TAX TREATIES—RECIPROCAL EXCHANGE OF INFORMATION—SUMMONS POWER CONTAINED IN IRC SECTION 7602 MAY BE USED TO OBTAIN INFORMATION FROM DOMESTIC SOURCES FOR USE BY CANADIAN AUTHORITIES IN INVESTIGATING THE CANADIAN TAX LIABILITY OF A CANADIAN COMPANY.

The Minister of National Revenue of Canada, pursuant to the Convention[1] and protocol for the avoidance of double taxation and prevention of fiscal evasion in the case of income taxes (hereinafter referred to as the tax treaty),[2] requested that the Internal Revenue Service (IRS) obtain certain information from domestic United States sources relevant to an investigation of the Canadian tax liability of Westward Shipping, Ltd. (hereinafter referred to as Westward), a Canadian corporation. The Internal Revenue Service responded by issuing summonses pursuant to section 7602 of the Internal Revenue Code (IRC)[3] to A.L. Burbank & Co., Ltd. and the Bank

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[1] The words "treaty" and "convention" will be used interchangeably to cover double taxation agreements.

[2] The pertinent provisions of the treaty are:

Article 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.

Article 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.

Convention with Canada for the avoidance of double taxation and prevention of fiscal evasion in the case of income taxes, Mar. 4, 1942, art. XIX, XXI, 56 Stat. 1399, T.S. No. 983, 124 U.N.T.S. 271 (effective June 15, 1942) [hereinafter cited as Canadian Convention].

[3] The pertinent provisions of the statute are:

EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, 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 collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

of Tokyo, Ltd. (both of New York), ordering them to produce books and records. The United States tax liability of Westward was not under investigation and the information sought by the Internal Revenue Service related solely to the investigation of Canadian tax liability by the Canadian tax authorities.[4] Appellees objected to the summonses as unenforceable under the IRC or the tax treaty.[5] The United States District Court for the Southern District of New York held that IRC section 7602 authorized the issuance of a summons only when the determination of a United States tax liability was in question[6] and that the summonses were therefore unenforceable.[7] On appeal to the Court of Appeals for the Second Circuit, *held,*

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(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

I.R.C. § 7602.

[4] The original affidavits filed by the Government indicated the summonses were issued to aid in the determination of both the Canadian and United States tax liability of Westward. However, on February 21, 1974, the Government stipulated that there was no claim of a potential United States liability and the summonses had been issued solely in response to the request by the Canadian authorities.

[5] The initial summons to appellee A.L. Burbank & Co., Ltd. was issued December 10, 1971. Written objections to the Internal Revenue Service were filed by the Canadian taxpayer Westward Shipping, Ltd. on December 22, 1971. On November 14, 1972, the Internal Revenue Service issued a second summons to appellee Burbank for the same information, but this summons purported to relate to the United States tax liability of appellee. After further objections by Westward, the Government declined to enforce the summons of November 14, 1972. Instead, the Government sought to enforce the original summonses of November and December, 1971.

[6] The district court concluded that within the meaning of I.R.C. § 7602, liability for an "internal revenue tax" was equivalent to liability for a United States tax. United States v. A.L. Burbank & Co., Ltd. and the Bank of Tokyo, Ltd., 74-2 U.S.T.C. 85559, 85562 (S.D.N.Y. 1974).

[7] The issue of Westward's standing to object to enforcement of the summonses was also before the district court. In denying Westward's motion to intervene, the court relied on the decision in In re Cole, 342 F.2d 5 (2d Cir. 1965), *cert. denied,* 381 U.S. 950 (1965), which was expressly affirmed in Donaldson v. United States, 400 U.S. 517 (1971). In *Cole* it was held that "[t]he taxpayer, under circumstances where only books, records and other papers belonging to the third party are the subject of the summons, has no standing to object to the summons." 342 F.2d at 8. The order denying Westward's motion to intervene was affirmed on appeal. 525 F.2d at 17. The Tax Reform Act of 1976 added a new provision, 26 U.S.C.A. §7609, relating to third-party summonses issued after February 28, 1977. Under the new law, a summons to a "third party recordkeeper" (*e.g.* a bank) must be followed within three days after service by notice to the taxpayer. *Id.* § 7609(a)1. The taxpayer then has the right to

reversed. The Internal Revenue Service can use its administrative procedures to obtain information requested by Canadian tax authorities for use in the investigation of the Canadian tax liability of a Canadian company, even though there is no United States interest in the investigation and a United States tax liability is not in question. *United States v. A.L. Burbank & Co., Ltd.*, 525 F.2d 9 (2d Cir. 1975), *cert. denied*, 97 S.Ct. 2647 (1976).

Currently there are 24 foreign governments with which the United States has conventions respecting the taxation of income.[8] These countries account for approximately 60 percent of our foreign trade and investment. Each convention has some provision for the exchange of information between the contracting states, the wording of which is sufficiently similar to be considered boilerplate.[9] Generally, the information to be exchanged is of two types: (1) that information which is already at the disposal of a contracting state;[10] and (2) that information which pertains to specific parties and must be obtained on an individual basis in response to a request from the other contracting state.[11] The first of these types is the

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intervene (thus resolving one issue facing the lower court in the instant case) and has the right to stay compliance by notifying the party summoned not to comply. The IRS must seek enforcement of the summons in federal court and the taxpayer has standing to challenge such enforcement. *See* [1976] 8 STAND. FED. TAX REP. (CCH) ¶ 5930 D.01.

[8] Conventions respecting taxation are currently in force with Australia, Austria, Belgium, Canada, Denmark, Finland, France, Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, South Africa, Sweden, Switzerland, Trinidad and Tobago, and the United Kingdom. 1976 *Treaties in Force*, Dep't State (U.S.).

[9] The treaty with New Zealand contains a typical information exchange provision:

> (1) The taxation authorities of the Contracting Governments shall exchange such information (being information available under the respective taxation laws of the Contracting Governments) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or for the administration of statutory provisions against legal avoidance 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 persons (including a court) concerned with the assessment or collection of the taxes which are the subject of the present Convention or the determination of appeals in relation thereto. No information shall be exchanged which would disclose any trade secret or trade process.

Convention with New Zealand for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, Mar. 16, 1948, art. XVI, para. (1), [1951] 2 U.S.T. 2378, T.I.A.S. No. 2360, 127 U.N.T.S. 133 (effective Dec. 18, 1951).

[10] *E.g.*, information contained in reports submitted by employers regarding income tax withheld from their employees.

[11] This second type of information led to the dispute in the case under discussion. Canada is the requesting state, the United States is the state being requested and the subject of the request was information regarding Westward which was in the possession of Burbank.

most commonly used; however, there are several limitations on this process for exchange of information common to most of the treaties:[12]

(a) the information must be necessary for carrying out the provisions of the convention or for the prevention of fraud;[13]
(b) the information must be treated as secret;[14]
(c) no information will be exchanged which would disclose any trade secret or trade process;[15] and
(d) the information must be available under the taxation laws of the respective contracting states.[16]

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[12] Joseph, *Income Tax Treaties—A Comparison of Basic Provisions*, 12 N.Y.U. 7TH INST. ON FED. TAX. 787, 814-19 (1954).

[13] *E.g.*,

> The taxation 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 this Convention or for the prevention of fraud or for the administration of statutory provisions against avoidance of the taxes which are the subject of this Convention.

Convention with Australia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, May 14, 1953, art. XVIII, para.(1), [1953] 4 U.S.T. 2274, T.I.A.S. No. 2880, 205 U.N.T.S. 253 (effective Jan. 1, 1953).

[14] *E.g.*, "[a]ny information so exchanged shall be treated as secret and shall not be disclosed to any person other than those concerned with the assessment and the collection of the taxes which are the subject of the present Convention." Convention and protocol with Greece for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, Feb. 20, 1950, art. XVII, [1954] 5 U.S.T. 47, T.I.A.S. No. 2902, 196 U.N.T.S. 291 (effective Dec. 30, 1953).

[15] *E.g.*,

> In no case shall the provisions of paragraph (1) [regarding the exchange of information] be construed so as to impose on one of the Contracting States the obligation—
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> . . . .
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> (c) To supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information, the disclosure of which would be contrary to public policy.

Convention with Norway for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and property with related notes, Dec. 3, 1971, art. 28, para. (2)(c), [1972] 23 U.S.T. 2832, T.I.A.S. No. 7474 (effective Nov. 29, 1972).

[16] *E.g.*,

> In no case shall the provisions of Article XVII, relating to mutual assistance in the collection of taxes, or of Article XVIII, relating to particulars in concrete cases, be construed so as to impose upon either of the contracting States the obligation
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> (1) to carry out administrative measures at variance with the regulations and practice of either contracting State, or
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> (2) to supply particulars which are not procurable under its own legislation or that of the State making application.

Convention and protocol with Sweden for the avoidance of double taxation and the establishment of rules of reciprocal administrative assistance in the case of income and other taxes, Mar. 23, 1939, art. XIX, para. (2), 54 Stat. 1759 (1939), T.S. No. 958, 199 L.N.T.S. 17 (effective Nov. 14, 1939).

Although this last provision is a point common to most conventions, there is a paucity of case law interpreting it.[17]

Articles XIX and XXI of the tax treaty with Canada provide for the reciprocal exchange of information useful in the assessment of taxes.[18] Although the primary purpose is "the avoidance of double taxation" on income,[19] this treaty is also intended to facilitate the exchange of information.[20] It does not provide specifically for compulsory issuance of summonses or for any other administrative procedures in individual cases,[21] but rather broadly mandates reciprocal exchange of tax related information which the respective authorities "have at their disposal or are in a position to obtain under [their own] internal revenue laws."[22] As section 7602 of the IRC provides the authority for issuance of summonses by the Internal Revenue Service where necessary to aid in the determination of liability for "any internal revenue tax,"[23] the enforcement of the summonses for such an exchange of information would depend on the breadth of the construction given to this delegation of summoning authority. The court, in its consideration of the reach of this summons power in the instant case, holds that such administrative procedures could be used not only in determination of United States tax liability, but also in compliance with requests by foreign tax authorities to assist in the investigation of a potential foreign tax liability.[24]

Such a liberal construction of the use of administrative procedures is supported by the treaty provisions. A narrower interpretation would entirely frustrate the purposes of the treaty[25] and possibly would have a deleterious effect upon relations under other income tax conventions which have information exchange provisions. The enforcement of the summonses in this case is also supported by the principle that treaties should be

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[17] "The Government argues that there has been no prior litigation on this point [scope of treaty clause permitting information that is available under the taxation laws of the contracting state to be exchanged] precisely because that position has not been challenged before." 525 F.2d at 15.

[18] Canadian Convention, *supra* note 2, art. XIX.

[19] Scope of §§ 519.101 to -.120, 76 C.F.R. § 519.102 (1974).

[20] Historically, treaties intended to foster cooperation in such exchanges of information preceded those designed to avoid double taxation. King, *Fiscal Cooperation in Tax Treaties*, 26 TAXES 889, 890 (1948).

[21] The provision in the treaty with Canada for the exchange of information on request has been characterized as "permissive," whereas the corresponding provision in certain other treaties, *e.g.*, Convention and protocol with the United Kingdom for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, Apr. 16, 1945, art. XX, 60 Stat. 1377 (1946), T.I.A.S. No. 1546, 6 U.N.T.S. 189 (effective July 25, 1946), is considered "mandatory." *Id.* at 893.

[22] Canadian Convention, *supra* note 2, art. XIX. This reading of the treaty by the district court was concurred in by the Second Circuit. 525 F.2d at 12.

[23] I.R.C. § 7602.

[24] 525 F.2d at 13.

liberally construed[26] to give effect to the intent of the contracting parties,[27] and to enlarge rights thereunder. Therefore the information exchange provisions in articles XIX and XXI of the treaty constitute authority for the use of administrative procedures contained in the IRC,[28] a domestic internal revenue statute. This use of domestic administrative procedures is bolstered by section 7852(d) of the IRC, which restricts application of any provisions of the IRC which contravene a treaty in force.[29] Thus, although the district court and the court of appeals reached opposite results in their interpretation of section 7602, the position of the reviewing court seems more in accord with the congressional intent to favor such an application,[30] as is apparent in section 7852(d).

The court is careful to point out that the treaty would authorize use of administrative procedures in this manner even though a Canadian interpretation might not imply a reciprocal obligation.[31] Under such circumstances the United States can continue to conform to its own obligation under its construction, even though the other party may repudiate its responsibility under the treaty. While statutory construction formed the predominant basis for the decision, the court was also influenced by the position of the Organization for Economic Cooperation and Development (OECD) with regard to such exchange of information provisions.[32] The exchange of information provisions of the OECD Model Tax Convention[33]

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[26] Canadian Convention, *supra* note 2, art. XIX.

[26] Lidstone, *Liberal Construction of Tax Treaties—An Analysis of Congressional and Administrative Limitations of an Old Doctrine*, 47 CORNELL L.Q. 529, 532 (1962).

[27] Bacardi v. Domenech, 311 U.S. 150, 163 (1940); Factor v. Laubenheimer, 290 U.S. 276, 292 (1933).

[28] 525 F.2d at 14.

[29] I.R.C. § 7852(d) provides: "No 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." *See also* Regulations affecting the Taxation of Nonresident Alien Individuals, Residents of Canada, and Canadian Corporations Under the Tax Convention Between the United States & Canada:

> § 519.120 Information in specific cases—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.

[30] Note 27 *supra*.

[31] 525 F.2d at 16.

[32] For a general discussion of the OECD position, *see* Pearson, *The OECD Draft Double Taxation Convention and Recent U.S. Treaties*, 48 TAXES 426 (1970).

[33] Article 26 of the OECD Model Convention provides:

> Exchange of Information
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> 1. The competent authorities of the Contracting States shall exchange such information as is necessary for the carrying out of this Convention and of the domestic laws of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is in accordance with this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to

are very similar to the exchange provisions in most United States tax treaties.[34] The Model Treaty's Revised Commentary of January 1975, paragraphs 12 and 14,[35] seems to clearly favor the government's position. This commentary indicates that

> [12] a Contracting State is not bound to go beyond its own internal laws . . . in putting information at the disposal of the other Contracting State. However, types of administrative measures authorized for the purpose of the requested State's tax must be utilized even though invoked solely to provide information to the other Contracting State.[36]

This is in accord with the court's opinion that the United States intended to utilize administrative procedures in such a situation even though they are taken solely to provide information to the other state tax authorities.[37]

In the instant case the court is properly concerned with the effect that a denial of enforcement of the summonses would have on other United States tax treaties with similar information exchange provisions. In that respect the decision is clearly result oriented. Due to the nearly identical wording used in these treaties, it is likely that the ruling will be very significant. The real impact, however, may depend on how vigorously the Internal Revenue Service seeks enforcement of summonses arising from similar information requests by countries other than Canada.[38] One might specu-

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any persons or authorities other than those concerned with the assessment or collection of the taxes which are the subject of the Convention.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on one of the Contracting States the obligation:

(a) to carry out administrative measures at variance with the laws or the administrative practice of that or of the other Contracting State;

(b) to supply particulars which are not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (order public).

[34] Kragen, *Double Income Taxation Treaties: The O.E.C.D. Draft*, 52 CALIF. L. REV. 306, 331 (1964).

[35] Paragraph 14 provides:

> Information is deemed to be obtainable in the normal course of administration if it is in the possession of the tax authorities or can be obtained by them . . . which may include special investigations or special examination . . . provided the tax authorities would make similar investigations or examinations for their own purposes. *This means that the requested state has to collect the information in the same way as if its own taxation was involved.*

(emphasis added).

[36] O.E.C.D. Model Treaty Revised Commentary of January 12, 1975, para. 12.

[37] 525 F.2d at 16.

[38] "We have reexamined the provisions in our income tax treaties for exchanges of information with a view to assuring that these provisions will be fully utilized by the Service in

late that the Internal Revenue Service was particularly interested in complying with the information request by the Canadian authorities because an unusually cooperative relationship has long existed between United States and Canadian taxing authorities.[39]

International cooperation in the use of administrative procedures is of primary importance in seeking to prevent fiscal evasion. Information pertinent to such an investigation would seldom be exchanged in the absence of a treaty obligation as customary international law does not require any cooperation between countries in tax matters.[40] Judicial decisions in some countries even forbid one sovereign state from supporting another in enforcement of its tax laws.[41] Few countries would encourage voluntary unilateral disclosure of sensitive tax information as this might result in unfavorable economic consequences in the form of capital outflows by international investors. Such a situation might prove disastrous to developing countries and countries such as Switzerland which are highly dependent on foreign capital. Although these interests favor only limited exchange of tax related information, the information exchange provision of treaties following the OECD Draft of 1963 are expansive.[42]

Tax treaties are beneficial to both individual and corporate taxpayers engaged in international transactions that generate business income, investment income, or earned income.[43] Generally these treaties reduce double taxation[44] and foster equality of treatment between domestic and foreign taxpayers.[45] The existence of tax treaties contributes to a feeling of certainty and predictability in the commercial environment of the contracting states[46] which, in turn, facilitates the movement of capital across

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connection with its international enforcement activities." Comments by Treasury Department's International Tax Counsel Robert T. Cole, *reprinted in* 36 J. TAX. 124 (1972).

[39] *See* address by Commissioner of Internal Revenue Mortimer Caplin, Third Canadian Conference, Tax Executives Institute *reprinted in* 14 TAX EXEC. 324 (1962).

[40] Kronauer, *Information given for Tax Purposes from Switzerland to Foreign Countries*, 30 TAX L. REV. 47, 49 (1974) [hereinafter cited as Kronauer].

[41] Note, *International Enforcement of Tax Claims*, 50 COLUM. L. REV. 490, 491 (1950); Robertson, *Extraterritorial Enforcement of Tax Obligations*, 7 ARIZ. L. REV. 219 (1966).

[42] "Article 26 of the OECD Draft Taxation Convention . . . proposes the exchange of all information necessary for carrying out the domestic laws of the contracting states concerning taxes covered by the treaty (whether necessary for the assessment of taxes or for the prevention of the evasion or tax fraud)." Kronauer, *supra* note 41, at 83.

[43] For a discussion of the scope of these income categories, see White, *Income Tax Treaties*, 52 A.B.A. J. 756, 757 (1966).

[44] Note 8 *supra*.

[45] "Our tax conventions also seek to assure non-discrimination in tax treatment for U.S. individuals and business ventures abroad . . . . Through tax conventions we have been able to secure commitments from other countries that U.S. citizens will get the same treatment as nationals of the country in which they are living." Surrey, *What Tax Conventions Accomplish*, 23 J. TAX. 364, 365 (1965).

[46] Hadari, *Tax Treaties and Their Role in the Financial Planning of the Multinational Enterprise*, 20 AM. J. COMP. L. 111, 119 (1972).

national boundaries.[47] "The result of this network of tax treaties is to reduce the risk and the costs of international investment and thus encourage the free international movement of persons and capital and produce a more optimal allocation of resources in the world."[48] These factors suggest the extent to which tax treaties can be used as an effective means of stimulating private investment in developing countries. Thus, it behooves the international business community to encourage adherence to the provisions of existing treaties and to press for the negotiation of additional treaties when possible. Obviously objections from individual taxpayers can be expected in certain disputed cases. Notwithstanding these objections, a consideration of all the relevant factors suggests that the objectives of the taxing authorities and private commercial interests can best be served by extending the use of tax treaties containing provisions for reciprocal administrative assistance. A growth in the number of such treaties could serve as a basis for an international minimum standard of cooperation in the tax field.

The benefits to be gained from an expansion of the notion of reciprocal administrative assistance are substantial, especially between the more industrialized nations with similar tax structures. Due to the increasingly global nature of the activities of large United States corporations, greater cooperation with respect to reciprocal information exchange and related administrative matters may be an invaluable investigative aid, enabling the Internal Revenue Service to determine more accurately a corporation's tax liability arising from foreign operations. This case evinces a willingness on the part of the United States to cooperate with other governments in tax investigations of foreign corporations despite the absence of any potential United States revenue gains to be derived from the investigative activity. Perhaps this attitude will encourage greater reciprocal foreign cooperation in the future.

Tim J. Floyd

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[47] "The general objective of tax treaties is to remove tax barriers to the international flow of capital . . ." *Id.*

[48] *Id.* at 135.