁰⁵ which involved a false ship registration, the court held that it would not refuse to enforce rights because some fiscal law of a foreign country had been violated.

As pointed out in *State ex rel. Oklahoma Tax Comm. v. Rodgers*,²⁰⁶ it was from the foregoing cases that the rule that "no country will take notice of the revenue laws of another" originated. "In none of them was an attempt made to collect a tax due a foreign state, but involved the question whether a contract violating a foreign law was enforceable in England."²⁰⁷ Be that as it may, courts have consistently refused to enforce the revenue laws of other countries,²⁰⁸ although as already noted, the trend in the United States is to enforce the laws of one state in another under the full faith and credit provisions of the United States Constitution.²⁰⁹

Under our Anglo-American legal system, the doctrine of *stare decisis* gives great weight to tradition, and in the area of international tax enforcement this doctrine has been used to solidify a principle of doubtful validity into a "strong fortress"²¹⁰ which has proved impervious to attempts at breach through judicial means.²¹¹

204. The court was probably referring to the case of *Boucher v. Lawson*, Cases Temp. Hardwicke 85, 95 (K.B. 1734). There the plaintiff shipped gold from Portugal to England in violation of Portuguese law. The master of the ship refused to deliver the gold in England, and defended the suit on the basis that since the act was criminal, the court should refuse a remedy. This defense was denied on the basis that to allow it would "cut off all benefit of such trade from this kingdom, which would be of very bad consequence to the principal and most beneficial branches of our trade."

205. 2 Phill. 801, 41 Eng. Rep. 1153 (K.B. 1848).

206. Note 201 *supra*.

207. *Id.* at 1120.

208. *Peter Buchanan, Ltd. v. McVey*, [1955] A.C. 516 (Erie, 1951); *Government of India, Ministry of Finance v. Taylor*, [1955] A.C. 491 (H.L.); *Cf. Moore v. Mitchell*, 30 F.2d 600, 604 (2d Cir. 1929) (concurring opinion, L. Hand); in his dissenting opinion in *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 413-14 (1964), Mr. Justice White, in indicating areas where the "act of state" doctrine is not applied, said: "The principle that the courts of one country will not enforce or give effect to the fiscal or penal claims of other countries is a rule of international law which is a part of the law of the United States."

209. *Milwaukee County v. M. E. White Co.*, 296 U.S. 268 (1935). However, where the revenue claim has not been reduced to judgment, the state court may refuse to enforce the revenue claim of another state. See *City of Philadelphia v. Cohen*, 11 N.Y.2d 401, 184 N.E.2d 167 (1962).

210. Opinion of Viscount Simonds in *Government of India, Ministry of Finance v. Taylor*, note 205 *supra*.

211. Some courts have indicated that if change is warranted, it is the task of the executive or legislative branches of government, *Government of India, Ministry of Finance v. Taylor*, *supra* note 205; "The apparent necessity of tax treaties underscores the conclusion that Congress has seen fit to handle [the international enforcement of tax claims] in another manner." *United States v. First Nat'l City Bank*, 321 F.2d 14, 24 (1963), *rev'd*, 379 U.S. 378 (1965).

C. *United States v. Harden*

The recent Canadian case of *United States v. Harden*,²¹² underscores the extent of governmental impotence in the international enforcement of tax claims, even when the taxpayer has agreed as to the correctness of the determination of the amount of taxes due, and when the claim was reduced to judgment. It seems especially anomalous that such a situation should exist between two countries having a common border, language²¹⁸ and similar economic interests.

1. THE FACTS

On June 10, 1957, the United States brought suit against Esperanza P. Harden in a United States District Court, alleging that she was indebted to the United States for unpaid taxes of some 865,000 dollars. As a result of pre-trial hearings before a district judge, it was stipulated that judgment might be entered against the taxpayer for a total of 639,500.15 dollars. Judgment was then entered pursuant to the stipulation.²¹⁴ The United States then instituted suit on the judgment in the Supreme Court of British Columbia. The defendant moved to set aside the proceedings on the ground that the action was an attempt to enforce the revenue laws of a foreign country, and this motion was granted.²¹⁵ The Court of Appeal for British Columbia affirmed,²¹⁶ as did the Supreme Court of Canada.²¹⁷

2. THE OPINION

The Supreme Court of Canada held that the rule that "foreign states cannot directly or indirectly enforce their tax claims here" was rooted in public policy, and could not be avoided through merger in a judgment, or by conversion into a contractual agreement.

While basically grounding its decision on the fact that all the precedents support the proposition of nonenforceability of international tax claims, it quoted language from both an English and an American case which suggest reasons for the existence of the doctrine. The English case, *Government of India, Ministry of Finance v. Taylor*,²¹⁸ stated that:

One explanation of the rule . . . may be thought to be that enforcement of a claim for taxes is but an extension of the sovereign power which imposed the taxes, and that an assertion

212. [1963] Can. Sup. Ct. 366.

213. La province de Quebec nonobstant.

214. *United States v. Harden*, Civil No. 710-57 (S.D. Cal.) Mar. 13, 1961, *modified* Mar. 24, 1961. The author has been advised by the Internal Revenue Service that Mrs. Harden obtained United States citizenship by marriage in 1917, and it is assumed that she was still a United States citizen during the tax years involved in the litigation being discussed.

215. *United States v. Harden*, 30 D.L.R.2d 566 (B.C. Sup. Ct. 1961).

216. *United States v. Harden*, 36 D.L.R.2d 602 (B.C. 1962).

217. [1963] Can. Sup. Ct. 366.

218. Note 208 *supra*.

of sovereign authority by one State within the territory of another, as distinct from a patrimonial claim by a foreign sovereign, is (treaty or convention apart) contrary to all concepts of independent sovereignties.

The American case cited was *Moore v. Mitchell*,²¹⁹ where Judge Learned Hand, in a concurring opinion, reasoned that:

To pass upon the provisions for the public order of another state is, or at any rate should be, beyond the powers of the court; it involves the relations between the States themselves, with which courts are incompetent to deal, and which are intrusted to other authorities. It may commit the domestic State to a position which would seriously embarrass its neighbor. Revenue laws fall within the same reasoning; they affect a State in matters as vital to its existence as its criminal laws. No court ought to undertake an inquiry which it cannot prosecute without determining whether those laws are consonant with its own notions of what is proper.

Considering further the *Taylor* case, the Court cited language to the effect that States "have not in the past thought it appropriate to seek to use legal process abroad against debtor taxpayers. They assumed, rightly, that the courts would object to being so used . . ."²²⁰

It is apparent that the law in its present state prohibits international enforcement of tax claims, in the absence of a treaty. In fact in the *Harden* case, the United States did not even contest this fact in its brief. It chose to rely on the arguments that a court should not look behind a judgment, and that the instant case involved a contractual agreement (the pre-trial stipulation). One can readily agree, however, that "although imbedded in a long legal tradition, the doctrine which prevents one state from enforcing its revenue laws in the courts of another deserves critical reappraisal."²²¹

D. *The Case for Comity*

Legal doctrines, however rooted in tradition, must periodically be tested to see whether they can meet the demands of a changing society.

The doctrine denying recognition to foreign tax claims arose when there was great commercial rivalry and international suspicion. It was

219. *Ibid.*

220. [1963] Can. Sup. Ct. 366, 372.

221. KATZ & BREWSTER, *THE LAW OF INTERNATIONAL TRANSACTIONS AND RELATIONS* 748 (1960); see also DICEY, *CONFLICT OF LAWS* (7th Ed. 1958): "Doubtless in individual cases these [foreign revenue laws] may have to be disregarded (as may any other type of foreign rule) on the grounds of public policy, but there is no logical justification (whatever may have been felt in the eighteenth century) for the indiscriminate exclusion of all foreign revenue law. Several judges have doubted the proposition, and the leading case supporting it seems to have been based on a misapprehension"; see also Note, 77 HARV. L. REV. 1327 (1964).

employed to enforce private commercial agreements that foreign revenue laws would otherwise have rendered invalid. Today conditions have changed. International trade has increased greatly, with international cooperation replacing suspicion; with regional economic planning replacing domestic protectionism. Isolationism is a product of the past, having been replaced by international aid, assistance, and interdependence.

Let us examine the arguments advanced by the advocates of the status quo. (Note: Some of these arguments have already been considered in the discussion of tax treaty provisions.)

1. A revenue law is the manifestation of sovereign power, and can have no extraterritorial effect.²²² This argument would be valid in the absence of the concept of comity. Since comity is a *privilege* extended by a sovereign, no affront to sovereignty can exist where the right is not absolute. On the contrary, the concept of international cooperation would seem to encourage one government to assist another in the exercise of its just functions.

Directly related to this argument is the one that one government should not punish violation of the laws of another government, or avenge a wrong done to another government. Whatever the validity of this argument as applied to crimes, it seems inapplicable to the failure of a taxpayer to fulfill a financial obligation to his country. "Tax laws are not passed to punish people."²²³

2. Holding a foreign tax law to violate our public policy might embarrass our government's international relations. This is the argument of Judge Hand in *Moore v. Mitchell*.²²⁴ In essence, it runs as follows:
 - a) We will not extend comity where to do so would violate our public policy.
 - b) This necessitates our courts' pronouncement as to whether or not a foreign law is of the type we will enforce.
 - c) Should we hold a foreign law to violate our public policy, we would be treading on delicate ground, and might embarrass our executive department in its conduct of our foreign affairs.
 - d) Rather than place our courts in this embarrassing predicament, our courts should refuse to enforce *any* foreign tax law.

222. *United States v. Harden*, D.L.R.2d 366, 378 (1963) citing *Government of India, Ministry of Finance v. Taylor*, *supra* note 205 at 511; see 1 OPPENHEIM, *INTERNATIONAL LAW* 328-330 (8th ed. 1955).

223. *State ex rel. Oklahoma Tax Commission v. Rodgers*, *supra* note 201, at 1127.

224. Note 208 *supra*.

It is true that determining questions of public policy is a difficult task for a court. But difficulty does not justify refusal to face the problem. Indeed, refusing to enforce a valid revenue law of a friendly country might cause even greater embarrassment to our nation than would result under the doctrine.

In the event that our government might be embarrassed by holding a foreign law to violate our public policy, the courts could always permit our State Department to appear in the case as *amicus curiae*.

3. It is difficult for a taxpayer to defend a suit for taxes arising in a foreign country. Any inconvenience resulting from having to defend a suit in a foreign country arises generally through the actions of the taxpayer in removing himself or his property from the taxing jurisdiction; the taxpayer thus should have no cause for complaint.

The present doctrine of refusing to enforce foreign revenue claims is conducive to jurisdiction-hopping, and results in loss of revenue with the attendant shifting of the tax burden to law-abiding citizens. The doctrine is no longer valid, and should be changed.

Unfortunately, judicial doctrine changes slowly, and some courts have indicated that if change is to come, it should emanate from the executive or legislative branches of the government.²²⁵ Therefore, the most expeditious manner of superseding Lord Mansfield's dictum appears to be by means of tax treaties containing reciprocal enforcement provisions.

IV. PREVENTION OF EVASION—A SUGGESTION FOR PROGRESS

A. *Judicial Reform*

1. DISCARD LORD MANSFIELD'S DICTUM

We have indicated that the rule of law that "One nation does not take notice of the revenue laws of another" is an anachronism that should have been discarded long ago. Unfortunately, however, it is unlikely that a change in viewpoint will be accomplished by judicial means. In fact, even if we were to assume that a change could occur, it would not happen in the near future. The process of legal evolution is a slow one, especially in international law, and there is no one forum which could effect a change that would be binding on all others. Change, as it surely must come, will have to arrive on another vehicle, preferably that of the bilateral or multilateral tax treaty.

225. See note 211 *supra*.

2. ENACT A FEDERAL LONG-ARM RULE

The case of *United States v. First National City Bank*, points up another problem that has not previously been considered herein. In that case the taxpayer (Omar, S.A.) had not been served, and the court did not have in personam jurisdiction over it. It was suggested that since the cause of action arose in New York, the government, to collect the taxes under injunction, could avail itself of New York's long-arm statute,²²⁶ which authorizes service of process outside of the jurisdiction for any cause of action arising therein.

It would be of great assistance to the government if this provision for extraterritorial effectuation of jurisdiction could be availed of no matter where in the world the defendant is found. Also, if collection provisions are inserted in our future tax treaties, in personam jurisdiction over the taxpayer might be a requisite to collection assistance by the other country. It is therefore suggested that the Federal Rules of Civil Procedure be amended to provide for this assumption of jurisdiction.²²⁷

B. Legislative Reform

1. TAX TREATIES

The most obvious direction for future legislative action lies in the field of ratifying tax treaties containing strong and effective enforcement provisions. However, this is a subject of sufficient importance to merit separate treatment.²²⁸

2. SAILING PERMITS

The present inadequacies of the sailing permit provisions have already been mentioned. While the direction for improvement lies primarily in the administrative sphere, legislative assistance could be rendered by the following means:

226. N.Y. CIV. PRAC. L. & R. 313; see note 184 *supra*.

227. *Cf.* § 6212, authorizing a notice of deficiency to be mailed to the taxpayer by registered or certified mail to his last address; § 6303 authorizes notice of demand for payment to be left at the dwelling or usual place of business of the taxpayer or to be sent by mail to his last known address. Under *Blackmer v. United States*, 284 U.S. 421 (1932), a citizen may be bound by a subpoena served on him in a foreign country, where the litigation involves "obligations inherent in allegiance." *Id.* at 438, n.5; see also *Uniform Interstate and International Procedure Act*, 11 AM. J. COMP. L. 415 (1962); as far as service in the United States in connection with a foreign action, see 18 U.S.C.A. § 1696 (1964), "The district court of the district in which a person resides or is found may order service upon him of any document issued in connection with a proceeding in a foreign or international tribunal."

To avoid assets of foreign taxpayers (individuals and corporations) from leaving the country (as in the *United States v. First Nat'l City Bank* case), it might be suggested that any such transfer of funds be subject to prior governmental control. However, in the writer's opinion, any such attempt at control would impose too great a restraint on international commerce.

228. See p. 76 *infra*.

1. The enactment of legislation prohibiting any transportation company from allowing passage to aliens who have not exhibited Certificates of Compliance, or proof that a certificate is not required.
2. The enactment of legislation imposing sanctions, financial or otherwise, on any transportation company not complying with the above.

3. ALIEN REGISTRATION CARDS

Present legislation requires all aliens to file with the Immigration and Naturalization Service an annual report of address form.²²⁹ This annual registration card could also be used as a source of information for the Internal Revenue Service by requiring the alien to indicate on the card whether or not he had any earnings from United States sources during the preceding year, or, in the case of resident aliens, whether they had earnings from any sources whatsoever during the preceding year.

This requirement would not impose a great burden on either the alien or the Immigration and Naturalization Service, and would provide the Internal Revenue Service with a valuable source of information.

C. *Administrative Reform*

1. SAILING PERMITS

Suggestions for legislative action in the Sailing Permit area have already been considered. Administrative procedures that would strengthen enforcement in this area could include the following:

1. In order to preclude transportation company employees from exercising their discretion in allowing aliens to embark without Sailing Permits, the Internal Revenue Service should provide all those not subject to the sailing permit requirements with a card or form to exhibit to the transportation company employees. These cards could be issued through the State Department to persons in exempt status.
2. An OIO agent should be stationed at each major terminal at cities providing points of departure for overseas, for purposes of enforcing the compliance provisions. Noncomplying passengers could be referred to this agent by transportation company personnel for a determination that no certificate is required, or for such other action as may be warranted. This agent might also physically restrain an evader from departing, if necessary.

²²⁹ 8 U.S.C.A. § 1305 (1964); for information currently required see 8 C.F.R. § 265.11 (1957).

3. Responsibility and control of point of departure enforcement should be transferred from local district director jurisdiction to the Office of International Operations, although the routine issuance of Certificates of Compliance could still remain a function of the local district director. This would serve to coordinate all international enforcement through the Office of International Operations, while leaving routine taxpayer contact to the local level.
4. The Internal Revenue Service should, in cooperation with the Immigration Service and State Department, initiate a taxpayer education program to inform aliens of the necessity for the Certificate of Compliance requirements, and of the need for effective enforcement.

This program should help offset any irritation that might be caused through the transition from a weak policy to an effective one. As one aspect of this program, circulars could be distributed through transportation companies or other sources having contact with departing aliens.

2. EXTENSION OF INFORMAL COOPERATION

The effectiveness of an international enforcement program depends to a great extent on the cooperation existing among tax administrators in various countries. Today, much is being done to educate foreign tax officials as to the necessity for a strong tax enforcement program. The Internal Revenue Service has set up a Foreign Tax Assistance Staff, which has initiated programs to assist countries in the development of their tax systems. On an unofficial level, the Harvard Law School trains foreign tax officials in its International Program in Taxation.

These activities should be encouraged and continued. The personal camaraderie thus developed among the tax officials of the world can be a significant element in the removal of barriers of distrust and misunderstanding that might otherwise exist.

D. *Tax Treaties*

1. FORWARD, NOT BACKWARD

In 1950, a writer commenting about the status of the use of tax treaties for international tax enforcement said "[A]lthough the need for improvement should be recognized, the achievements of the immediate past should not be ignored."²³⁰ At the time there were but eight treaties

230. Note, *International Enforcement of Tax Claims*, *supra* note 200, at 504.

in force; today there are more than twenty.²³¹ Today, fifteen years later, those "achievements" have all but disappeared.

Not only have all the subsequent treaties failed to include meaningful collection provisions, but even the collection provisions in the older treaties have been largely ignored. The Treasury Department has concentrated all its treaty activity in the area of prevention of double taxation, and the second avowed purpose of the treaties, "Prevention of Fiscal Evasion," has become the forgotten stepchild of international taxation. The reasons for this have already been mentioned: Congressional disapproval in the past, administrative indifference, and Treasury Department preoccupation with substantive treaty problems.

The attempts in the late 1940's to put effective collection provisions in treaties failed primarily because at the time the Treasury Department was not in a position to refute the contention that international evasion was no real problem, and did not warrant interference with our international trade. It has become evident that Congressional attitudes have since changed. With the advent of the predecessor of the OIO in 1955, the Treasury Department was able to accumulate information and statistics indicating widespread abuses in the international area. Congress responded by enacting strong enforcement legislation in 1960, and even stronger legislation in 1962.

What is now needed is a comprehensive program on the part of the Treasury Department to educate Congress as to the need for strong collection provisions in our new treaties. Congress helped solve the problem of obtaining *information* by the 1960 and 1962 Revenue Acts. But we have indicated that information is not enough. The taxes must be *collected*.

2. INCENTIVES

Once Congress is convinced that we should have collection provisions in our treaties, our next task will be to convince the countries with which we are negotiating tax treaties, that these collection provisions would also be in their interest.

This may be a problem, especially with the less developed countries. They may understandably take the attitude that they cannot afford to allocate any of their meager resources to collecting our taxes for us. After all, few of their taxpayers have investments in other countries,

231. Although only twenty-two treaties are presently in effect, many former colonies of countries with whom we have treaties are still covered by such treaties, resulting in the United States having tax treaty relationships with these additional countries: Burundi, Congo (Brazzaville), Congo (Leopoldville), Cyprus, Jamaica, Kenya, Nigeria, Rwanda, and Sierra Leone; U.N. Doc. No. F/3905/Add. 1, Annex III, p. 24 (May 26, 1964). Trinidad and Tobago terminated its treaty with the United States effective January 1, 1966. Treasury Dept. News Release F-330, Jan. 6, 1966.

and the chances of their calling on us for assistance with collection of their taxes is remote.

A suggestion that might meet this argument would be to offer to these countries a collection allowance of, perhaps, fifteen percent of the delinquent taxes collected for us, to offset any possible costs of collection. This would provide the needed incentive to induce the foreign country to make a determined effort to collect our taxes. The overall cost of these collection allowances would be comparatively small, and the knowledge that the tax evader will face rigorous enforcement by the tax officials of any country to which he repairs may well deter evasion.

Of course, the approval of Congress would have to be obtained for this provision. But Congress could also provide that any collection allowances so paid should be assessed against the taxpayer involved, resulting in no net collection cost to our government.

3. PROMULGATION OF REGULATIONS

The administrative and legal problems inherent in enforcement of collection provisions are not suitable for resolution on a local enforcement level. Guidelines must originate at the national level for local enforcement officers to follow. It is therefore imperative that the Treasury Department promulgate regulations under the tax treaties that will end the doubt, confusion, and uncertainty that presently attend and impede the full and effective implementation of the collection provisions.

Merely having collection provisions in a treaty is not enough. Full use must be made of them. The Justice and Treasury Departments should indicate, as a matter of policy, that their respective tax enforcement units should act to exploit these enforcement tools to their fullest extent.

4. UNIFORMITY OF TREATIES—OECD

In an effort to achieve a degree of uniformity in the drafting of income tax treaties, the Fiscal Committee of the Organization for Economic Cooperation and Development (OECD) promulgated a Model Income Tax Treaty.²³² This draft treaty was meant to be used as a guide by countries negotiating treaties, and also contained provisions relating to the exchange of information between governments. The model provision is as follows:

Article 26
Exchange of Information

1. The competent authorities of the Contracting States shall exchange such information as is necessary for the carrying out of this Convention and of the domestic laws of the Con-

232. Report of Fiscal Committee, O.E.C.D. Draft Double Taxation Convention on Income and Capital C(63) 87 (1963).

tracting States concerning taxes covered by this Convention insofar as the taxation thereunder is in accordance with this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any persons or authorities other than those concerned with the assessment or collection of the taxes which are the subject of the Convention.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on one of the Contracting States the obligation:
 - a) To carry out administrative measures at a variance with the laws or the administrative practice of that or the other Contracting State;
 - b) To supply particulars which are not obtainable under the laws or in the normal course of the administration of that or 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 (order public).²³³

The official commentary which accompanies the draft article indicates that the purpose of the above provisions is not to prevent evasion, but merely to obtain sufficient information from which to lay a basis for taxation under the Convention.²³⁴ The Commentary also states that "Contracting States should be free to agree bilaterally on special provisions intended to prevent fiscal fraud or evasion of tax."

Because the draft provision has no application to the prevention of evasion, the United States must insist on such "special provisions" in its treaties.²³⁵

It is regrettable that the Model Convention did not contain provisions against evasion. First, these measures may now be looked upon as unusual or extraordinary measures, and it may be difficult to persuade other countries as to their necessity. Second, a uniform provision for prevention of evasion would simplify the promulgation of regulations, since all efforts could then be concentrated on drafting one set of regulations that could apply to all treaties.

5. MULTILATERAL TREATIES

The recommendation of the Council of the OECD that members examine the feasibility of concluding multilateral treaties based on the

233. *Id.* at 56.

234. *Id.* at 157.

235. As one indication of the difficulty that may be encountered in convincing other nations of the need for strong enforcement provisions, Switzerland entered an express reservation on the Article. *Report of Fiscal Committee, supra* note 232 at 160.

OECD model may well foreshadow a new era of international cooperation.²³⁶ Whatever the merits of such a treaty from the standpoint of eliminating double taxation, it is very doubtful whether such a treaty could presently be enacted with the anti-evasion provisions herein advocated. Perhaps, and hopefully, the passage of time will be accompanied by such progress in this area that such a multilateral treaty could become a reality. However, it appears that our efforts could be directed more fruitfully toward first achieving success on a bilateral basis.

The successful enactment of strong collection provisions in treaty after treaty would then indicate a trend which might be followed in a multi-national agreement.

CONCLUSION

The main reason for the extensiveness of international tax evasion is a psychological one. The informed evader knows that even if his nefarious activities are brought to light by the tax authorities, there is little chance of the government collecting the tax deficiency thus established so long as the evader and his property remain outside of the physical jurisdiction of the country to which the taxes are owed.

Through a determined effort on the part of the Treasury Department to insert effective enforcement provisions in our tax treaties, artificial national boundaries will no longer serve the evader as a shelter behind which he can avoid the payment of his just tax obligations.

Moreover, the sinew of an enforcement muscle thus strengthened may well of itself dissuade many a potential evader from embarking on his evil course.

By convincing the evader that his efforts will prove to no avail, the ultimate method of preventing international tax evasion will have been achieved.

236. See Fox, *Functioning of the Office of International Operations*, 22 N.Y.U. TAX INST. 735, 748 (1964); Surrey, *Remarks Before the Tax Executives Institute, Montreal, Canada*, September 21, 1964, at 26.