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Tax Treaties-Exchange of Information-Use of IRS Subpoena Power in Response to Specific Requests for Information-United States v. A.L. Burbank & Co.

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Tax Treaties—EXCHANGE OF INFORMATION—USE OF IRS SUBPOENA POWER IN RESPONSE TO SPECIFIC REQUESTS FOR INFORMATION—*United States v. A.L. Burbank & Co.*, 525 F.2d 9 (2d Cir. 1975), cert. denied, 96 S. Ct. 2647 (1976).

In late 1971 the Internal Revenue Service (IRS) issued administrative summonses to A.L. Burbank & Co., Ltd. (Burbank) and the New York branch of the Bank of Tokyo requiring them to produce books and records relevant to the potential Canadian tax liability of Westward Shipping, Ltd. (Westward), a Canadian corporation. The summonses were issued by the IRS in response to a request for information by Canadian authorities. Westward filed written objections to the summonses, arguing that they were not authorized by the Internal Revenue Code or by the 1942 Tax Treaty between the United States and Canada.¹ The IRS responded by issuing a new summons to Burbank, purporting to deal with Burbank's domestic tax liability but requesting the same materials as did the original summonses. When this new summons was challenged and stayed, the IRS sought enforcement of the original summonses in federal district court. In this proceeding, the IRS admitted that the information was sought because of the request by Canadian authorities for aid in their tax investigation of Westward and not because of any potential tax liability of the American corporations. The district court denied enforcement.² On appeal, the United States Court of Appeals for the Second Circuit reversed,³ holding that the use of the IRS subpoena power solely to obtain information for use by Canadian authorities in a Canadian tax investigation was authorized by section 7602 of the Internal Revenue Code and articles XIX and XXI of the 1942 Income Tax Treaty with Canada.⁴

1. Convention for the Avoidance of Double Taxation, Mar. 4, 1942, United States-Canada, 56 Stat. 1399, T.S. No. 983.

2. *United States v. A.L. Burbank & Co.*, 74-2 U.S. Tax Cas. ¶ 9779 (S.D.N.Y., Aug. 1, 1974), *rev'd*, 525 F.2d 9 (2d Cir. 1975), *cert. denied*, 96 S. Ct. 2647 (1976).

The district court also denied Westward's motion to intervene, but allowed Burbank and the Bank of Tokyo to challenge the summonses. The denial of intervention was affirmed by the court of appeals. The intervention issue will not be treated in this case note.

3. *United States v. A.L. Burbank & Co.*, 525 F.2d 9, 13-14 (2d Cir. 1975), *cert. denied*, 96 S. Ct. 2647 (1976).

4. 56 Stat. 1405, 1406.

I. BACKGROUND

A. *United States Income Tax Conventions*

The 1942 Income Tax Convention with Canada is one among twenty-two⁵ similar conventions concluded by the United States with various countries since 1939.⁶ Once ratified, these conventions are recognized by the courts as treaties and as part of the

5. Treaties in force on January 1, 1976 with exchange of information provisions were: Convention for the Avoidance of Double Taxation, May 14, 1953, United States-Australia, [1953] 4 U.S.T. 2274, T.I.A.S. No. 2880; Convention for the Avoidance of Double Taxation, Oct. 25, 1956, United States-Austria, [1957] 8 U.S.T. 1699, T.I.A.S. No. 3923; Convention for the Avoidance of Double Taxation, July 9, 1970, United States-Belgium, [1972] 23 U.S.T. 2687, T.I.A.S. No. 7463; Convention for the Avoidance of Double Taxation, May 6, 1948, United States-Denmark, 62 Stat. 1730, T.I.A.S. No. 1854; Convention for the Avoidance of Double Taxation, Mar. 6, 1970, United States-Finland, [1971] 22 U.S.T. 40, T.I.A.S. No. 7042; Convention for the Avoidance of Double Taxation, July 28, 1967, United States-France, [1968] 19 U.S.T. 5280, T.I.A.S. No. 6518; Convention for the Avoidance of Double Taxation, Feb. 20, 1950, United States-Greece, [1954] 5 U.S.T. 47, T.I.A.S. No. 2902; Convention for the Avoidance of Double Taxation, May 7, 1975, United States-Iceland, [1975] 26 U.S.T. 2004, T.I.A.S. No. 8151; Convention for the Avoidance of Double Taxation, Sept. 13, 1949, United States-Ireland, [1951] 2 U.S.T. 2303, T.I.A.S. No. 2356; Convention for the Avoidance of Double Taxation, Mar. 30, 1955, United States-Italy, [1956] 7 U.S.T. 2999, T.I.A.S. No. 3679; Convention for the Avoidance of Double Taxation, Mar. 8, 1971, United States-Japan, [1972] 23 U.S.T. 967, T.I.A.S. No. 7365; Convention for the Avoidance of Double Taxation, Dec. 18, 1962, Luxembourg, [1964] 15 U.S.T. 2355, T.I.A.S. No. 5726; Convention for the Avoidance of Double Taxation, Apr. 29, 1948, United States-Netherlands, 62 Stat. 1757, T.I.A.S. No. 1855; Convention for the Avoidance of Double Taxation, Mar. 16, 1948, United States-New Zealand, [1951] 2 U.S.T. 2378, T.I.A.S. No. 2360; Convention for the Avoidance of Double Taxation, Dec. 3, 1971, United States-Norway, [1972] 23 U.S.T. 2832, T.I.A.S. No. 7474; Convention for the Avoidance of Double Taxation, July 1, 1957, United States-Pakistan, [1959] 10 U.S.T. 984, T.I.A.S. No. 4232; Convention for the Avoidance of Double Taxation, Dec. 13, 1946, United States-South Africa, [1952] 3 U.S.T. 3821, T.I.A.S. No. 2510; Convention for the Avoidance of Double Taxation, Mar. 23, 1939, United States-Sweden, 54 Stat. 1759, T.S. No. 958; Convention for the Avoidance of Double Taxation, May 24, 1951, United States-Switzerland, [1951] 2 U.S.T. 1751, T.I.A.S. No. 2316; Convention for the Avoidance of Double Taxation, Jan. 9, 1970, United States-Trinidad and Tobago, [1971] 22 U.S.T. 164, T.I.A.S. No. 7047; Convention for the Avoidance of Double Taxation, July 22, 1954, United States-West Germany, [1954] 5 U.S.T. 2768, T.I.A.S. No. 3133, *as amended*, Sept. 17, 1965, 16 U.S.T. 1875, T.I.A.S. No. 5920.

On May 13, 1976, the Department of the Treasury announced that income tax treaty negotiations were underway or contemplated in the near future with Australia, Bangladesh, Botswana, Brazil, Canada, Costa Rica, Denmark, India, Iran, Jamaica, Malta, Morocco, Netherlands, Singapore, Spain, Tunisia, Yugoslavia, and Zambia. 41 Fed. Reg. 20,427 (1976). It was also announced that negotiations were nearly completed with Indonesia, Kenya, Philippines, Republic of China (Taiwan), and South Korea. *Id.* The following treaties had been signed: Cyprus (Apr. 19, 1974), Egypt (Oct. 28, 1975), Israel (Nov. 20, 1975), and the United Kingdom (Dec. 31, 1975). The treaties with Egypt and Israel had also been submitted to the Senate for approval. *Id.*

6. The earliest tax convention still in force was concluded in 1939 with Sweden. *Supra* note 5.

law of the land without any further legislative action.⁷ This recognition arises from article VI of the Constitution, which places the Constitution, laws made in pursuance of the Constitution, and treaties made under the authority of the United States all on the same footing as the "supreme Law of the Land."⁸ A distinction is often made, however, between self-executing and nonself-executing treaties; the former being those that take domestic effect upon ratification, the latter requiring enabling legislation.⁹ Income tax treaties considered by the courts have been regarded as self-executing.¹⁰

The purposes of tax treaties are to prevent double taxation (taxation by both countries) and tax evasion (taxation by neither country) in cases where a citizen of one country has income from sources within another country.¹¹ In order to facilitate these purposes, the treaties usually contain provisions for the exchange of information between the two countries. Much information is exchanged on a routine basis, while more detailed information is exchanged upon specific request.¹² For example, article XIX of

7. *Samann v. Comm'r*, 313 F.2d 461, 463 (4th Cir. 1963); *American Trust Co. v. Smyth*, 247 F.2d 149, 153 (9th Cir. 1957).

8. U.S. CONST. art. VI, cl. 2:

This Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Wright, *Treaties as Law in National Courts: The United States*, 16 LA. L. REV. 755, 756 (1956) states: "In the United States, it is the general principle, deduced from article VI and other articles of the Constitution, that both treaties and customary international law are parts of the law of the land, directly applicable by the courts."

9. *Foster v. Neilson*, 27 U.S. (2 Pet.) 253, 314 (1829): "Our constitution declares a treaty to be the law of the land. It is, consequently, to be regarded in courts of justice as equivalent to an act of the legislature, whenever it operates of itself without the aid of any legislative provision."

RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 141 (1965) reads:

§ 141. Effect of Treaty as Domestic Law

(1) A treaty made on behalf of the United States . . . that manifests an intention that it shall become effective as domestic law of the United States at the time it becomes binding on the United States

(a) is self-executing in that it is effective as domestic law of the United States, and

(b) supersedes inconsistent provisions of earlier acts of Congress or of the law of the several states of the United States.

10. See 525 F.2d at 14, and cases cited note 7 *supra*.

11. *E.g.*, Convention for the Avoidance of Double Taxation, Mar. 4, 1942, United States-Canada, 56 Stat. 1399, T.S. No. 983.

12. *E.g.*, *id.* arts. XIX-XXI.

the Canadian treaty provides that each country will furnish the information that its authorities "have at their disposal or are in a position to obtain under its revenue laws" to the extent that such information may be of use to the other country in assessing taxes.¹³ Article XXI states that upon request the Commissioner of Internal Revenue may furnish Canadian authorities such information as he is "entitled to obtain under the revenue laws of the United States."¹⁴ The reciprocal situation is also provided for.¹⁵ The use of the provisions to request specific information from United States tax authorities has been quite limited, except perhaps in the case of Canada,¹⁶ and there have been no prior judicial determinations of the validity or interpretation of the provisions.¹⁷

B. Applicable Sections of the Internal Revenue Code

Tax treaties provide no independent compulsory process, but rather depend on provisions of the Internal Revenue Code.¹⁸ For instance, the Canadian treaty contains no independent power to

13. *Id.* art. XIX:

With a view to the prevention of fiscal evasion, each of the contracting States undertakes to furnish to the other contracting State, as provided in the succeeding Articles of this Convention, the information which its competent authorities have at their disposal or are in a position to obtain under its revenue laws in so far as such information may be of use to the authorities of the other contracting State in the assessment of the taxes to which this Convention relates.

The information to be furnished under the first paragraph of this Article, whether in the ordinary course or on request, may be exchanged directly between the competent authorities of the two contracting States.

14. *Id.* art. XXI:

1. If the Minister in the determination of the income tax liability of any person under any of the revenue laws of Canada deems it necessary to secure the cooperation of the Commissioner, the Commissioner may, upon request, furnish the Minister such information bearing upon the matter as the Commissioner is entitled to obtain under the revenue laws of the United States of America.

2. If the Commissioner in the determination of the income tax liability of any person under any of the revenue laws of the United States of America deems it necessary to secure the cooperation of the Minister, the Minister may, upon request, furnish the Commissioner such information bearing upon the matter as the Minister is entitled to obtain under the revenue laws of Canada.

15. *Id.*

16. Lazerow, *The United States-French Income Tax Convention*, 39 *FORDHAM L. REV.* 649, 723 (1971); 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, 48 n.6 (1974).

17. *United States v. A.L. Burbank & Co.*, 525 F.2d 9, 14 (2d Cir. 1975).

18. *Id.* at 12.

subpoena records, but allows exchange of such information as the IRS is entitled to obtain under existing United States revenue laws.¹⁹ Under section 7602 of the Internal Revenue Code, the IRS may compel production of records for the following purposes:

. . . [1] ascertaining the correctness of any return, [2] making a return where none has been made, [3] determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or [4] collecting any such liability

For these purposes the IRS can subpoena books, papers, records, and other data and require certain persons to appear and give testimony.²⁰ The 1954 Internal Revenue Code also contains, in section 7852(d), a statement that "[n]o provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title."

C. *Use of the IRS Subpoena Power under the Tax Conventions*

If there is a potential American tax liability, section 7602 of the Internal Revenue Code clearly authorizes use of the subpoena power by the IRS to investigate that liability. The specific issue raised in the instant case, however, is whether the section 7602 subpoena power can be used to gather information in response to a request from Canada under the tax treaty when there is no concurrent domestic tax liability. In relation to that issue, the legislative history of the United States-Canada Tax Treaty and several others, the Government's interpretation of the Canadian treaty, and the provisions of three model income tax conventions will be examined.

The amount of legislative material pertaining to the use of the subpoena power under the tax conventions is not large.²¹ The most extensive discussion of the administrative assistance aspects of the treaties occurred during the Senate hearings²² on a

19. Notes 13 & 14 *supra*.

20. I.R.C. § 7602.

21. The legislative reports, hearings, and debates on all the income tax conventions through 1961 are reprinted in 1 & 2 JOINT COMM. ON INT. REV. TAX., LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS (1962) [hereinafter cited as LEG. HIST. OF U.S. TAX CONV.].

22. *Convention with France on Double Taxation: Hearings on Exec. A. Before a Subcomm. of the Senate Comm. on Foreign Relations*, 80th Cong., 1st Sess. (1947), reprinted in 1 LEG. HIST. OF U.S. TAX CONV., *supra* note 21, at 945-1129.

supplementary convention with France²³ in 1947. This convention contained information exchange provisions similar to those in the 1942 treaty with Canada.²⁴ Much of the testimony, however, pertained to provisions for mutual collection of taxes and to the amount of information that would be exchanged automatically. The question of whether the subpoena power was to be used to gather information in cases lacking concurrent liability was not discussed directly, although the tenor of the debate suggests that the participants assumed the subpoena power would be available for that purpose.²⁵

The report on the 1942 treaty with Canada sent to the Senate by the Acting Secretary of State states that the exchange of information provisions "mark an important step in the direction of fiscal cooperation between the two countries" and that the provisions "materially complement our domestic system of information at the source and, it is anticipated, will be of considerable value" in administering internal revenue laws. The report also states that the exchange articles would provide, on a reciprocal basis, general comprehensive information and "information in the case of specific taxpayers with respect to whom information is available in Canada."²⁶ Although it does not deal specifically with the subpoena power, the report seems to indicate an expectation that the information exchange provisions should have broad application.

The floor debate on the Canadian treaty²⁷ deals more specifically with the issue in the instant case. During that debate Senator George of the Senate Foreign Relations Committee and floor manager of the treaty made the following statements:

I do not think that there is anything in the convention which would require furnishing information beyond what each Government has the right to ask of its own citizens at the present time.

. . . .

. . . . The convention does not undertake to confer upon either the United States or Canada any extra power with respect

23. Supplementary Convention for the Avoidance of Double Taxation, Oct. 18, 1946, United States-France, 64 Stat. pt. 3 at B3, T.I.A.S. No. 1982.

24. *Id.* arts. 8, 11.

25. See *Hearings on Exec. A.*, *supra* note 22, at 28-45 (testimony of Mr. Carroll); *id.* at 68-77 (testimony of Mr. Fernald).

26. *Report of the Acting Secretary of State on S. Exec. B.*, 77th Cong., 2d Sess., Mar. 6, 1942, reprinted in 1 LEG. HIST. OF U.S. TAX CONV., *supra* note 21, at 448-49.

27. 88 CONG. REC. 4642-47, 4713-14 (1942), reprinted in 1 LEG. HIST. OF U.S. TAX CONV., *supra* note 21, at 461-70.

to inquiries made of the citizens of either country. It does not undertake to confer power upon Canada to make inquiry of an American citizen residing in the United States, or upon the United States to make inquiry of a Canadian citizen residing in Canada.²⁸

But later in the same debate the following exchange took place:

Mr. TAFT. . . .

In other words, if an American citizen were using a Canadian bank deposit to evade income taxation, I think the convention would permit the United States Government to ask the Canadian Government to obtain information from its own bank and furnish it to this Government in connection with the enforcement of our internal revenue laws.

Mr. GEORGE. It does provide for exchange of information, as the Senator from Ohio points out.

Mr. TAFT. But no general information of that kind would be requested except perhaps in specific cases in which inquiry was being made relative to income-tax evasion.²⁹

Senator Taft's remarks describe a situation in which Canada would be asked to subpoena records from a Canadian bank solely to aid an American tax investigation. Since the treaty was meant to operate reciprocally, if Senator Taft's understanding of the treaty was correct, the United States could be asked to use its subpoena power in the converse situation. It is significant that Senator George appears to have approved Senator Taft's statement. There was no dissenting argument by any of the Senators present.

The 1962 Income Tax Treaty with Luxembourg contains provision for the exchange of "information available under the respective taxation laws of the Contracting States."³⁰ This is similar to the language in the Canadian treaty describing the information to be exchanged as that which the authorities are in a position to obtain under their revenue laws.³¹ The Senate report accompanying the Luxembourg treaty stated that: "The information to be exchanged is that which would be available under the taxation laws of the country to which the request for information is directed if the tax of the requesting country were its own tax."³²

28. *Id.* at 4714.

29. *Id.*

30. Convention for the Avoidance of Double Taxation, Dec. 18, 1962, United States-Luxembourg, art. XVIII, [1964] 15 U.S.T. 2355, T.I.A.S. No. 5726.

31. Note 13 *supra*.

32. S. EXEC. REP. NO. 10, 88th Cong., 2d Sess., 38 (1964), *reprinted in* 1 TAX TREATIES (CCH) ¶ 5348, at 5356 (July 27, 1964).

This seems to contemplate use of the subpoena power to gather information in response to a treaty request even though no domestic taxes are involved.

The Treasury Regulations issued pursuant to the 1942 Tax Treaty with Canada are not helpful in this context inasmuch as they merely echo the wording found in the exchange of information articles of the treaty.³³ Regulations to other treaties are similarly unhelpful.³⁴ However, the IRS argued in the instant case that its position was approved by the State and Treasury Departments and represented the consistent United States interpretation of the treaty.³⁵

The validity of the Government's interpretation of the United States tax treaties is supported by the League of Nations and Organization for Economic Co-operation and Development (OECD) model income tax convention drafts. The League of Nations Fiscal Committee sponsored model drafts in 1943 and 1946.³⁶ Both drafts provide for the exchange, subject to reciprocity and on special request, of "such information in matters of taxation as the competent authorities of each State have at their disposal or are in a position to obtain under their [revenue] laws."³⁷ The commentary to the drafts reads:

The information that may be applied for under this article may be in the hands of the administration to which the request is directed or it may have to be secured from an outside source. This source may be the party concerned himself or persons who, as a result of their relations with the taxpayer, can give information about his affairs, or resort may have to be made to experts or witnesses.³⁸

The securing of information from outside sources, it seems, would involve use of the subpoena power.

33. Treas. Reg. § 519.120 provides:

Under the provisions of Article XXI of the convention and upon request of the Minister, the Commissioner may furnish to the Minister any information available to, or obtainable by, the Commissioner under the revenue laws relative to the tax liability of any person (whether or not a citizen or resident of Canada) under the revenue laws of Canada.

34. *E.g.*, *id.* § 520.118 (Sweden); *id.* § 514.116 (France).

35. 525 F.2d at 15.

36. LEAGUE OF NATIONS, FISCAL COMMITTEE, LONDON AND MEXICO MODEL TAX CONVENTIONS, COMMENTARY AND TEXT (1946), reprinted in 4 LEG. HIST. OF U.S. TAX. CONV., *supra* note 21, at 4319, 4326.

37. *Id.* at 100, 101.

38. *Id.* at 49.

The OECD model draft was promulgated in 1966.³⁹ Both the United States and Canada are members of the OECD,⁴⁰ and the United States has sought to amend many of its treaties to conform to the OECD model.⁴¹ The commentary to the OECD draft indicates that upon request for information by one contracting State, the other State must use the same administrative measures that it would use in investigating its own taxes, even though information is sought solely to aid the requesting State.⁴² The commentary indicates that these measures include special investigations and examinations of business accounts.⁴³ The Treasury Department has also adopted a model treaty which embodies these same requirements.⁴⁴ This model specifically allows for the furnishing of depositions and copies of unedited documents such as books and records.⁴⁵

II. INSTANT CASE

The district court could find nothing in the 1942 Tax Treaty or section 7602 of the Internal Revenue Code that authorized use of the IRS subpoena power solely to aid a Canadian tax investigation. Focusing on the phrase in 7602, "determining the liability of any person for any internal revenue tax," the court concluded that "internal revenue tax" meant "United States tax" and that the section 7602 subpoena power should be limited to investigations involving domestic tax liabilities. Inasmuch as the treaty contemplated use only of existing IRS subpoenas, the court reasoned that the IRS could supply Canadian authorities only with information already in possession of the IRS or that might be obtained in the course of legitimate domestic tax investigations.⁴⁶

In reversing, the court of appeals felt that such a limited construction of section 7602 would frustrate the purposes of the

39. ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT DRAFT CONVENTION FOR THE AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME AND CAPITAL (1966) [hereinafter cited as OECD DRAFT], reprinted in 1 TAX TREATIES (CCH) ¶ 151 (1966).

40. *United States v. A.L. Burbank & Co.*, 525 F.2d 9, 15 (2d Cir. 1975).

41. *Surrey, Factors Affecting U.S. Treasury in Conducting International Tax Treaties*, 28 J. TAX. 277, 277 (1968).

42. *United States v. A.L. Burbank & Co.*, 525 F.2d 9, 16 (2d Cir. 1975) (quoting the commentary to the OECD draft).

43. *Id.*

44. UNITED STATES MODEL INCOME TAX TREATY, art. 26 (1976), reprinted in 2 TAX TREATIES (CCH) ¶ 9767 (1976).

45. *Id.*

46. 74-2 U.S. Tax Cas. ¶ 9779, at 85,562.

Canadian and other similar tax treaties. The court stated that one of the treaty's purposes was to provide for the exchange of whatever information might be obtained under the administrative laws of each country in order to prevent fiscal evasion. The court concluded that even though section 7602 was written to apply to United States tax liabilities, it should not be construed to exclude use of the very procedures to which the treaty refers. Therefore, the court read the treaty as allowing the IRS to use the same procedures and techniques in investigating exclusively Canadian tax liabilities as could be used in American tax investigations.⁴⁷ The court found support for this interpretation of the treaty in the canon of construction that treaties should be broadly construed to give effect to their purposes and that when a provision admits of two constructions, one restricting and the other enlarging rights that may be claimed under it, the more liberal interpretation is to be preferred.⁴⁸ The court also considered section 7852(d)'s provision that no part of the Internal Revenue Code should be applied in opposition to any prior treaty obligation and concluded that the district court's narrow reading of section 7602 would be contrary to the treaty and thus unenforceable.⁴⁹

Evidence was presented to the court that Canadian authorities do not interpret the treaty to mean that they are required to subpoena records solely to aid an American tax investigation.⁵⁰ The appellees argued that the treaty should be construed in light of the Canadian interpretation and that the United States should not be obligated to provide any more information than Canada would provide to the United States. The court rejected these arguments, stating that the official United States interpretation was not that of the Canadian authorities, and that even if Canada did not fulfil its treaty obligations as viewed by the United States, the court still had to sanction fulfillment of American obligations until such time as the treaty might be denounced. Therefore, the court concluded that the Canadian interpretation of the treaty was not relevant in the instant case.⁵¹

47. 525 F.2d at 13, 14.

48. *Id.* at 14.

49. *Id.*

50. In a telephone interview on October 29, 1976, a spokesman for the Canadian Ministry of Revenue denied that Canada interprets the treaty differently from the United States in regard to the subpoena power. It was asserted that the decision in the instant case is consistent with Canadian practice in responding to requests for information by the United States under the treaty. Telephone interview with A.C. Bonneau, Director of the International Relations Division, Canadian Ministry of Revenue (Oct. 29, 1976).

51. 525 F.2d at 14-15.

The court also considered the model income tax treaty promulgated by the OECD. The appellees read the information exchange provisions of the OECD draft⁵² as not requiring use of the subpoena power in the instant case and argued that the United States and Canada must interpret the 1942 treaty consistently with the OECD draft since no attempt has been made to amend the 1942 treaty since publication of the OECD draft in 1966.⁵³ However, the court found the OECD provisions and the accompanying commentary to be consistent with the interpretation placed on the 1942 treaty by the IRS.⁵⁴

The legislative history of the treaty was only briefly considered by the court in a footnote at the end of the opinion.⁵⁵ The court found most of the history to be unenlightening except for the exchange quoted above⁵⁶ between Senators George and Taft, which it found to support the Government's position.

III. ANALYSIS

The conclusion that the 1942 Tax Treaty with Canada authorized use of the subpoena power in the instant case was correct inasmuch as it accords with the legislative history of the treaty and general principles of treaty construction. The interpretation should have come as no surprise to those familiar with the OECD draft and the new United States Model Treaty. However, the instant decision raises serious questions as to the operation of the exchange of information provisions in United States tax treaties.

A. *Implications of the Decision*

The decision in the instant case will probably stand as the interpretation not only of the 1942 Tax Treaty with Canada but of all the tax conventions with similar exchange of information provisions.⁵⁷ The court regarded its decision as necessary to avoid frustrating all the tax conventions with comparable exchange provisions,⁵⁸ and in view of the similarity of the provisions in all the treaties there is little to suggest that contrary interpretation by other courts is likely. As a result, American taxpayers—

52. OECD DRAFT, *supra* note 39, art. 26.

53. On May 13, 1976, the Treasury Department announced that negotiations on a new treaty were underway with Canada. 41 Fed. Reg. 20,427.

54. 525 F.2d at 15-17.

55. *Id.* at 17 n.7.

56. Text accompanying note 29 *supra*.

57. Note 5 *supra*.

58. 525 F.2d at 13 n.2.

particularly large corporations with international dealings—may have their records subpoenaed by the IRS at the request of any of twenty-two or more countries.

This prospect is especially disconcerting in view of the recent Supreme Court decision in *United States v. Bisceglia*.⁵⁹ In *Bisceglia*, the IRS had learned that a federal reserve bank had received from a bank in Kentucky two large deposits of badly deteriorated \$100 bills. Suspecting that the bills represented transactions that had not been reported for tax purposes, the IRS issued a "John Doe" summons to the Kentucky bank calling for production of all books and records that would provide information as to the unknown depositor of the bills. When the bank refused to comply, the IRS sought judicial enforcement. The district court narrowed the subpoena to include only large deposits of \$100 bills during a one-month period and enforced it as modified. Although the Sixth Circuit reversed,⁶⁰ the Supreme Court upheld enforcement of the subpoena, holding that the IRS has statutory authority to issue a "John Doe" summons to discover the identity of a person involved in transactions suggesting the possibility of liability for unpaid taxes.⁶¹

The full import of *Bisceglia* is not yet clear. Justice Blackmun in his concurring opinion emphasized that *Bisceglia* is a narrow decision involving a specific investigation where it was virtually certain that only one individual or entity was involved in transactions strongly indicating tax liability and thus does not authorize an exploratory search where "neither a particular taxpayer nor an ascertainable group of taxpayers is under investigation."⁶² Justice Stewart, however, maintained that "[a]ny private economic transaction is now fair game for forced disclosure, if any IRS agent happens in good faith to want it disclosed."⁶³ At the least it is clear from the opinion that the subpoena power is not limited to "investigations which have already focused upon a particular return, a particular named person, or a particular potential tax liability."⁶⁴

This broadening of the IRS power, which has caused alarm

59. 420 U.S. 141 (1975).

60. *Bisceglia v. United States*, 486 F.2d 706 (6th Cir. 1973), *rev'd*, 420 U.S. 141 (1975).

61. 420 U.S. at 144, 151. Other cases sanctioning use of a "John Doe" summons include *United States v. Carter*, 489 F.2d 413 (5th Cir. 1973); *United States v. Turner*, 480 F.2d 272 (7th Cir. 1973); *Tillotson v. Boughner*, 333 F.2d 515 (7th Cir. 1964), *cert. denied*, 379 U.S. 913 (1964).

62. 420 U.S. at 151-52 (Blackmun & Powell, J.J., concurring).

63. *Id.* at 159 (Stewart & Douglas, J.J., dissenting).

64. *Id.* at 149.

in its potential domestic application,⁶⁵ is even more alarming if extended through tax treaties to foreign governments to give them this same ability to investigate unknown taxpayers and pry into suspicious transactions. If not limited it would grant foreign nations an awesome power to delve into the affairs of American citizens. At the same time, to the extent that foreign nations make treaty requests in cases where American tax liability is lacking, the IRS will gain access to otherwise unavailable information. There are considerations, however, that may limit the above effects.

B. Possible Limitations on the Use of Section 7602

In making requests for information under tax treaties, most countries will likely be motivated by diplomatic considerations to make their requests as reasonable as possible. In addition, a certain amount of discretion seems to be vested in the IRS in carrying out treaty requests for information,⁶⁶ and thus the IRS can also be expected to screen these requests and gather information in the least intrusive manner. To the extent that these practical limitations are ineffective, the courts should also be able to act to curtail extreme or unfair use of the IRS subpoena power. One limiting factor may be found by the courts in the reciprocal nature of treaty obligations; others may be found in the existing statutory and case law that provides for judicial enforcement of subpoenas.

1. Reciprocity

The court in the instant case rejected the notion that if Can-

65. Note, *IRS Subpoena Power to Investigate Unknown Taxpayers*, 50 N.Y.U.L. REV. 177, 195 (1975):

Bisceglia, read in the broadest possible way, permits the IRS to subpoena documents concerning the possible tax liability of any taxpayer, known or unknown. . . . If the requirement of an investigation is not linked to the presence of a particular person, and the statute is read at its broadest, third parties such as banks could be required to produce virtually any records concerning taxpayers at the third party's expense and with relatively little potential value to the IRS or the public policy of revenue collection. . . . Since practically everyone falls within the "regulation" of the IRS, since income tax liability reflects virtually all of one's finances, and since most of one's life can be connected in some way to these finances, the IRS would have an awesome ability, far greater than that of any other governmental agency, to delve into individual lives and harass third parties. Protection is required for the general public as well as for those directly involved in the transactions.

66. See, e.g., UNITED STATES MODEL INCOME TAX TREATY, art. 26 (1976), reprinted in 2 TAX TREATIES (CCH) ¶ 9767 (1976).

ada refused to carry out its treaty obligations the United States would be excused from its reciprocal obligations.⁶⁷ But a different reciprocity limitation exists in the exchange of information articles of the United States Model Treaty⁶⁸ and the OECD draft,⁶⁹ which provide that a party to the treaty is not required to carry out administrative procedures that vary from its laws or practice or from the laws or practice of the other contracting country or to supply information that could not be obtained under the laws of the other country. These provisions embody reciprocity of obligation by placing the exchange of information on a least common denominator basis. Thus, a country with a narrower subpoena power than the United States could not take advantage of the broader measures available to the IRS; and countries whose administrative measures do not include "John Doe" summonses would not be able to take advantage of *Bisceglia*.

This limitation clearly exists in the newer treaties, which are similar to the OECD and United States model treaties,⁷⁰ and in some of the older treaties.⁷¹ But it may not apply to the 1942 treaty with Canada, since it contains no "lowest common denominator" provision. Inasmuch as treaties both before and after the 1942 United States-Canada Treaty contained the limiting provision,⁷² it appears that the exchange of information with Canada was not meant to be strictly reciprocal. However, the United States and Canada are currently negotiating a new income tax convention,⁷³ and since both are members of the OECD, it is likely that the new treaty will include the "lowest common de-

67. Note 51 and accompanying text *supra*.

68. UNITED STATES MODEL INCOME TAX TREATY, art. 26 (1976), reprinted in 2 TAX TREATIES (CCH) ¶ 9767 (1976).

69. OECD DRAFT, *supra* note 39, art. 26.

70. The exchange of information provisions of the treaties with Belgium (art. 26), Finland (art. 29), France (art. 26), Iceland (art. 29), Japan (art. 26), and Norway (art. 28) are substantially similar to those of the model treaties. Note 5 *supra*.

71. The treaties with Sweden (art. XX) and Greece (art. XX), *supra* note 5, contain least common denominator provisions similar to those in the model conventions.

72. In addition to the treaties indicated in notes 70 & 71 *supra*, two obsolete treaties contained the lowest common denominator provision. Convention for the Avoidance of Double Taxation, July 25, 1939, United States-France, art. 24, 59 Stat. 893, T.S. No. 988; Convention for the Avoidance of Double Taxation, Oct. 28, 1948, United States-Belgium, art. XVIII, [1953] 4 U.S.T. 1647, T.I.A.S. No. 2833.

A 1945 convention with the United Kingdom did not contain the provision even though it was recognized that the British system of information gathering was less comprehensive than that of the United States. *Report of the Secretary of State on S. Exec. D.*, 79th Cong., 1st Sess., Apr. 16, 1945, reprinted in 2 LEG. HIST. OF U.S. TAX CONV., *supra* note 21, at 2577.

73. 41 Fed. Reg. 20,427 (1976).

nominator" provisions of the OECD draft,⁷⁴ in which case a reciprocity limitation will exist upon requests for information by Canadian authorities.

The least common denominator provisions limit the measures that the IRS is *obligated* to use to gather information.⁷⁵ It is not clear whether the IRS may go beyond what it is strictly required to do; for instance, whether the IRS could use a "John Doe" summons even though the requesting country does not utilize such an administrative measure. It seems, however, that in cases where the recipient of an IRS summons challenges the summons on grounds of improper purpose or overbreadth, the courts could restrict the IRS to using only those procedures that are required under the tax treaty. Whether the courts will do so remains to be seen.

2. *Judicial enforcement*

Under section 7604 of the Internal Revenue Code, an IRS summons to produce records must be enforced through the federal district courts if resisted by the recipient.⁷⁶ This provides an opportunity for the recordholder to challenge the summons on any applicable grounds.⁷⁷ A limited discovery may be allowed if necessary,⁷⁸ and enforcement orders are appealable.⁷⁹ Furthermore, the Supreme Court has stated that to obtain enforcement of a summons the IRS must show that (1) the investigation will be conducted pursuant to a legitimate purpose, (2) the inquiry is relevant to the purpose, (3) the information sought is not already within the Commissioner's possession, and (4) the administrative steps required by the Code have been followed.⁸⁰

Presumably, all of the above conditions will apply with equal force when the subpoena is issued for the purpose of providing foreign tax authorities with requested information. Thus the

74. As members of the OECD, the United States and Canada must notify the OECD of the reasons why they do not adopt any provision of the OECD draft in any tax convention between them. 4 LEG. HIST. OF U.S. TAX CONV., *supra* note 21, at 4704.

75. Notes 68 & 69 *supra* and accompanying text.

76. *Reisman v. Caplin*, 375 U.S. 440 (1964); *United States v. McCarthy*, 514 F.2d 368, 371-72 (3d Cir. 1975); *United States v. Sun First Nat'l Bank*, 510 F.2d 1107, 1109 (5th Cir. 1975), *cert. denied*, 423 U.S. 927 (1975).

77. *Reisman v. Caplin*, 375 U.S. 440, 449 (1964); *United States v. McCarthy*, 514 F.2d 368, 372 (3d Cir. 1975).

78. *United States v. Lomar Discount Ltd.*, 61 F.R.D. 420 (N.D. Ill. 1973), *aff'd*, 498 F.2d 1404 (7th Cir. 1974).

79. *Reisman v. Caplin*, 375 U.S. 440, 449 (1964).

80. *United States v. Powell*, 379 U.S. 48, 57-58 (1964).

courts can require that the requesting country provide sufficient underlying information to justify its request for information and to ensure that the court's process is not abused.⁸¹ This is not per se a limitation on the use of *Bisceglia* by foreign governments, but it will at least permit the courts to pass on the reasonableness of a "John Doe" summons and to limit or refuse to enforce it if, in the court's opinion, such limitation or refusal is warranted.

3. Discretionary judicial limitation

a. *Burdensomeness.* In a number of recent cases involving the subpoenaing of large numbers of bank records, the banks complained that compliance with the summonses entailed an unreasonable financial burden.⁸² Most of the courts were not very sympathetic to the plea of financial burden as justification for withholding enforcement of the summonses, and following the reasoning of the court in *United States v. Dauphin Deposit Trust Co.*⁸³ that "the recipient of a summons has a duty of cooperation and . . . at least up to some point must shoulder the financial burden of cooperation," they found that the financial burdens were not excessive or unreasonable.⁸⁴ Even though financial burden generally will not excuse compliance with an IRS summons, it may call forth special protection by the courts. In *United States v. Friedman*,⁸⁵ it was held that courts have the power to require the IRS to reimburse a summons recipient for the cost of producing requested records.⁸⁶ Enforcement of the summons may even

81. *Id.* at 58:

Nor does our reading of the statutes mean that under no circumstances may the court inquire into the underlying reasons for the examination. It is the court's process which is invoked to enforce the administrative summons and a court may not permit its process to be abused. Such an abuse would take place if the summons had been issued for an improper purpose, such as to harass the taxpayer or to put pressure on him to settle a collateral dispute, or for any other purposes reflecting on the good faith of the particular investigation. (footnote omitted).

82. *E.g.*, *United States v. Friedman*, 532 F.2d 928 (2d Cir. 1976); *United States v. Continental Bank & Trust Co.*, 503 F.2d 45 (10th Cir. 1974); *United States v. Dauphin Deposit Trust Co.*, 385 F.2d 129 (5th Cir. 1967), *cert. denied*, 390 U.S. 921 (1968).

83. 385 F.2d 129, 130 (5th Cir. 1967), *cert. denied*, 390 U.S. 921 (1968).

84. *Id.* at 130. *See also* *United States v. Continental Bank & Trust Co.*, 530 F.2d 45, 48 (10th Cir. 1974); *United States v. Jones*, 351 F. Supp. 132, 134 (M.D. Ala. 1972).

85. 532 F.2d 928 (3d Cir. 1976).

86. *Id.* at 938. *See also* *United States v. Farmers & Merchants Bank*, 397 F. Supp. 418, 421 (C.D. Cal. 1975) (holding that bank should not have to bear more than nominal costs). *But see* *United States v. Mellon Bank*, 410 F. Supp. 1065, 1069 (W.D. Pa. 1976). In passing on the need for reimbursement, the courts have not focused on specific dollar limits; rather they have discussed the overall reasonableness of the burdens imposed on

be conditioned on the payment of such costs by the IRS.⁸⁷

The bank cases suggest the use of a balancing test⁸⁸ in determining the burden that recordholders should be required to bear in complying with a summons. The need of the IRS for the material and the duty of the one having the material to cooperate with the IRS are to be weighed against the right of the person to be free from unreasonable impositions by the government. A special application of the balancing test in tax treaty cases is suggested by *United States v. Harrington*,⁸⁹ where the court stated that judicial protection against sweeping or irrelevant orders is particularly appropriate in cases where a subpoena is directed not to the taxpayer but to a third party who happened to have dealings with the taxpayer.

In cases where the IRS is seeking information solely in response to a foreign request pursuant to a tax treaty, the courts should be especially sensitive to the burden placed on the recipient of the summons; consequently, the balancing test should be weighted more favorably in the recipient's favor. If there is a duty to cooperate with the IRS in its administration of the tax laws, that duty is not as strong when the laws are those of a foreign power. And if judicial protection is appropriate for a third party receiving a subpoena, that protection is even more appropriate when the subpoena is issued at the request of foreign tax authorities. The fact that twenty-two or more countries may be able to request information through the IRS dictates that the courts exercise controls over the burdens placed on those who possess the information to protect them from unreasonable impositions.

b. Privacy. The dissent in *United States v. Bisceglia* expressed concern that the summons in that case would involve the deposit slips of many innocent depositors and thus apprise the IRS of their identities.⁹⁰ The concern that a summons would infringe on the privacy of uninvolved parties and give the IRS un-

the summons recipient. Where the cost involved is not beyond that which the recipient may be reasonably expected to bear as a cost of doing business, the summons will be enforced without reimbursement. *United States v. Friedman*, 532 F.2d at 938. Willingness on the part of the IRS to furnish labor or copiers may also be relevant. *United States v. Mellon Bank*, 410 F. Supp. at 1069.

87. *United States v. Friedman*, 532 F.2d 928, 937 (3d Cir. 1976).

88. *United States v. Farmers & Merchants Bank*, 397 F. Supp. 418, 420 (C.D. Cal. 1975). See also *Oklahoma Press Publ. Co. v. Walling*, 327 U.S. 186, 203-04, 213 (1946).

89. 388 F.2d 520, 523 (2d Cir. 1968); accord, *United States v. Theodore*, 479 F.2d 749, 754 (4th Cir. 1973); *United States v. Berkowitz*, 355 F. Supp. 897, 901 (E.D. Pa. 1973), aff'd, 488 F.2d 1235 (3d Cir. 1973), cert. denied, 421 U.S. 946 (1975).

90. 420 U.S. at 156 n.2.

warranted access to information was dealt with rather cursorily by the Tenth Circuit Court of Appeals in *United States v. Continental Bank & Trust Co.*⁹¹ In that case, the court simply stated that although a search of the bank records of uninvolved parties had not been justified as relevant to a legitimate purpose, the bank had not suggested that the IRS was "attempting to investigate indirectly persons whom it could not investigate directly."⁹²

A similar problem arises when the IRS subpoenas records solely to aid a foreign government's investigation where there is no potential tax liability. In such a situation there is no legitimate purpose beyond that of satisfying a treaty request to justify the investigation. Accordingly, if the IRS is allowed to examine the subpoenaed records or to record the information before passing it on to the requesting country, then the IRS is being allowed to "investigate indirectly persons whom it could not investigate directly," and governmental access to private information is correspondingly increased.

A strong collective private interest exists in minimizing the opportunities for the IRS to pry into private affairs and in curtailing the flow of information into government computer banks.⁹³ The possible infringement of that interest in situations such as the instant case suggests that action similar to that of the district court in *United States v. Friedman*⁹⁴ may be appropriate. In that case, where IRS agents would have seen the bank records of many uninvolved parties in the course of their investigation, the judge held that the IRS had to pay to have the bank's employees search the records and extract the relevant information.⁹⁵ In tax treaty cases a further order could be made limiting the right of the IRS to examine or copy the records before passing them on to the requesting country.

91. 503 F.2d 45 (10th Cir. 1974).

92. *Id.* at 50.

93. One author, after noting the broad range of uses, both proper and improper, that can be made of information obtained by the IRS (*e.g.*, criminal prosecutions, exchanges with other federal agencies, political purposes, and harassment) said:

In federal tax investigations, therefore, it is not only the private interest of a particular individual or group to be free from harassment which must be placed on the scale Rather, it is *the collective private interest of all citizens in keeping potentially enormous investigative power within bounds* which is to be considered.

Miller, *Administrative Agency Intelligence-Gathering: An Appraisal of the Investigative Powers of the Internal Revenue Service*, 6 B.C. INDUS. & COM. L. REV. 657, 664-65, 667 (1965)(emphasis in original, footnotes omitted).

94. 388 F. Supp. 963 (W.D. Pa. 1975), *rev'd on other grounds*, 532 F.2d 928 (3d Cir. 1976).

95. *Id.* at 970.

IV. CONCLUSION

If the interpretation given the 1942 Tax Treaty with Canada by the Second Circuit is applied to the twenty-one other tax treaties currently in force, a broad power will be created for foreign governments to inquire into the affairs of Americans. The courts can limit these effects somewhat, but the greater responsibility rests with the legislative and executive branches. It seems doubtful that all the ramifications of the exchange of information provisions have been considered by those involved in the negotiation or ratification of the tax treaties. The subpoena power is perhaps a necessary adjunct to the information exchange provisions in cases where there is no domestic tax liability. If the power is necessary, Congress should take appropriate action to limit the conditions under which information is available and the methods by which it is to be collected and transmitted. Legislation could be passed to require that the Government bear all costs incident to collecting requested information. This would alleviate much of the burden on those who have their records subpoenaed. The IRS could also be required to use only Office of International Operations⁹⁶ personnel to gather and transmit information to requesting countries; the communication of information to other branches of the IRS could be prohibited. This would prevent the IRS from using treaty requests from foreign governments as a tool to gather information for its own purposes. Finally, a body outside the IRS might be created to screen incoming requests in order to ensure that foreign nations are not using the tax treaties for improper purposes such as prying into American business and private dealings.

96. The Office of International Operations is the branch of the IRS primarily involved in handling matters arising under the tax treaties. 1 INT. REV. MANUAL (CCH) 1033-3 (1976).