

12-1-1982

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Hugh Spall

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Recommended Citation

Hugh Spall, *International Tax Evasion and Tax Fraud: Typical Schemes and the Legal Issues Raised by Their Detection and Prosecution*, 13 U. Miami Inter-Am. L. Rev. 325 (1981)

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International Tax Evasion and Tax Fraud: Typical Schemes and the Legal Issues Raised by Their Detection and Prosecution

HUGH SPALL*

During the latter half of the 1970's, the Federal Government began allocating increased amounts of resources for the investigation and prosecution of white collar crime.¹ In response to the increased attention that these offenses received, legal writers began devoting attention to the legal issues raised by these types of offenses.² One category which received attention was the crime of tax fraud. Most articles, however, discussed issues in a domestic fraud case. The peculiar issues that arise when tax evasion takes on an international character were largely ignored.³

The Internal Revenue Service, hereinafter referred to as the I.R.S., believes that the use of foreign jurisdictions for tax evasion

*Associate Professor of Economics Central Washington University (on leave as a John M. Olin Fellow at the University of Miami Law and Economics Center), J.D. 1982 University of Miami Law School; member of the Washington Bar.

1. The term "white collar crime" lacks a formal definition. The term was coined by journalists to cover a gamut of offenses ranging from extortion to securities fraud. Many of the offenses arise from statutes that regulate economic activity. The crime can be committed by violating a statute or administrative regulations promulgated to enforce the statute. Sometimes a crime is labeled "white collar crime" because of the accused's identity (businessman or government official) rather than because of the nature of the offense. The offenses most commonly considered white collar offenses are: mail and wire fraud, conspiracy, violation of the Travel Act, conflicts of interest, bribery, extortion, perjury, false statements, defrauding the government, Medicaid and Medicare fraud, violation of the Foreign Corrupt Practices Act, RICO offenses, criminal antitrust violations, violations of the Food and Drug Act, environmental crimes, computer crimes, and, of course, tax fraud. See 18 AM. CRIM. L. REV. (1980) (entire issue devoted to white collar crime) and Doramus, *The White Collar Chafes: Looking for Evidence After Indictment*, LITIGATION, Spring 1980, at 16.

2. Note 1, *supra*. See also, Obermaier, *Special Aspects of Litigating White Collar Criminal Cases*, LITIGATION, Spring 1980, at 12. Other examples also exist, but citation to them would not be helpful.

3. See, e.g., Garbis, *Defenses and Discovery in Tax Fraud Investigations*, 10 CUM. L. REV. 655 (1980); Dickstein and Forbes, *Tax Fraud*, 18 AM. CRIM. L. REV. 298 (1980); Feffer and Abrams, *Trial of a Criminal Tax Fraud Case: Prosecution and Defense Perspectives*, LITIGATION, Spring 1980, at 19; Smith and Robinson, *Tax Fraud: An Overview for Practitioners*, 57 TAXES 331 (1979); Walter, *The Battle for Information: Strategies of Taxpayers and the I.R.S. to Compel (or Resist) Disclosure*, 56 TAXES 740 (1978). None of these authors discusses the issues raised in this paper.

purposes has been increasing and shows potential for serious abuse.⁴ To counteract this problem, the agency plans to ask Congress for more resources for the detection and prosecution of this offense.⁵ As a result, the legal issues present in this type of offense are likely to appear with greater frequency in the future.

This study addresses the legal issues that are likely to arise in a prosecution for tax evasion when the evasion scheme makes use of foreign tax jurisdictions. It is composed of three parts: Part I describes common tax evasion schemes and the government's methods of proving the offense in court; Part II describes the investigative techniques that the I.R.S. uses to detect the crime and to gather evidence for presentation in court. This part of the study also discusses the legal issues that may arise during the course of information gathering and at trial when the evidence is introduced. Part III summarizes Parts I and II and presents overall conclusions.

I. COMMON TAX FRAUD SCHEMES AND METHODS OF PROVING THEM

A. *Evasion and Fraud in Federal Tax Law*

The Internal Revenue Code distinguishes between an attempt to evade or defeat a tax imposed by the code⁶ and the crime of tax fraud.⁷ Although different maximum penalties can be imposed upon conviction of the two crimes,⁸ in practice the courts and practitioners use the two concepts interchangeably.⁹ Both crimes require a "willful" state of mind,¹⁰ with "willful" being defined as the intentional violation of a known legal duty.¹¹ The major practical distinction

4. INTERNAL REVENUE SERVICE: TAX HAVENS AND THEIR USE BY UNITED STATES TAXPAYERS—AN OVERVIEW: A REPORT TO THE COMMISSIONER OF INTERNAL REVENUE, THE ASSISTANT ATTORNEY GENERAL (TAX DIVISION) AND THE ASSISTANT SECRETARY OF THE TREASURY (TAX POLICY), 3-5,9 (1981).

5. *Id.* at 10.

6. I.R.C. § 7201 (1976).

7. I.R.C. § 7206 (1976).

8. Compare I.R.C. § 7201 (1976), with I.R.C. § 7206 (1976).

9. H. BALTER, TAX FRAUD AND TAX EVASION, ¶ 2.02, at 2-3 (4th ed. 1976 & 1980 Cum. Supp.).

10. *Id.*

11. *United States v. Pomponio*, 429 U.S. 10 (1976). The government charged the *Pomponio* taxpayers with violating section 7206 of the Code (the tax fraud section) in two ways: (1) by causing their controlled corporation to report payments to the taxpayers as loans when in fact the payments were dividends, and (2) claiming partnership losses when the losses were attributable to the corporation. Upon conviction, the taxpayers appealed. The court of appeals reversed because the statute required the jury to find that the taxpayer had an evil motive and the jury had been

between the two concepts is that a tax must be due and owing before one can be guilty of tax evasion, whereas one can be guilty of tax fraud even if no tax is due and owing.¹² In most cases, of course, taxpayers who falsify material matters on tax documents are also attempting to defeat or evade a tax. Sometimes, however, a taxpayer with an illegal source of income may be more concerned with concealing the income source than with evading the tax. A taxpayer with illegal income may decide that it is easier for the government to convict him of tax evasion instead of the underlying offense which gives rise to the income¹³ and foreclose this line of attack by paying

instructed that motive was irrelevant unless it bore on intent. In a per curiam opinion, the Supreme Court reversed the court of appeals, holding that willfulness required no proof of motive other than an intentional violation of a known duty. *Id.* at 12.

12. Compare I.R.C. § 7201, with I.R.C. § 7206 (1976). Section 7201 speaks of an attempt to defeat a tax whereas section 7206 speaks of falsifying returns and other documents with respect to a material matter. The section does not speak of a tax due and owing. Thus, a taxpayer could be guilty of tax fraud if he reported all of his income but falsified the source of his income.

A taxpayer found himself in this situation in *United States v. DiVarco*, 484 F.2d 670 (7th Cir. 1973). The taxpayer reported his income but misstated its source. He argued that since there was no showing that he had understated his income, he should not be prosecuted under I.R.C. § 7206 (1) (1976). Instead, he wanted to be found in violation of 18 U.S.C. § 1001 (the false statement statute) because the statute of limitations barred prosecution for this offense. The district court held that the taxpayer could be prosecuted under section 7206(1) for falsifying his source of income even if he had reported the amount earned as this was a material misstatement within the meaning of the statute. The Seventh Circuit affirmed the judgment of the district court.

13. The conviction of alleged Chicago mobsters Al Capone and Jake Guzik provide classic examples of this proposition. *Capone v. United States*, 51 F.2d 609 (7th Cir. 1931); *Guzik v. United States*, 54 F.2d 618 (7th Cir. 1931). Income tax evasion is easier to prove than other criminal offenses because the corpus of the crime (a tax due and owing and willfulness) can be proven entirely by circumstantial evidence. *Holland v. United States*, 348 U.S. 121 (1954) provides an excellent illustration. The taxpayers in *Holland* reported \$10,211 of taxable income while their net worth (assets minus liabilities, both valued at cost) increased by \$32,000 during the taxable year. The government inferred from this evidence that the taxpayers had unreported income which they used to acquire assets. The taxpayers countered by claiming that they had accumulated a cash hoard of \$104,000 prior to 1933 — the date that the government had computed their opening net worth. The government did not introduce evidence which directly contradicted this claim. Instead, it relied on the inference that anyone with this amount of cash would not have lost their café, lost their furniture, and accumulated unpaid debts of \$35,000 in the 1930's. In addition, the government showed that the taxpayers' income tax returns from 1913 to 1933 did not show enough taxable income to enable the taxpayers to accumulate that amount of cash. The Court held that the net worth could be used to prove income tax evasion where opening and closing net worth could be proven with reasonable certainty, the resulting increase could not be explained by reported taxable income, the government proves a taxpayer has a source of taxable income, and the underreporting of income was willful. *Id.* at 132, 137-39.

taxes. While he could accomplish this goal by reporting his income and claiming his fifth amendment privilege,¹⁴ he may be reluctant to do so for fear of drawing attention to himself. A taxpayer with an illegal source of income who believes his illegality is not suspected may decide that reporting his income, but misstating its source, is a particularly attractive option. For him, as well as for taxpayers who wish to evade taxes, foreign tax havens offer a singularly attractive opportunity.

B. Tax Havens and Common Tax Evasion Schemes.

The term "tax haven" has numerous definitions.¹⁵ This study adopts the I.R.S.'s use of the term. The agency defines a tax haven as a country characterized by:

(1) tax rates which are lower than the tax rates imposed by the countries whose residents use the tax havens;

(2) commercial and bank secrecy laws which the jurisdiction refuses to breach, even when faced with a serious violation of the laws of another country;

(3) relative importance of banking in the economy;

(4) availability of modern communications facilities;

(5) lack of currency controls on non-residents with respect to foreign currency; and, in most cases,

(6) aggressive self promotion as a tax haven.¹⁶

Based on these criteria, the I.R.S. considers eleven countries tax havens: the Bahamas, Bermuda, Cayman Islands, Hong Kong, Luxembourg-Belgium (trade data for the two countries cannot be separated), the Netherlands, Netherlands Antilles, Panama, Singapore, and Switzerland.¹⁷

14. *United States v. Sullivan*, 274 U.S. 259, 263 (1927). Sullivan, a bootlegger, was convicted of failing to file an income tax return. The court of appeals reversed his conviction, holding that illegal income was taxable but that a recipient of illegal income was excused from filing a tax return by the fifth amendment. The Supreme Court reversed the court of appeals, holding that Sullivan was required to file a return but that he could claim the fifth amendment privilege with respect to any answers that could incriminate him.

15. For a discussion of these definitions, see INTERNAL REVENUE SERVICE, *supra* note 4, at 14.

16. *Id.* at 14-20.

17. *Id.* at 17 nn.6, 20, 149. The Netherlands is considered to be a tax haven because her special holding company legislation and network of income tax treaties facilitate the use of Netherlands companies by third country residents in spite of her high tax rates.

The I.R.S. has identified five common patterns of tax evasion involving the use of tax havens: double trusts, use of secret bank accounts to hold unreported income, use of controlled foreign corporations to inflate the expenses or basis of property of a U.S. based corporation, use of commodities transactions to generate ordinary losses followed by long term capital gains, and repatriation of untaxed funds.¹⁸ Any one of these schemes can be used for tax evasion, tax fraud, or a combination of both.

The commercial secrecy laws of the tax havens make these schemes viable by allowing the taxpayer to conceal his ownership interests in business entities and foreign bank accounts. The Confidential Relationships (Preservation) Law of the Cayman Islands, for example, forbids the disclosure of all corporate information except the name of the corporation, the date of incorporation, and the registered office of the corporation.¹⁹ The latter can be the office of the corporate attorney.²⁰ In Switzerland, the situation is not much better. Although corporations are subject to extensive public disclosure requirements, ownership interests can be concealed easily through the use of nominees and bearer shares.²¹ In addition, the Swiss penal code makes information gathering without governmental authorization a crime, thus subjecting I.R.S. agents to risk of imprisonment if they should attempt to gather information without Swiss government approval.²² The United States has two treaties with Switzerland which pledge cooperation in the investigation of tax crimes, but the I.R.S. has not found them useful in their enforcement endeavors.²³

Without direct access to commercial and bank information regarding individual taxpayers who conduct business through tax havens, the I.R.S. is deprived of investigating many of their tax evasion and tax avoidance schemes. For example, section 482 authorizing the I.R.S. to reallocate income among related taxpayers,²⁴ is a dead letter if the I.R.S. cannot prove that two taxpayers are related. Section 6038, which requires U.S. controlled foreign corporations to maintain records reporting income, balance sheets, and transactions with related entities,²⁵ cannot be enforced if the I.R.S. cannot find out who

18. *Id.* at 118-24. The I.R.S. actually identifies eight patterns of tax evasion but these eight patterns have been condensed into the five patterns listed above.

19. INTERNAL REVENUE SERVICE, *supra* note 4, at 198-200.

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. I.R.C. § 482 (1976).

25. I.R.C. §§ 6038, 964(c), Treas. Reg. 1.964-3(a)(b).

controls a foreign corporation. In view of these difficulties, the I.R.S.'s difficulties in prosecuting tax crimes when the taxpayer uses a tax haven in his criminal efforts is not surprising. During the period 1978-81, for example, the I.R.S. identified 250 criminal cases involving offshore transactions, but was forced to forgo prosecution in many of these because a key element of the case could not be established.²⁶

Once incorporated behind the shield of the commercial secrecy laws, a taxpayer can proceed with his illegal schemes. If he wants to evade taxes, he can buy from the foreign corporation at inflated prices, reducing his U.S. income, increasing his basis in U.S. property, and, at the same time, increasing the profits of his foreign subsidiary. If the taxpayer does not wish to evade taxes, but merely wishes to conceal an illegal source of income, the foreign corporation can buy goods from the taxpayer at inflated prices, or it could hire the U.S. taxpayer as a "consultant." Either activity could provide a legitimate source for the income that the taxpayer reports to the I.R.S.

These schemes are not foolproof. The I.R.S. has methods of circumventing the commercial secrecy laws.²⁷ The use of tax havens, however, does make the usual methods of proving tax crimes more difficult to apply.

C. *Methods of Proving the Crime*

The government has three methods of proving tax evasion: (1) proving the receipt of specific items of unreported taxable income or the overstatement of deductions; (2) the net worth-expenditure method of reconstructing taxable income; and (3) the bank deposit-cash expenditure method of reconstructing taxable income.²⁸ Any reasonable method of proof is permissible, but these three methods are the most common.²⁹ Each of these methods merits further discussion.

The receipt of specific items of income or the overstatement of deductions can be proven in a variety of ways. The government can demonstrate that the taxpayer did not record certain cash receipts.³⁰

26. INTERNAL REVENUE SERVICE, *supra* note 4, at 111.

27. *See infra* text at 338.

28. BALTER, *supra* note 9, ¶13.03[3] & [4], at 13-12 to 13-42.

29. *Id.* ¶13.03[4][c], at 13-40.

30. *Shaffer v. Wilson*, 523 F.2d 175 (10th Cir. 1975) provides a good example. Shaffer was a dentist who failed to record all of his receipts in his log book. Instead, these unrecorded receipts were recorded in a second book, called a "cheat book." In addition, Dr. Shaffer padded his supply expenses and wrote checks for services never performed. Unfortunately for Dr. Shaffer, he felt compelled to brag about his exploits to patients and employees. A search warrant was issued, based on the

Alternatively, if the taxpayer does not receive cash remuneration, the government can use the concept of economic benefit to demonstrate that the taxpayer had an unreported taxable event.³¹ If a corporation is involved, the government might prove that the taxpayer engaged in a sham transaction to disguise a dividend as a non-taxable disbursement—for example, disguising a dividend as a loan.³²

The use of foreign tax havens presents a problem when the I.R.S. attempts to prove specific items of unreported income or specific overdeductions. The books of a foreign entity that does no business in the United States are not subject to administrative summons or grand jury subpoena unless the entity is controlled by the U.S. taxpayer.³³ Even if they are controlled by a U.S. taxpayer, the government may be unaware of the true state of control, or if aware of it, unable to prove the control in an enforcement proceeding.³⁴ The government, therefore, may be unable to prove that a specific expense was ever incurred because it cannot examine the books of the other firm for a corresponding receipt entry. Likewise, if proof of control is absent, the government will be unable to prove the taxpayer is using the foreign firm to fraudulently reassign income.

The net worth method of reconstructing income provides an alternative to proving tax evasion by showing the omission of specific items of income or overstatement of deductions. In order to prove tax evasion by the net worth method, the government must establish:

- (1) a reliable net worth at the beginning of the tax year (assets minus liabilities, both valued at cost);
- (2) a reliable net worth at the close of the tax year; and

affidavits of three former employees, and his records and "cheat book" were seized. Dr. Shaffer was convicted of income tax evasion.

31. *Davis v. United States* 226 F.2d 331 (6th Cir. 1955). Davis was the sole owner of a corporation. He took corporate receipts and used them for personal expenses and investments without reporting them on the corporate books. When he was indicted on income tax evasion he defended on the ground that the funds would be taxable income to him only if they were dividends. He argued that the government did not prove that the corporation had sufficient earnings and profits to pay a dividend. The court held that whether the cash represented a dividend was not relevant. He had received command over property and the enjoyment of an economic benefit. Even though creditors of the corporation might be able to attack his title to the property, he had command over it. Command over property and enjoyment of an economic benefit are a proper base for taxation. *Id.* at 334-35.

32. For an example of this approach, see *supra* note 11.

33. See I.R.C. § 7604(a) (1976).

34. See *supra* notes 19-23, and accompanying text.

(3) a likely source of taxable income or the negation of *all* sources of non-taxable income.³⁵

The opening net worth figure must be proven with reasonable certainty and the I.R.S. must diligently investigate any leads that the taxpayer provides which can explain the change in net worth.³⁶

The difference between net worth at the end of the taxable year and the beginning of the taxable year, plus non-deductible expenditures, plus certain other adjustments, equals the taxpayer's estimated taxable income.³⁷ The difference between estimated taxable income and reported taxable income equals unreported income. The government, of course, must still prove that the understatement of income was willful.³⁸

A reliable opening net worth statement is essential to a net worth case.³⁹ If the taxpayer can demonstrate that the I.R.S. has overlooked assets or liabilities, then the calculations described in the previous paragraph are unreliable and the taxpayer can win acquittal.

Practitioners believe that it is not difficult for the I.R.S. to determine the existence and cost of nearly all the taxpayer's assets except cash on hand (as distinguished from cash in the bank) as of a given date.⁴⁰ Thus, the overlooked cash hoard becomes the classic defense in a net worth case. If believed at trial,⁴¹ prior accumulated cash

35. BALTER, *supra* note 9, ¶13.03[4][a], at 13-14. The net worth method was sanctioned by the United States Supreme Court in *United States v. Johnson*, 319 U.S. 503 (1943). Johnson was a Chicago gambler who reported up to one-half million dollars of gambling winnings as income. The government was unable to prove that Johnson had more income than he reported because the gambling houses that he owned destroyed their records. Instead, the prosecution proved that his expenditures exceeded his available resources. The Court held that the evidence was sufficient to sustain a conviction. In explaining its decision, the Court stated that requiring more proof than the record disclosed "would be tantamount to holding that skillful concealment is an invincible barrier to proof." *Id.* at 516-18.

36. *Holland v. United States*, 348 U.S. at 125, 137-38. *United States v. Massei*, 355 U.S. 595 (1958). *Massei* answered a question that *Holland* left unresolved—must the government show a likely source of taxable income when using the net worth-expenditures method of proof or can it negate all sources of non-taxable income? The Court held that the government could negate all sources of non-taxable income. *Id.* at 595. The Court's holding was published in a curt *per curiam* opinion that did not even bother to report the facts of the case.

37. 348 U.S. at 125. For a numerical illustration of the net worth-expenditures method of proof, see Plotkin, *Government Theories of Tax Fraud: An Analysis of the Most Used Methods*, 37 J. TAX. 211, 213, Exhibit III (Oct. 1972).

38. *Holland v. United States*, 348 U.S. at 139.

39. *Id.* at 132.

40. BALTER, *supra* note 9, ¶13.03[4][a][ii], at 13-18.

41. The conventional wisdom is that the cash hoard defense is usually unsuccessful. *Id.* ¶13.02[4][a][ii], at 13-20, 13-21 n.65.

hoards can destroy the government's net worth calculations. The government cannot defeat the argument by suggesting that the cash hoard was accumulated out of unreported income in years not covered by the indictment because the government must prove tax evasion for the years stated in the indictment.⁴² A cash hoard which the government failed to include in opening net worth, even if accumulated from the proceeds of tax evasion during a pre-indictment year, would tend to negate the inference of evasion in the years covered by the indictment.

The previous paragraph describes the typical issues that arise in a domestic evasion case when the government uses the net worth method of proving evasion. As indicated, the government's major problem is establishing opening net worth, and in particular, negating the suggestion that it has failed to account for large sums of cash in the taxpayer's possession at the beginning of the tax year. When a taxpayer uses a tax haven in his evasion scheme, however, the government's major problem is different. In this type of case, the government's major proof problem is the taxpayer's net worth at the close of the tax year. An example may make the problem clear.

A typical tax evasion scheme involves surreptitiously removing untaxed income from the United States and depositing it in a tax haven.⁴³ A taxpayer is supposed to report his foreign bank holdings at tax time,⁴⁴ but of course, a tax evader will not. The deposit becomes security for a loan from the receiving bank or some other bank within the tax haven. The loan is then used to purchase assets in the United States or in some other country. If the taxpayer is investigated by the I.R.S., the taxpayer explains that he has been able to acquire his additional assets because he has obtained a bank loan. Both the bank and the taxpayer claim the bank loan is a signature loan, not a secured loan. Because of the bank secrecy laws in the tax haven, the I.R.S. is unable to prove otherwise. Since the government is unable to prove the taxpayer's net worth at the close of the tax year is higher than at the beginning of the year, the government cannot prosecute.⁴⁵

This fact pattern is similar to the fact pattern occurring in *X v. Eidgenössische Steuerverwaltung*,⁴⁶ a famous Swiss banking case.

42. *Id.* ¶13.02[3], at 13-13.

43. INTERNAL REVENUE SERVICE, *supra* note 4, at 116.

44. 31 U.S.C. § 1121 (1970), 31 C.F.R. § 103.24 (1977).

45. INTERNAL REVENUE SERVICE, *supra* note 4, at 116.

46. BGE 96I737 (Dec. 23, 1970); 2 CCH TAX TREATIES, New Developments, 9795 (June 28, 1971).

Only an excerpt of the case has been reported. According to the private publication of a Swiss scholar, the facts can be summarized as follows:⁴⁷ X, who was domiciled in the United States, sent funds from his untaxed earnings to a Swiss bank. The bank made a loan to X who repaid the loan and deducted the interest from his U.S. income tax. After repayment of the loan, the bank repaid the interest plus the principal to X (probably as a refund of X's original deposit). The government requested information about X's transaction with the bank under the 1951 tax treaty between the two countries and the request was granted.⁴⁸ The victory was hollow, however, for Switzerland does not transmit information to the United States in a form which makes it admissible in U.S. criminal proceedings.⁴⁹ Thus, unless the information was useful in locating other evidence, the government's victory accomplished very little.

The United States has two treaties with Switzerland in which the nations pledge to cooperate in tax investigations. The first is an income tax treaty, ratified in 1951. The second is a mutual assistance treaty in criminal matters, which became effective in 1973. When X arose, the 1973 treaty was not in existence. The outcome, however, would probably have been the same under the 1973 treaty as under the 1951 treaty. The 1973 treaty offers little, if any improvement over the 1951 treaty.⁵⁰ The limited usefulness of these treaties is not unusual. In the I.R.S.'s experiences, tax treaties with other countries have not been helpful in criminal tax investigations.⁵¹

The previous discussion suggests that the I.R.S. has difficulty proving tax evasion by using the net worth-expenditures method of reconstructing income when the taxpayer makes use of tax havens to conceal his financial transactions. The root of the problem consists of obtaining an accurate estimate of the taxpayer's foreign assets in a form admissible in U.S. courts. In a net worth case, the usual approach is to have the taxpayer stipulate or admit to his initial net

47. Kronauer, *Information Given for Tax Purposes from Switzerland to Foreign Countries Especially to the United States for the Prevention of Fraud or the Like in Relation to Certain American Taxes*, 30 TAX L. REV. 47, 70-71 (1974), summarizing HOEHN, IN DAS SCHWEIZERISCHE BANKGEHÄMNIS, BANKWIRTSCHAFTLICHE FORSCHUNGEN BAND 10, at 39 (1972).

48. *Id.* at 70-71.

49. *Id.* at 75; Abrams, *Tax Evasion and Swiss Banking Secrecy*, PRACTICAL LAW, June 1, 1978, at 77, 81; Switzer, *Exchange of Information Articles*, 26 CAN. TAX. I. 306, 311 (1978).

50. INTERNAL REVENUE SERVICE, *supra* note 4, at 210; Abrams, *supra* note 49, at 82.

51. *Id.* at 208.

worth.⁵² The I.R.S. then estimates expenditures and closing net worth by examining public records, bank records, and obtaining admissions. The taxpayer, however, does not have to make statements to the I.R.S. He can invoke his fifth amendment privilege against self incrimination, forcing the I.R.S. to rely on the unprivileged information that it can gather through summons, subpoenas, and search warrants,⁵³ further increasing the government's evidence problems.

Practitioners believe that the probability of successfully defending a tax evasion charge largely depends on how successfully the taxpayer can assert his fifth amendment privilege.⁵⁴ Some of the most damaging evidence presented in court is information that the defendant provided but did not have to provide.⁵⁵ The secrecy laws of tax havens will not protect the taxpayer if the I.R.S. can convince a taxpayer using a tax haven to stipulate to his net worth or foreign liabilities. One wonders, however, whether a taxpayer, who is sophisticated enough to use a tax haven for tax evasion purposes, will voluntarily provide information about his assets and liabilities.

Tax havens place obstacles in the path of the I.R.S. when it attempts to use the net worth method of proving tax evasion, especially when the I.R.S. attempts to use the bank deposits method of proof. There are three requirements for a bank deposit case: (1) a going business to explain the source of the reconstructed income; (2) periodic deposits—reasoned to be the result of a going business; and (3) an adjustment of deposits to reflect current income only.⁵⁶

The adjustment to deposits occurs as follows:⁵⁷ first, deduct items of a non-income nature (e.g., loans) to estimate the component of deposits reflecting income, and then add known cash expenditures not reflected in deposits. The sum of net deposits plus known cash expenditures equals estimated gross income. Next, subtract deductible business expenses and add cash item expenses from the estimated gross income. The resulting figure is estimated adjusted gross income. This

52. BALTER, *supra* note 9, ¶13.03[4][a][ii], at 13-20 n.64; Feffers and Abrams, *supra* note 3, at 19.

53. For a discussion of the issues raised by summons, subpoenas, and search warrants in domestic tax fraud cases, see Garbis, *supra* note 3 and *Notes: Discovery in the IRS Summons Enforcement Proceeding: Less Certain Than Death and Taxes*, 31 U. FLA. L. REV. 321 (1979).

54. See Garbis, *supra* note 3, at 655-56; Feffers and Abrams, *supra* note 3, at 19; Smith and Robinson, *supra* note 3, at 331.

55. *Id.*

56. BALTER, *supra* note 9, ¶13.03[4][b], at 13-39.

57. Plotkin, *supra* note 37, at 212.

figure can be compared to the figure the taxpayer reported to determine whether the taxpayer has concealed income.⁵⁸

The bank deposits-cash expenditure method of reconstructing income suffers from many of the same difficulties as the net worth method when the taxpayer uses a foreign tax haven. Unless the taxpayer cooperates with the I.R.S., and honestly reports his initial level of assets and liabilities, the Service cannot be certain that it has netted all items of a non-income nature out of the taxpayer's bank deposits. A taxpayer might willingly report a loan from a foreign bank to explain a deposit, "forgetting" to mention that it is secured by a bank deposit that he has spirited out of the country. Unless the I.R.S. can penetrate the tax haven's bank secrecy laws, the government may be unable to prove tax evasion at trial.

II. METHODS OF OBTAINING EVIDENCE ABROAD

The I.R.S. has five methods of obtaining evidence for use in tax trials: (1) voluntary cooperation of the taxpayer; (2) compulsory process; (3) search warrants; (4) tax treaties; and (5) covert operations.⁵⁹ Methods one and three, voluntary cooperation and search warrants, do not raise unusual legal issues when evasion or fraud take on an international character. The remaining three techniques, compulsory process, exchange of information treaties, and covert operations, raise issues which are not likely to appear in a domestic tax evasion case.

A. *Compulsory Process*

Compulsory process can take one of three forms: (1) an I.R.S. summons, (2) a grand jury subpoena, and (3) letters rogatory.

(1) *The Summons*

The I.R.S. can issue an administrative summons ordering a taxpayer or third party record keeper to produce his books and records for examination.⁶⁰ When the taxpayer or record keeper receives the summons, he has several options: (1) he can refuse to appear; (2) he can appear and refuse to produce his books and records, stating his reasons for refusing;⁶¹ or (3) he can comply.

58. For a numerical example, *see id.*, Exhibit II.

59. INTERNAL REVENUE SERVICE, *supra*, at 180-210.

60. I.R.C. § 7602 (1976).

61. *Reisman v. Caplin*, 375 U.S. 440, 445 (1964).

If the summons recipient refuses to appear, he can be fined, or imprisoned, or both.⁶² These sanctions, however, cannot be imposed without a court order.⁶³ The statute providing venue for such an action fails to provide venue for a person or business domiciled outside of the United States.⁶⁴ Thus, an action cannot be taken against a taxpayer or record keeper until he enters the United States unless the summons recipient is a U.S. citizen and the government chooses to proceed against him by grand jury subpoena.⁶⁵ Once within the jurisdiction of a district court, however, contempt proceedings could be initiated. Given the language of 7210, the summons recipient would probably be held in contempt for failure to appear in response to the summons.⁶⁶ If the summons recipient is a third party record keeper who does not anticipate ever entering the jurisdiction of a U.S. district court, this sanction is probably insufficient to force compliance with the statute. If he does not fall into this category, however, his wisest course of action is to appear. A summons recipient will not be held in contempt if he appears before the I.R.S. and refuses to produce his books and records, giving a good faith reason for doing so.⁶⁷ If he appears and refuses to produce the required information, the I.R.S. must seek an order to compel production from the U.S. district court.⁶⁸ At the hearing, which is an adversarial proceeding, the taxpayer can litigate his challenge to the summons.⁶⁹ After hearing

62. I.R.C. § 7210 (1976).

63. *Reisman*, 375 U.S. at 446-48.

64. I.R.C. §§ 7402(b) (1976), 7604(a) (1976). See *United States v. Hankins*, 581 F.2d 431, 438 n.11 (1978). Hankins was an attorney who was ordered to testify about the tax affairs of one of his clients by the district court. On appeal, he challenged the jurisdiction of the district court, arguing that 7402(b) only gave jurisdiction to the court sitting in the district where the taxpayer resided or was found. The court rejected his argument, holding that section 7402(b) was a venue provision and that the attorney had waived his objection by not raising it in district court.

65. The I.R.S., however, can circumvent this limitation on its summons power by submitting the matter to a grand jury who can issue a subpoena. 28 U.S.C. § 1783 (1976). The constitutionality of subpoenaing U.S. citizens residing abroad was upheld in *United States v. Blackmer*, 284 U.S. 421 (1932). Blackmer was a U.S. citizen who fled abroad to avoid testifying in the Teapot Dome Scandal. In order to force testimony from the scandal's participants, Congress passed the Walsh Act, currently 28 U.S.C. § 1783 (1976). The constitutionality of the Walsh Act was upheld in the *Blackmer* case. For a history of the subpoena power over U.S. citizens abroad, see Gallagher, *Subpoena Service on Citizens Residing Abroad: A Proposal for the Adoption of an International Approach in Criminal Proceedings*, 12 INT'L LAW. 563 (1978).

66. *Reisman*, 375 U.S. at 446-47; I.R.C. § 7210 (1976).

67. *Reisman*, 375 U.S. at 447.

68. *Id.* at 445-46.

69. *Id.* at 449.

argument, the court orders production on pain of contempt or quashes the summons.

In challenging a summons, the summoinee can claim four defenses: (1) the requested information is not relevant; (2) compliance would violate his fourth and fifth amendment rights; (3) the information is privileged; or (4) that the summons has been issued for an improper purpose.⁷⁰ These issues have been litigated extensively where domestic evasion and fraud are involved, and therefore will not be discussed here.⁷¹ When tax evasion occurs with the help of a tax haven, however, an I.R.S. summons can raise issues which do not occur in a domestic tax case. These issues will be discussed here.

Suppose that a summons recipient controls a foreign subsidiary, and further, that the I.R.S. issues a summons which orders him to produce the subsidiary's records for an audit. Next, assume the subsidiary is located in a jurisdiction with a commercial secrecy law and local law makes revelation of these records a crime. Can the taxpayer refuse to surrender records on the grounds that doing so will subject him to criminal sanctions in the foreign country?

Most of the litigation concerning the effect of foreign law on the production of business records occurs because a party to a private civil lawsuit fails to comply with discovery order. There is one case where compliance with an I.R.S. summons was litigated — *First National City Bank of New York v. IRS*.⁷² This case involved a summons to a third party record keeper, but the rationale would seem to apply equally to the summoinee in our example. In this case, the I.R.S. served a summons on Citibank at its New York office calling on Citibank to produce all relevant records, wherever held, relating to the accounts of a corporate customer of the bank.⁷³ The bank produced its New York records but refused to produce records physically located in Panama, claiming that to do so would violate Panamanian law and established principles of international comity.⁷⁴ The district court modified the summons and ordered production of local records only.⁷⁵ The Second Circuit found the evidence insufficient to establish that production of the records would violate Panamanian law and reversed, ordering reinstatement of the original summons.⁷⁶ The

70. *Id.*

71. *See supra* note 53.

72. 271 F.2d 616 (2d Cir. 1959).

73. *Id.* at 618.

74. *Id.*

75. *Id.*

76. *Id.* at 619-20.

court stated in dicta, however, that production of the records should not be ordered if it would violate Panamanian law.⁷⁷

Whether *First National City Bank of New York* is still good law is doubtful. A summons is enforced by a court order to produce documents, in effect by a subpoena. The case law gives mixed results when third party record holders have had their records subpoenaed and refused to comply because compliance would violate foreign law. In general, however, the more recent case law seems to indicate that the subpoena will be enforced.

(2) Subpoenas

Three years after *First National City Bank of New York* was decided, the Panamanian secrecy law became an issue again.⁷⁸ A grand jury issued a subpoena *duces tecum* for the records of bank accounts of four individuals and one corporation.⁷⁹ In this case, the bank was able to demonstrate that compliance with the subpoena would violate Panamanian law.⁸⁰ Although the violation would be equivalent to a misdemeanor, the district court refused to order Chase to produce the records held by its Panamanian branch. The Second Circuit affirmed.⁸¹

The decision of the Second Circuit was criticized as inconsistent with *Société Internationale v. Rogers*,⁸² a United States Supreme Court case.⁸³ In *Société Internationale*, the Court distinguished the power to order production of records from the due process limitations on the penalty that could be imposed for failure to obey a production order. *Société Internationale* arose under the Trading with the Enemy Act. *Société Internationale*, a Swiss company, petitioned for the return of property seized during World War II. The district court ordered the company to produce certain records as part of discovery.⁸⁴ The firm did not produce them, claiming that their production would violate Swiss law and that the Swiss Federal Attorney had issued an order prohibiting their release.⁸⁵ The district court dis-

77. *Id.* at 619.

78. *In re Chase Manhattan Bank*, 297 F.2d 611 (2d Cir. 1962).

79. *Id.* at 611-12.

80. *Id.* at 613.

81. *Id.* at 612-13.

82. 357 U.S. 197 (1958).

83. *Note: Discovery of Documents Located Abroad in U.S. Antitrust Litigation: Recent Developments in the Law Concerning Illegality Excuse for Non-Production*, 14 VA. J. INT'L L. 747, 752-55 (1974).

84. *Société Internationale v. Rogers*, 357 U.S. at 200.

85. *Id.* at 200-01.

missed the complaint for failure to comply with discovery and the D.C. Circuit affirmed.⁸⁶ The Supreme Court reversed.⁸⁷

In arriving at its decision, the Court noted that the case presented two issues: (1) Did the court have the power to order production of documents when to do so would violate the laws of another sovereign?⁸⁸ (2) Should the court have dismissed the complaint for failure to comply with the order?⁸⁹ The first question was answered in the affirmative; the Court answered the second question in the negative. In explaining its decision the Court stated:

We think that a party "refuses to obey" simply by failing to comply with an order. So construed the Rule allows a court all the flexibility it might need in framing an order appropriate to a particular situation. Whatever its reasons, petitioner did not comply with the production order. Such reasons and the willfulness or good faith of petitioner can hardly affect the fact of noncompliance and *are relevant only to the path which the District Court might follow in dealing with petitioner's failure to comply* . . . (emphasis added).

The provisions of Rule 37 which are here involved must be read in light of the provisions of the Fifth Amendment that no person shall be deprived of property without due process of law. . . . Certainly substantial constitutional questions are provoked by such action . . . petitioner's failure to satisfy fully the requirements of this production order was due to inability fostered neither by its own conduct nor by circumstances within its control. It is hardly debatable that fear of criminal prosecution constitutes a weighty excuse for nonproduction, and this excuse is not weakened because the laws preventing compliance are those of a foreign sovereign. . . .

It does not claim that Swiss laws protecting banking records should here be enforced. It explicitly recognizes that it is subject to procedural rules of United States courts in this litigation and has made full effort to follow these rules. It asserts no immunity from them. It asserts only its inability to comply because of foreign law.

In view of the findings in this case, the position in which petitioner stands in this litigation, and the serious constitutional questions we have noted, we think that Rule 37 should not be construed to authorize dismissal of this complaint because of peti-

86. *Id.* at 203.

87. *Id.* at 213.

88. *Id.* at 204.

89. *Id.* at 206.

tioner's noncompliance with a pretrial production order when it has been established that failure to comply has been due to inability, and not to willfulness, bad faith, or any fault of petitioner.⁹⁰

Société Internationale is a case interpreting the discovery rules of the Federal Rules of Civil Procedure. It is not a case in which a party was held in contempt for failing to obey an I.R.S. summons or a grand jury subpoena. A discovery order, however, is an order to produce information, as is a grand jury subpoena or a court order to comply with an I.R.S. summons. *Société Internationale*, therefore, may have application to grand jury subpoenas and court orders to comply with I.R.S. summonses. *Société Internationale* suggests that courts have the power to order production of records when the production would violate foreign law, but that due process may require the court to forgo sanctions if the recipient of the order makes a good faith effort to comply (e.g., seeks permission from the foreign government to comply), but cannot do so without incurring criminal sanctions in the foreign jurisdiction.

This same issue was addressed seven years later in sections 39 and 40 of the RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES. These sections state:

Section 39

Inconsistent Requirements Do Not Affect Jurisdiction.

(1) A state having jurisdiction to prescribe or to enforce a rule of law is not precluded from exercising its jurisdiction solely because such exercise requires a person to engage in conduct subjecting him to liability under the law of another state having jurisdiction with respect to that conduct.

(2) Factors to be considered in minimizing conflicts arising from the application of the rule stated in subsection (1) with respect to enforcement jurisdiction are stated in Section 40.

Section 40

Limitations on Exercise of Enforcement Jurisdiction.

Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as (a) vital national interests of each of the states, (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose

90. *Id.* at 208-12.

upon the person, (c) the extent to which the required conduct is to take place in the territory of the other state, (d) the nationality of the person, and (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.⁹¹

Shortly thereafter, courts began applying sections 39 and 40 when the objects of the subpoenas and court orders claimed that compliance would place them in violation of foreign laws.⁹²

Sections 39 and 40 of the RESTATEMENT (SECOND) have been applied only once in a tax evasion case—*In re United States v. Field*.⁹³ In this case, a bank official from Grand Cayman refused to answer questions before a grand jury investigating income tax evasion.⁹⁴ The district court held him in contempt and he appealed, claiming that the act of testifying would subject him to criminal sanctions in the Grand Caymans for violating the bank secrecy laws. The Fifth Circuit, in affirming the contempt citation, applied section 40 of the RESTATEMENT (SECOND), but completely ignored factor (b)—the hardship imposed on the individual by enforcement.⁹⁵ One commentator has criticized the court for failing to consider this factor,⁹⁶ but argued that its consideration would not have changed the result.⁹⁷

The commentator is probably correct, although he does not offer a detailed explanation of his conclusion. In passing, he suggests that the penalty imposed on an individual will not preclude enforcement when significant state interests are involved.⁹⁸ He does not, however, specify the “significant interests” at stake.

Political issues of enormous significance are at stake. The Federal Government channels billions of dollars of revenue to finance “social

91. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES, §§ 39, 40 (1965).

92. This approach is currently being used. See *In re Westinghouse Uranium Contracts*, 563 F.2d 992 (10th Cir. 1977) (discovery order in a breach of contract action); *In re United States v. Field*, 532 F.2d 404 (5th Cir. 1976) (grand jury subpoena in a tax evasion case); *In re United States v. First National City Bank*, 396 F.2d 897 (2d Cir. 1968) (subpoena *duces tecum* issued pursuant to an antitrust investigation).

93. 532 F.2d at 407.

94. *Id.* at 405.

95. See *id.* at 407-09.

96. Note: *United States v. Field*, 532 F.2d 404 (5th Cir. 1976)—*Alien's Fifth Amendment and International Law Defenses Held Invalid Before Federal Grand Jury Investigating Tax Evasion Schemes Involving Foreign Banks*, 30 TAX LAW. 470 (1977).

97. *Id.* at 476-77.

98. *Id.* at 476.

programs" (a euphemism for income redistribution). As explained in Part I of this study, tax havens provide an opportunity to evade being taxed. The bank secrecy laws of the tax havens play an indispensable role in this process. To allow those laws to provide an excuse for awarding compulsory process in a tax evasion case is to decide that those with income derived from money capital cannot be taxed. Since this category of taxpayer includes a large number of individuals, a decision to respect foreign bank secrecy laws would ultimately result in the necessity of choosing between the following options: (1) reduced social spending, or (2) replacement or supplementation of the income tax with some form of tax that cannot be evaded by transferring funds to tax havens (e.g., a sales tax). To present the Federal Government with that set of options would touch off vicious political warfare, something U.S. courts have not been willing to do since 1935.

Under these circumstances, due process considerations will yield. In *Société Internationale*, the United States Supreme Court faced this issue much more forthrightly than the Fifth Circuit did in *Field*. The Supreme Court recognized that serious due process questions were involved.⁹⁹ By forcing the corporation to produce records in Switzerland, the record keeper was placed in danger of having the corporation's Swiss property confiscated. The court refused to subject the corporation to a risk of loss of property. In contrast, the *Field* court was willing to subject an individual to a risk of loss of liberty. The countervailing state interest in *Field* was stronger than in *Société Internationale*, but what is significant is that the *Field* court *never considered the due process rights of the individual*. The Fifth Circuit's sole reference to the fifth amendment was a statement that the amendment did not apply because the act of testifying put the official in danger of criminal sanctions, not the content of his answers.¹⁰⁰ The fifth amendment, however, also states: "No person should . . . be deprived of life, liberty or property without due process of law. . . ." ¹⁰¹ Thus, there was a serious fifth amendment issue that the court did not face.

Although the *Field* decision is not compatible with that of *Société Internationale*, it is in the spirit of recent criminal tax evasion cases decided by the United States Supreme Court.¹⁰² In *United States v. LaSalle National Bank*, the Court held that the I.R.S. could issue a

99. 357 U.S. at 210-211.

100. 532 F.2d at 406-07.

101. U.S. CONST. amend. V.

102. See, e.g., *United States v. LaSalle National Bank*, 437 U.S. 298 (1978); *United States v. Payner*, 447 U.S. 727 (1980).

summons to a trustee of property compelling the production of books and papers over the taxpayer's objections *after* an I.R.S. special agent had decided to recommend criminal prosecution of the taxpayer.¹⁰³ The Court explained that the civil and criminal aspects of the Internal Revenue Code were inseparably intertwined and that the government does not abandon its interest in unpaid taxes merely because a criminal prosecution has begun. The Court stated: "Logically, . . . , the I.R.S. could use its summons authority under section 7602 to uncover information about the tax liability created by a fraud regardless of the status of the criminal case."¹⁰⁴ The Court stated further that the only limits on the summons power are the limits that Congress imposes by statute.¹⁰⁵

United States v. Payner is in keeping with the spirit of *LaSalle*. In the *Payner* case, the Supreme Court upheld a conviction against a third party based on evidence derived from a theft committed by an I.R.S. informant against a Bahamian bank official.¹⁰⁶ The Court held that the defendant lacked standing to suppress the evidence under the fourth amendment and under the Court's general supervisory power because he was not the thief's victim.¹⁰⁷

LaSalle National Bank and *Payner* are consistent with the Court's general approach to tax evasion cases. The Court has been quite candid about the way that it approaches evasion cases. In *United States v. Bisceglia*,¹⁰⁸ the Court stated, "we recognize that the authority vested in tax collectors may be abused, as all power is subject to abuse. However, the solution is not to restrict that authority so as to undermine the efficacy of the federal tax system . . ." ¹⁰⁹ (emphasis added). In *Donaldson v. United States*,¹¹⁰ the Court, speaking of the use of the summons power, stated, "to draw a line where a special agent appears would require the Service, in a situation of suspected but undetermined fraud, to forego either the use of the summons or the potentiality of an ultimate recommendation for prosecution. "We refuse to draw the line and thus to stultify enforcement of federal law"¹¹¹ (emphasis added). The Court cited the *Donaldson* language

103. *LaSalle National Bank*, 437 U.S. at 300-05, 313-15.

104. *Id.* at 312.

105. *Id.* at 311-12.

106. *Payner*, 447 U.S. at 730, 735-36.

107. *Id.* at 731-32, 735-36.

108. 420 U.S. 141 (1975).

109. *Id.* at 146.

110. 400 U.S. 517 (1971).

111. *Id.* at 535-36.

two years later in *Couch v. United States*.¹¹² In *United States v. Powell*, the Court held that probable cause was not necessary to issue an I.R.S. summons, stating “. . . we reject such an interpretation because it might seriously hamper the Commissioner in carrying out investigations he thinks warranted . . .”¹¹³ (emphasis added).

*Upjohn Company v. United States*¹¹⁴ provides the only recent example where the Supreme Court has sided with the taxpayer in a contest over the I.R.S.'s power to compel the production of information. In *Upjohn*, the I.R.S. attempted to acquire questionnaires, notes, and memoranda compiled by corporate attorneys who were investigating whether the firm's employees had bribed foreign officials.¹¹⁵ The Court held that the records were protected by the attorney-client privilege and the work-product doctrine.¹¹⁶ It should be noted, however, that the taxpayer was not attempting to defeat a tax evasion indictment. *Upjohn* voluntarily reported the payments to the I.R.S. and gave the agency a list of the people interviewed by corporate counsel.¹¹⁷ Thus, the ability of the I.R.S. to enforce the law was not at issue. The decision, therefore, does not represent a departure from the Court's apparent policy of giving the I.R.S. a free hand to enforce the tax laws.

The United States Supreme Court has never decided whether due process is violated by punishing a foreign bank official or corporate officer for refusing to testify about the activities of a U.S. taxpayer before a grand jury when such testimony might subject him to criminal prosecution in his own country. The Court's decision in *Société Internationale* suggests that they would give the issue serious consideration. Given the approach taken by the RESTATEMENT (SECOND), however, and the government's need for revenue, the Court would probably decide that due process was not violated. If Field had appealed, the Court would probably have upheld the Fifth Circuit.

(3) Letters Rogatory

Letters rogatory are requests for assistance from a court to a foreign government, usually in the form of written rogatories.¹¹⁸ The

112. 409 U.S. 322, 326 (1973).

113. 379 U.S. 48, 53-54 (1964).

114. 449 U.S. 383 (1981).

115. *Id.* at 387-88.

116. *Id.* at 389-91, 396-97.

117. *Id.* at 387, 396.

118. Doramus, *supra* note 1, at 18.

interrogatories are filed with the district court along with a motion for their issuance.¹¹⁹ If granted, they are translated, and sent to the foreign country through diplomatic channels to the other country's foreign ministry.¹²⁰ If the other country cooperates, its courts summon the witness and obtain answers to the interrogatories under oath.¹²¹ The answers are returned through the same channels that they were sent.¹²²

Letters rogatory are not used frequently in tax cases.¹²³ The I.R.S. avoids using them because of excessive turn around time, from three months to a year, and because the decision to grant assistance is completely within the discretion of foreign authorities.¹²⁴

C. Tax Treaties

United States tax treaties in force contain an article obligating both countries to exchange information on matters relating to tax administration.¹²⁵ The United States currently has over thirty income tax treaties in force, including some with nations generally considered to be tax havens.¹²⁶ Nevertheless, the utility of this treaty network is limited. The United States has no treaty with the Bahamas, Bermuda, the Caymans or Panama.¹²⁷ Where a treaty exists, the treaty partner is obligated to give only that information obtainable under local law.¹²⁸ If a country has a commercial secrecy law, for example, corporate ownership information will not be obtainable. Also, a treaty partner might not be obligated to perform actions that the United States cannot perform.¹²⁹ Suppose, for example, that the I.R.S. has recommended prosecution to the Department of Justice. Under the *LaSalle* decision, the agency can no longer use the administrative summons to gather information.¹³⁰ Under the tax treaties, the treaty partner might not be obligated to use its administrative process to help the I.R.S.

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

123. INTERNAL REVENUE SERVICE, *supra* note 4, at 205.

124. *Id.* at 205.

125. *Id.* at 207.

126. *Id.* at 149.

127. *Id.* at 208.

128. *Id.*

129. *Id.*

130. *LaSalle National Bank*, 437 U.S. at 311-13.

Although U.S. tax treaties contain articles providing for an exchange of administrative information, only one treaty exists where the United States and its treaty partner agree to lend mutual assistance to each other in criminal cases. This treaty is with Switzerland, an important tax haven.¹³¹ The I.R.S., however, reports that the treaty has not been useful because: (1) the treaty is limited to criminal matters; (2) the treaty applies to tax crimes only if the subject of the investigation is an organized crime figure; and (3) under Swiss implementing legislation, the subject of the investigation can contest the taking of authenticated testimony, delaying production of testimony for up to one year.¹³²

If an organized crime figure is not the subject of the investigation, the Swiss mutual assistance treaty cannot be invoked,¹³³ and the I.R.S. has to proceed under article 16 of the 1951 treaty.¹³⁴ According to a leading Swiss scholar, the 1951 treaty has four defects which limit its usefulness in tax fraud matters:¹³⁵

- (1) the United States must prove a sufficient basis for suspicion of tax fraud "or the like" to get information from Switzerland, but such proof is often unavailable without Swiss information;

131. INTERNAL REVENUE SERVICE, *supra* note 4, at 209. See 12 I.L.M. 916 (1973) for the text of the treaty. Thirty-five crimes are covered by the treaty.

132. *Id.* at 210.

133. *Id.* at 210; Abrams, *supra* note 49, at 82.

134. (1) The competent authorities of the contracting States shall exchange such information (being information available under the respective taxation laws of the contracting States) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the like in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than those concerned with the assessment and collection of the taxes which are the subject of the present Convention. No information shall be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.

(2) [Not relevant because it concerns the collection of taxes.]

(3) In no case shall the provisions of this Article be construed so as to impose upon either of the contracting States the obligation to carry out administrative measures at variance with the regulations and practice of either contracting State or which would be contrary to its sovereignty, security or public policy or to supply particulars which are not procurable under its own legislation or that of the State making application.

Quoted in Kronauer, *supra* note 47, at 71.

Paragraph 2 of article II of the income tax treaty provides: "In the application of the provisions of the present Convention by one of the contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under its own tax laws."

Quoted in *id.* at 79 n.128.

135. *Id.* at 78, 79, 81, 82, 85.

- (2) the term tax fraud is undefined so the term in Switzerland is given its Swiss law meaning. Under local law, tax fraud is using legal documents (but not tax returns) to obtain an illegal tax advantage;
- (3) Swiss law limits the duty of third party record keepers to disclose documents. Although the Swiss government can request disclosure through the owners of the documents, the taxpayer has the option of paying a fine instead of disclosing them;
- (4) the information is not provided in a form that is admissible in U.S. courts.

The 1951 and 1973 treaties raise some interesting issues. First, must the I.R.S. forgo use of the administrative summons if it requests Swiss assistance under the Swiss treaties? The *LaSalle* court stated that the I.R.S. could not use its summons authority if it had made a commitment in an institutional sense, to prosecute.¹³⁶ The 1973 treaty does not authorize the release of any information except that which will contribute substantially to a conviction.¹³⁷ The same problem seems to be present under the 1951 treaty. The United States, according to Swiss interpretation of the treaty, has agreed to use the information it receives *only* in tax fraud cases.¹³⁸ As a result, the target of the investigation could argue that the request for information under the treaty shows that the agency has abandoned any intent to proceed in a civil action against the taxpayer. If the courts accept this argument, a request for information under the treaties would require the I.R.S. to forgo the use of the summons.

Whether this argument will be successful is not clear. The I.R.S. could argue that a request for information does not mean that it has made an institutional commitment to prosecute because the treaty does not obligate it to use the information. Given the reluctance of the Supreme Court to impede I.R.S. enforcement of the tax laws,¹³⁹ the argument might succeed. As the Court points out, however, the same argument could be made after the I.R.S. recommends prosecution to the Department of Justice (the Court's own cutoff point for use of the administrative summons).¹⁴⁰ At stake is the interpretation of section

136. *LaSalle National Bank*, 437 U.S. at 316.

137. INTERNAL REVENUE SERVICE, *supra* note 4, at 210.

138. Kronauer, *supra* note 47, at 96.

139. See *infra* text at 354.

140. *LaSalle National Bank*, 437 U.S. 312-13 & n.15.

7602, and the Court has said that Congress intended no broader authority.¹⁴¹ Thus, the Court might go the other way, although the author personally doubts this.

The second issue which might arise under the Swiss treaties is whether information gathered under the treaty can be used in a civil case. The treaty permits gathering information for criminal uses, not for civil uses. Since a treaty is the law of the land,¹⁴² use of the information in a civil trial might be barred.

Two obstacles to using the treaty to suppress evidence in a civil case stand in the taxpayer's path. First, does a taxpayer have standing to challenge a treaty violation by the U.S. government? Second, can the taxpayer claim the benefit of the treaty after *United States v. Janis*?

The taxpayer should have standing. The first criteria of standing, a personal stake in the outcome, is satisfied. The second criteria, an interest within the zone of interests protected by the treaty,¹⁴³ also seems satisfied. The taxpayer in a civil case falls within the zone of interests that the treaty is designed to protect (i.e., non-criminal commercial and banking interests in the signatory nations).

The issue of whether the taxpayer can prevent the government from using tax information obtained under the Swiss treaty in a civil trial is a close question under the *Janis* case. The use of such information would violate a treaty and treaties have the force of law. In *Janis*, however, the United States Supreme Court permitted evidence seized in violation of the Fourth Amendment to the Constitution to be used in a civil tax case.¹⁴⁴ Does *Janis* mean that the taxpayer cannot suppress evidence in a civil trial if the government seeks to use it in violation of a treaty that it has not renounced? The answer to this question should be no. To understand why, a knowledge of the *Janis* fact pattern is necessary.

In *Janis*, local police raided a bookkeeping establishment, seizing records with an invalid warrant.¹⁴⁵ The police turned the records over to the I.R.S. who assessed back wagering taxes on the bookie.¹⁴⁶

141. *Id.*

142. "... all treaties made, or which shall be made; under the Authority of the United States, shall be the supreme Law of the Land . . ." U.S. CONST., art. VI, § 2.

143. *Association of Data Processing Service Organizations, Inc. v. Camp*, 397 U.S. 150 (1970).

144. 428 U.S. 433 (1976).

145. *Id.* at 436, 438.

146. *Id.* at 437.

The taxpayer paid and then sued for refund.¹⁴⁷ Both parties stipulated that the civil tax assessment was based solely on the illegally seized items and information supplied by the officer who obtained the warrant.¹⁴⁸ The Supreme Court framed the issue as follows: "Is evidence seized by a state criminal law enforcement officer in good faith, but nonetheless unconstitutionally, inadmissible in a civil proceeding by or against the United States?"¹⁴⁹

The Court held that the evidence was admissible.¹⁵⁰ In explaining its decision, the Court stated that "the prime purpose of the [exclusionary] rule, if not its sole purpose," is to deter police misconduct.¹⁵¹ The Court reasoned that the deterrence function had already been performed when the evidence was excluded in the state criminal trial.¹⁵² Exclusion in a civil tax trial would have little additional deterrent effect and would hamper enforcement of a valid law.¹⁵³

The taxpayer can probably suppress the evidence obtained in violation of a treaty in a civil tax trial in spite of *Janis*. The *Janis* court permitted the use of illegally obtained evidence because local police would not be deterred from illegal activity by the possibility that the evidence seized would be suppressed in a federal civil tax trial.¹⁵⁴ The Court implied that the result would have been different if federal agents had seized the evidence.¹⁵⁵ Thus, the Court would probably agree that suppression serves the policy of deterrence when federal tax authorities seek to use evidence obtained for tax purposes in a tax trial in violation of a law (treaty) governing the use of that information.

A final issue which could arise under the Swiss treaty (or under any tax treaty) is the application of the exclusionary rule to evidence seized in violation of the taxpayer's fourth and fifth amendment rights. Suppose a foreign official seizes evidence in a manner which complies with the law of his own government, but the seizure does not comply with the Constitution of the United States. Assuming that the courts cannot avoid the issue by finding a lack of standing,¹⁵⁶ is the evidence admissible in U.S. courts?

147. *Id.* at 438.

148. *Id.*

149. *Id.* at 434.

150. *Id.* at 454.

151. *Id.* at 446.

152. *Id.* at 448.

153. *Id.*

154. *Id.* at 447, 453-54.

155. *Id.*

156. See the discussion of *United States v. Payner*, *infra* text at 355.

The issue has not yet arisen. There are non-tax cases, however, where foreign authorities have seized evidence in violation of the accused's fourth and fifth amendment rights and turned the evidence over to U.S. authorities. The general rule for fourth amendment violations under these circumstances can be stated as follows: the evidence is admissible as long as foreign authorities are not acting as agents for U.S. authorities, U.S. authorities do not participate in the search, and the violation which occurs at the hands of foreign officials is not so outrageous as to require suppression under the Court's general supervisory powers over the justice system.¹⁵⁷

Whether foreign authorities are acting as agents of the U.S. government is a question of fact.¹⁵⁸ If the sole purpose for conducting the search was to obtain information for the U.S. government, and the search violated the defendant's fourth amendment rights, the evidence must be suppressed.¹⁵⁹ If the person conducting the search had motives other than helping the U.S. government, evidence seized in an illegal search is admissible.¹⁶⁰ Merely providing information to

157. *United States v. Morrow*, 537 F.2d 120 (5th Cir. 1976) (warrantless search by Canadian police in a securities fraud case); *United States v. Marzano*, 537 F.2d 257 (7th Cir. 1976) (arrest without probable cause and illegal search under U.S. law by Canadian authorities of suspects in a \$3,000,000 theft); *United States v. Cotroni*, 527 F.2d 708 (2nd Cir. 1975) (wiretap without judicial authorization by Canadian authorities in a narcotics importation scheme); *Brennan v. Univ. of Kansas*, 451 F.2d 1287 (10th Cir. 1971) (civil case for return of work product seized by Italian authorities for a fellow researcher in search that was legal under Italian law but not U.S. law); *Stonehill v. United States*, 405 F.2d 738 (9th Cir. 1968) (civil tax case in which Philippine authorities seized evidence in violation of both the U.S. Constitution and Philippine law—although this was a civil tax case, the court's opinion discusses the use of this evidence in the context of criminal law); *Brulay v. United States*, 383 F.2d 345 (9th Cir. 1967), *cert. denied*, 389 U.S. 986 (1967) (illegal search of narcotics smuggler by Mexican authorities); *Birdsell v. United States*, 346 F.2d 775 (5th Cir. 1965) (illegal search of a suspect in a car theft ring by Mexican authorities).

158. *Marzano*, 537 F.2d at 270; *see Stonehill*, 405 F.2d at 743-46 (lengthy discussion of several cases).

159. *Id.* at 270-71; *see* 405 F.2d at 745 (discussing *Corngold v. United States*, 367 F.2d 1 (9th Cir. 1966)); *Morrow*, 537 F.2d at 139 (exclusionary rule invoked if foreign authorities are acting as agents for their U.S. counterparts), *contra Birdsell*, 346 F.2d at 782 (a Fifth Circuit case that was apparently rejected by a later Fifth Circuit case—*see* 537 F.2d at 270-71 discussing *Corngold*).

160. *Id.* at 271. Although not stated as a holding in the other cases in note 157, in each of the other cases, the court reports, as a fact, that U.S. authorities did not request foreign authorities to search the suspect and his belongings, thus removing the issue of whether the motive of the foreign authorities was to aid U.S. authorities. *See* 537 F.2d at 270 (superintendent Trickler reached his own decisions about what to do with the information the agents gave him); *Controni*, 527 F.2d at 712; *Stonehill*, 405 F.2d at 746; *Brulay*, 383 F.2d at 348; *Birdsell*, 346 F.2d at 782-83 (defendant, who was unable to speak Spanish, was arrested by Mexican police while attempting to pass himself off as a Mexican).

a foreign government is not sufficient to be a participant in the acts that a foreign government takes based on the information. The mere presence of federal officials does not make them participants either.¹⁶¹

The Court's fourth amendment exclusionary rule in cases involving illegal foreign searches is based on three propositions. First, the fourth amendment is directed at federal and state officials, not foreign officials.¹⁶² Second, the exclusionary rule is not mandated by the fourth amendment. It is a prophylactic rule designed to deter fourth amendment violations.¹⁶³ Third, foreign officials are unlikely to be deterred by the exclusionary rule.¹⁶⁴ Thus, the rule only applies when federal officials instigate the search or participate so substantially that the search turns into a joint venture.¹⁶⁵

The number of reported cases where the accused alleges that foreign authorities violated his fifth amendment rights is quite small.¹⁶⁶ The general rule flowing from these cases is that evidence obtained from involuntary statements must be suppressed.¹⁶⁷ Miranda violations by foreign authorities, however, do not mandate suppression unless U.S. authorities participate in the questioning without giving the warnings.¹⁶⁸

A different rationale supports the fifth amendment rule. The fifth amendment directly states that no person "shall be compelled in

161. 537 F.2d at 270; 405 F.2d at 746; 346 F.2d at 782.

162. 527 F.2d at 712; 405 F.2d at 743; 383 F.2d at 348; 343 F.2d at 782.

163. 527 F.2d at 707; 405 F.2d at 743; 383 F.2d at 348.

164. *Morrow*, 537 F.2d at 139; 537 F.2d at 271 (quoting *Brulay*); 405 F.2d at 743; 383 F.2d at 348.

165. 537 F.2d at 139; 405 F.2d at 743, 745. A joint venture includes the situation where U.S. officials request a search and the search would not have been undertaken without the request. See the court's discussion of *Corngold v. United States*, 367 F.2d 1 (9th Cir. 1966).

166. *Bram v. United States*, 168 U.S. 532 (1897) (coerced confession elicited by Canadian authorities); *Kilday v. United States*, 481 F.2d 655 (5th Cir. 1973) (bank embezzlement suspect questioned by Argentina police without Miranda warnings and with U.S. Consul serving as interpreter—statements admissible because test is whether statements are coerced, not whether Miranda warnings are given); *United States v. Welch*, 455 F.2d 211 (2d Cir. 1972) (suspect accused of possessing and transporting stolen U.S. Treasury bill was questioned by Bahamian police in presence of F.B.I. agent without being given Miranda warnings—test when foreign officials do the questioning is voluntariness of statements, not whether Miranda warnings are given. The purpose of Miranda is to deter improper interrogation. This purpose is not served by requiring Miranda warnings before interrogation by foreign authorities); *Brulay v. United States*, 383 F.2d 345 (9th Cir. 1967), *cert. denied*, 389 U.S. 986 (1967) (test is voluntariness of statements).

167. *Bram v. United States*, 168 U.S. 532 (1897).

168. *United States v. Welch*, 455 F.2d 211, 213 (2d Cir. 1972); *Brulay v. United States*, 383 F.2d 345 (9th Cir. 1967), *cert. denied*, 389 U.S. 986 (1967).

any criminal case to be a witness against himself.”¹⁶⁹ Moreover, unlike the fourth amendment, with its discussion of warrants, the fifth amendment contains no language which hints that its prohibitions apply only to actions of federal and state governments.

Two policies underlie the suppression of coerced foreign confessions. First, as enunciated by the United States Supreme Court in 1897, coerced confessions are suppressed because of their unreliability.¹⁷⁰ Second, accepting coerced statements into evidence is, of itself, a violation of the fifth amendment.¹⁷¹ Based on these policy considerations, suppression is mandated if a foreign government violates the accused's fifth amendment rights. Whether foreign authorities were acting as U.S. agents, or whether U.S. officials participated in the investigation is not relevant.

The previous discussion suggests that a tax evader with standing can suppress evidence obtained by foreign officials in response to a request for assistance under a tax treaty if the foreign officials violate the accused's fourth and fifth amendment rights in obtaining the information. If the violation consists of an illegal search, suppression is mandated because the purpose of the search is to aid the U.S. government. The only exception to this result would be if the foreign government conducts the search for reasons unrelated to the U.S. request. If the violation is an illegal search violation, suppression must occur because the search was instigated by the U.S. government when it requested assistance under the treaty. Without exception, the illegal search cases have held the evidence is admissible only when the search is not conducted for U.S. purposes. If the violation is a violation of the privilege against self incrimination, the evidence must always be suppressed.

The previous paragraph, however, begs an important question. Is it possible for an individual to be the victim of an illegal search in a foreign jurisdiction under modern constitutional law? The United States Supreme Court has stated that an illegal search consists of an invasion of a legitimate expectation of privacy.¹⁷² Can an individual have a legitimate expectation of privacy in a foreign jurisdiction where he does not have the protection of the U.S. Constitution and the Bill of Rights?

169. U.S. CONST. amend. V.

170. *Bram*, 168 U.S. at 547.

171. *Brulay*, 383 F.2d at 349 n.5.

172. *Payner*, 447 U.S. at 731.

If an expectation of privacy exists in books and records (the most important type of privacy to a tax evader), it should be found in the tax havens with their strict commercial secrecy laws. In the case of the Bahamas, the United States Supreme Court has already held that the secrecy law does not provide an expectation of privacy. The Court found an expectation of privacy lacking because the Bahamian courts can force the revelation of information.¹⁷³ In addition, the Court stated (in dicta) that U.S. citizens do not have an expectation of privacy in the Bahamas because U.S. law requires citizens to report their relationships with foreign financial institutions.¹⁷⁴

Given the hesitancy of the courts to make it difficult to enforce the tax laws, the courts may hold that a taxpayer has no expectation of privacy overseas when the issue is actually litigated. Such a holding would not dispose of the issue, because the courts would still have jurisdiction under their general supervision powers and the due process clause. The issues involved would change.¹⁷⁵ Instead of asking whether a reasonable expectation of privacy was violated, the courts would engage in a balancing of interests.¹⁷⁶ With the high priority that tax law enforcement receives in the courts, courts would probably allow the introduction of evidence obtained in a search that was illegal under U.S. law if the search was not legal under foreign law. Proving that a search was not legal under foreign law, of course, would be a difficult task for the taxpayer.

D. Covert Operations

Covert operations include the use of informants, illegal searches, bribery and theft. Former Treasury officials, as well as current officials, have admitted obtaining evidence in violation of both U.S. and foreign criminal laws.¹⁷⁷ Some of these were highly successful. Operation Tradewinds, for example, resulted in audit deficiencies in forty-five cases and several criminal prosecutions.¹⁷⁸ An offshoot of Opera-

173. *Id.* at 731-33.

174. *Id.* at 732 n.4.

175. See Stotzky and Swan, *Due Process Methodology and Prisoner Exchange Treaties: Confronting an Uncertain Calculus*, 62 MINN. L. REV. 733 (1978).

176. *Id.* at 795.

177. Payner, 447 U.S. 733-34 n.5; Guttentag, *Enforcing United States Tax Law Where the Information or Taxpayer Is Overseas*, 12 INT'L LAW. 609, 616 (1978); OVERSIGHT HEARINGS INTO THE OPERATIONS OF THE IRS BEFORE A SUBCOMMITTEE OF THE HOUSE COMMITTEE ON GOVERNMENT OPERATIONS (OPERATION TRADEWINDS, PROJECT HAVEN AND NARCOTICS TRAFFICKERS TAX PROGRAM), 94th Cong., 1st Sess. (1975), INTERNAL REVENUE SERVICE, *supra* note 4, at 115-16.

178. *Id.* at 155.

tion Tradewinds, Project Haven, resulted in the recent case of *United States v. Payner*.¹⁷⁹

In *United States v. Payner*, an I.R.S. informant learned that a Bahamian bank official was planning a visit to Miami.¹⁸⁰ He knew that the official would be carrying bank records and designed a scheme to obtain access to them. This scheme was approved by his I.R.S. control agent.¹⁸¹ The informant arranged a date for the official with a former employee of his. The official left his briefcase in the employee's apartment. While the couple was at dinner, the informant entered the apartment using a key that the employee had provided him for the occasion.¹⁸² He removed the official's briefcase from the apartment and gave it to the I.R.S. agent who photocopied the records.¹⁸³ The records were returned before the couple returned.¹⁸⁴ One of the documents in the briefcase provided the lead that ultimately led to Payner's conviction.¹⁸⁵

The district court recognized that Payner lacked standing to suppress the documents under the fourth amendment, but exercised its supervisory powers to suppress the evidence because it was tainted with gross illegality.¹⁸⁶ The court of appeals affirmed.¹⁸⁷ The Supreme Court reversed, and held that "the supervisory power [did] not authorize a federal court to suppress otherwise admissible evidence on the ground that it was seized unlawfully from a third party not before the court."¹⁸⁸ There is, however, a fascinating footnote in the case. In oral argument, the government reported that the I.R.S. had "called off" Operation Tradewinds.¹⁸⁹ Furthermore,

The Commissioner also adopted guidelines that require agents to instruct informants on the requirements of the law and to report known illegalities to a supervisory officer, who is in turn directed to notify appropriate state authorities. IRS Manual Suppl. 9-21, §§ 9373.3(3), 9373.4 (Dec. 27, 1977). Although these measures appear on their face to be less positive than one might expect from an

179. 447 U.S. 727 (1980).

180. *Id.* at 730.

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id.*

186. *Id.* at 730-31.

187. *Id.* at 731.

188. *Id.* at 735.

189. *Id.* at 733 n.5.

agency charged with upholding the law, they do indicate disapproval of the practices found to have been implemented in this case. We cannot assume that similar lawless conduct, if brought to the attention of responsible officials, would not be dealt with appropriately. To require in addition the suppression of highly probative evidence in a trial against a third party would penalize society unnecessarily.¹⁹⁰

This footnote may suggest that the Supreme Court will use its supervisory powers to suppress evidence if the Agency, as an institution, engages in future violations of U.S. law to gather evidence, even if the party before the court is not the victim of the violation.

The *Payner* burglary was highly successful in terms of tax enforcement. Over 300 U.S. citizens and firms were identified as having accounts with the bank.¹⁹¹ Six dozen criminal cases were brought, as well as numerous tax cases.¹⁹² In view of this success, the I.R.S. can be expected to continue its covert operations, although the incidents of *Payner* type abuses should subside.

It is unlikely that illegal activity by I.R.S. informants will completely disappear. Although the I.R.S. now requires agents to instruct informants on the law, there is no guarantee that an over zealous informant will not violate a suspect's constitutional rights. If this happens, what legal issues will appear at trial?

First, the issue of standing must be resolved.¹⁹³ If the defendant's rights have not been violated, and the illegal activity was not solicited or approved by the I.R.S., *Payner* suggests that the evidence will be admitted. Assuming standing is not involved, the question will be similar to the one presented by the government's request for assistance under the tax treaty. In fact, since the I.R.S. has used foreign police officials as informants in the past,¹⁹⁴ a fact pattern may appear in which the violator of a taxpayers rights is a foreign police official.

190. *Id.* Although the Court does not mention it, the I.R.S. agent involved was suspended for his actions. Guttentag, *supra* note 177, at 616.

191. INTERNAL REVENUE SERVICE, *supra* note 4, at 116.

192. *Id.*

193. In *United States v. Salvucci*, 448 U.S. 83, 87 n.4 (1980), the United States Supreme Court said that the issue of standing was not relevant. The issue was whether a legitimate expectation of privacy had been invaded. If not, the defendant could not suppress evidence. The practical effect is not different from the standing doctrine. The defendant cannot suppress evidence seized from a third party in violation of the fourth amendment.

194. INTERNAL REVENUE SERVICE, *supra* note 4, at 114-15.

Since the foreign official will not be acting in his official capacity, however, the fact pattern will diverge from the pattern presented when a foreign official violates the rights of a U.S. resident while responding to an official U.S. request for assistance in tax enforcement matters.

The end result should not change. Evidence seized in violation of the fourth amendment by an I.R.S. informant should be suppressed if the defendant has standing and the informant was serving as an agent of the I.R.S. This rule is similar to the rule governing fourth amendment violations by foreign officials. In addition, the rule is identical to the rule governing searches and seizures by informants in domestic criminal cases.¹⁹⁵

Whether the informant is acting on his own or as an agent of the government is a factual question. At one extreme an employer hires a private detective to investigate an employee and then turns the products of a warrantless search over to the government.¹⁹⁶ The evidence is admitted.¹⁹⁷ At the other extreme, an airline employee would only open a parcel at the request of the government.¹⁹⁸ The evidence is suppressed because the search, in substance, becomes a government search.¹⁹⁹ In the middle of the spectrum is an informant who had received \$375 for past information.²⁰⁰ Federal agents request that he report suspicious parcels, but he takes it upon himself to open suitcases.²⁰¹ The evidence is admitted because he exceeded his instructions and because his previous contacts with the government were too minimal(\$375) to convert the search into a government search.²⁰²

195. *Burdeau v. McDowell*, 256 U.S. 465 (1921) (private detective, working for employer investigating an employee's fraud, conducted an illegal search—evidence admissible because federal agents not informed of search until after it was over); *United States v. Bomengo*, 580 F.2d 173 (5th Cir. 1978) (apartment engineer who was also a former police informant and former police officer forced open an apartment door while looking for a water leak and found two hand guns with silencers—evidence admissible because entry was for non-official purposes); *United States v. Valen*, 479 F.2d 467 (3d Cir. 1973) (paid informer for Customs Agents conducted an illegal search of drug smugglers' suitcases—evidence admissible because informant's contacts with customs agents were minimal and his instructions were to report suspicious parcels, not search them); *Corngold v. United States*, 367 F.2d 1 (9th Cir. 1966) (airline employee opened a parcel at request of government agent—evidence suppressed).

196. *Burdeau v. McDowell*, 256 U.S. at 472-73.

197. *Id.* at 475-76.

198. *Corngold*, 367 F.2d at 5.

199. *Id.*

200. *Valen*, 479 F.2d at 469.

201. *Id.*

202. *Id.*

In contrast to an illegal search and seizure, the rule for fifth amendment violations is clearer. If coerced statements are inherently unreliable,²⁰³ and accepting coerced statements into evidence is itself a fifth amendment violation,²⁰⁴ coerced statements should be suppressed. Unlike the fourth amendment, case law does not appear to inquire into the motives of the person violating the accused's fifth amendment rights.

From the defendant's point of view, the main obstacle to exerting his rights at trial may be discovering that his rights were violated. Discovering a fifth amendment violation does not present a problem, but some types of fourth amendment violations (a burglary with photocopied documents that lead to other documents) may never be discovered.

III. SUMMARY

The I.R.S. faces several obstacles when tax evaders use international tax havens to evade paying U.S. taxes or to conceal the source of their income. By making use of commercial and bank secrecy laws, the taxpayer can make it difficult for the government to use two of their most powerful methods of proof: the net worth method and the bank deposit expenditure method. Each of these methods can be defeated by the taxpayer proving that he has acquired assets with unsecured foreign loans. In fact, the loans are secured by deposits, but the government may not be able to prove this in court because of bank secrecy laws in the tax havens.

The I.R.S. has five methods of acquiring evidence for use in tax trials: voluntary cooperation of the taxpayer, compulsory process, search warrants, tax treaties and covert operations. Many tax evaders are convicted because they cooperate voluntarily with the government, not realizing the consequences of such cooperation. If the taxpayer does not cooperate, the Service's task becomes more difficult.

Compulsory process consists of the I.R.S. summons, the grand jury subpoena, and letter rogatory. Taxpayers with subsidiaries in countries with commercial secrecy laws have attempted to defeat summons and subpoenas on the grounds that to comply would subject them to criminal or civil sanctions in the foreign jurisdiction. This argument has enjoyed some success, but courts have found it unpersuasive in recent years. Although serious due process questions are

203. *Bram*, 168 U.S. at 547.

204. *Brulay*, 383 F.2d at 349 n.5.

involved, which recent decisions have ignored, the United States Supreme Court's hesitation to impede enforcement of the tax laws suggests that record keepers with subsidiaries in foreign countries will be forced to supply information even if the due process issue is squarely faced. Present tax laws would be difficult, if not impossible to enforce, if record keepers were excused from complying with compulsory process because foreign legislation makes compliance a crime. Besides abdicating national sovereignty, such a decision would create political questions of the highest magnitude. The country would be faced with deciding whether to reduce social spending or change to a system of consumption based taxation. The Court is unlikely to place this issue before the legislature.

The United States has tax treaties with several foreign countries, but none with the Bahamas, Bermuda, the Caymans, and Panama, all important tax havens. The treaties that exist have several limitations and are of limited usefulness in producing information that is admissible in court. The information is often not in a form that is admissible. Even if in admissible form, there is a danger. Since U.S. and foreign laws differ, foreign authorities may use methods to produce the evidence which complies with their law, but violates the U.S. Constitution. If so, and if the accused has standing to object to use of the evidence, case law suggests that the evidence would have to be suppressed. Suppression would result because the U.S. government, by requesting foreign assistance, instigated the violation.

Covert operations have resulted in several prosecutions. Some of the operations, however, violated U.S. and foreign law. Case law suggests that violations of fourth amendment rights by I.R.S. informants will result in suppression if the informant is serving as the agent of the U.S. government. Evidence obtained by violating the taxpayer's fifth amendment rights, however, will probably result in suppression. Of course, these conclusions presume that the defendant knows his rights have been violated. When the violation consists of a fifth amendment violation, discovery of the violation presents no problem. In contrast, certain types of fourth amendment violations are difficult to detect and the taxpayer may never be aware that his rights have been violated.