Collection of Foreign Tax Judgements: When Your Other Problems Come Home

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Panelists

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Hypothetical

• U.S. taxpayer has an unpaid foreign tax liability. What options are available to foreign jurisdiction to collect the outstanding tax liability?

• How do the following factors affect the answer?
  o Identity and citizenship of the U.S. taxpayer?
  o Which foreign jurisdiction seeks to collect the tax liability?
  o Type of unpaid tax liability?
  o Income tax treaty with the U.S.?
  o Other factors?
Exchange of Information

- Common methods for the exchange of information ("EOI") include:
  - Bilateral tax treaties
  - Tax Information Exchange Agreements
  - Multilateral treaties and agreements
  - Mutual legal assistance treaties
- EOI can either be requested or produced spontaneously
  - "Spontaneous exchange of information, which operates through the exchange of information provisions of international exchange agreements, involves the transmission of information that has not been specifically requested by a Competent Authority, but which in the judgment of the providing authority may be of interest to a foreign partner for tax purposes. The exchange typically involves information discovered during a tax examination, investigation, or other administrative procedure that suggests or establishes noncompliance with the tax laws of a foreign partner, or that is otherwise determined to be potentially useful to a foreign partner for tax purposes." I.R.M. 4.60.1.3(1).
- FATCA/IGA
- CRS (Common Reporting Standard)
(2) EOI analysts assigned to foreign-initiated requests for information review each request as well as the applicable treaty or agreement to ensure the below elements are included in the request:

a. The request pertains to a foreign jurisdiction with which the U.S. has a treaty or agreement covering EOI for purposes of the tax(es) and matters subject to foreign examination, investigation, or administrative procedure;

b. Designation of the Commissioner, LB&I as the U.S. Competent Authority to which the request is addressed;

c. Signature of the current foreign Competent Authority official;

d. Contact information for the foreign exchange of information representative assigned to the request;

e. A statement indicating the relevant treaty or agreement providing for the exchange of information;

f. A statement indicating the request is in conformity with the laws and administrative practices of the foreign jurisdiction, and that if the requested information was within the jurisdiction of the foreign partner, then the foreign partner would be able to obtain the information under its laws or in the normal course of its administrative practice;

g. A statement indicating the foreign Competent Authority has pursued all domestic means available to obtain the information, except those that would give rise to disproportionate difficulties;
(2) EOI analysts assigned to foreign-initiated requests for information review each request as well as the applicable treaty or agreement to ensure the below elements are included in the request:

h. Name of the taxpayer(s) under foreign examination or investigation, as well as any other available identifying information (e.g., addresses, date of birth, etc.);

i. Types of taxes and periods under foreign examination or investigation;

j. Location of the information requested, including sufficient identifying information (e.g., name, address, date of birth, etc.) pertaining to the individual or entity in possession or control of the information;

k. Background information regarding the foreign examination, investigation, or procedure, including a description of the specific foreign tax matters involved;

l. Description of the requested information’s "foreseeable relevance" to the foreign examination, investigation, or procedure, i.e., an explanation of how the requested information would be pertinent to the administration or enforcement of the foreign taxes at issue;

m. Detailed description of the specific information requested;

n. A statement as to whether the documents need to be certified, and if so, the purpose and nature of the requested certification (for applicable certification procedures, see IRM 4.60.1.2.2.5, Foreign-Initiated Specific Requests for Information – Apostille and "Full Faith and Credit" Letter Certifications, and IRM 4.60.1.2.2.6, Foreign-Initiated Specific Requests for Information – Tax Return Certifications and Testimony Authorizations); and

o. Any statute of limitations, court, or similar dates by which the information is required.
John Doe Summons

- Used by the IRS to obtain information about unknown individuals from financial institutions
- Recent Examples:
  - Finland
    - “Court Authorizes Service of John Doe Summons Seeking Information About Finnish Residents Using Bank of America, Charles Schwab, and TD Bank Payment Cards Linked to Non-Finnish Bank Accounts,” DOJ Press Release, May 1, 2019
  - The Netherlands
  - Norway
“MCAR is an agreement between the United States and the treaty partner to combat international tax avoidance and evasion. It is a mutual obligation to collect taxes on behalf of another country. The treaties provide that each contracting country can take whatever actions it would take to collect its own taxes in order to collect the taxes of a treaty partner. Each country uses its own unique collection tools to collect the tax of a treaty partner.” I.R.M. 5.21.7.4(2)

Each country has an obligation to assist in collection of tax on the other country’s behalf

Inbound v. Outbound MCARs

Some MCARs are broader than others, allowing for the collection of different types of tax

- Canada – All taxes including both individual and business
- Denmark – Income taxes
- France – Income taxes & estate taxes
- The Netherlands - Income taxes
- Sweden – Income taxes
- Japan – Income, gift, estates, employment, and certain excise taxes (recently enacted)
Mutual Collection Assistance Requests

- Administered by LB&I Competent Authority with assistance from SB/SE Field Collection Area Operations
- The MCAR process may not be used by a foreign country to collect revenue from a U.S. citizen
- Procedures:
  - A treaty partner submits a letter requesting assistance from the LB&I Competent Authority.
    - The letter must include language that the tax was “finally determined” and provide the following information:
      - The taxpayer’s name;
      - The taxpayer’s address;
      - Type of tax/tax periods;
      - Amounts due in the currency of the treaty partner;
      - The date of the “Collection Expiration Statute Date”; and
      - Any known levy sourced or assets located within the United States.
  - The MCAR coordinator will prepare an assessment certificate which includes:
    - The amount of the foreign tax liability, in U.S. dollars, using the exchange rate as of the date the Assessment Certificate is prepared;
    - A taxpayer control number (TCN) created as a taxpayer identifying number for the case; and
    - The signature of the MCAR coordinator and the date of the Assessment Certificate.
The IRS will conduct research on the taxpayer and send the taxpayer the MCAR First Notice and MCAR Final Notice.

- CDP rights conferred to “any person” under I.R.C. § 6630
  - Are CDP rights triggered in response to an MCAR Final Notice?

The taxpayer has the following options for ending the MCAR case:

- Full payment;
- Enter into an installment agreement;
  - Note - the IRS does not have the authority to enter into an Offer in Compromise with the taxpayer on behalf of the treaty partner.
- Dispute the underlying tax liability with the treaty partner;
- Prove U.S. citizenship;
- Enter into currently not collectable or unable to pay status with the IRS; or
- File for bankruptcy with the IRS filing a proof of claim with the Bankruptcy Court.

Should the taxpayer fail to comply with one of the above procedures, the IRS can issue a Levy, file a Notice of Federal Tax Lien, or move forward with the seizer and sale of the taxpayer’s property.
Mutual Collection Assistance Requests

- MCAR Challenges
  - *Retfalvi v. United States*, 930 F.3d 600 (4th Cir. 2019) (Inbound MCAR)
    - A Canadian citizen became a permanent resident of the U.S.
    - The Canada Revenue Agency ("CRA") audited the taxpayer's return and sent him a Notice of Assessment.
    - After the assessment, the taxpayer became a U.S. citizen.
    - The CRA referred the assessment to the U.S. using the procedures found in the U.S.-Canada Income Tax Treaty.
    - Taxpayer paid the assessment in the U.S. and filed a refund action in district court.
    - The United States District Court for the Eastern District of North Carolina concluded that the IRS was authorized by the U.S.-Canada Income Tax Treaty to collect outstanding Canadian income taxes payable by a U.S. resident and citizen, when the Canadian liability was assessed prior to Retfalvi becoming a U.S. citizen (upheld on appeal).
    - U.S. citizen taxpayer was living in Canada operating a business. He did not file Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations. IRS assessed penalties against the taxpayer for failure to file the form. The taxpayer challenged the penalties before the IRS, lost, and refused to pay.
    - Under the U.S.-Canada Treaty, the U.S. requested the Canadian tax authority hold the taxpayer's Canadian income tax refund until the penalties were paid.
    - Taxpayer challenged the MCAR, arguing it was unconstitutional under the Fifth and Eighth Amendments.
    - Court found in favor of the U.S. and upheld the MCAR.
Revenue Rule

- Common law prohibition on courts from enforcing internal revenue laws of a foreign country.
- “When a foreign nation appears as a plaintiff in our courts seeking enforcement of its revenue laws, the judiciary risks being drawn into issues and disputes of foreign policy that are assigned to – and better handled by – the political branches of government.” Attorney Gen. of Can. v. R.J. Reynolds Tobacco Holdings, Inc., 268 F.3d 103, 111 (2d. Cir. 2001).

- The substance, not the form, of the action is determinative as to whether the Revenue Rule applies.
  - Even if the pleadings do not use the labels “tax” or “revenue,” the court will look at the substance of the claim to determine exactly what the foreign government is attempting to collect through the U.S. court system.
Limited Exception to the Revenue Rule

- When a foreign government is acting as a commercial actor, rather than as the sovereign collecting tax, the Revenue Rule does not bar collection in U.S. courts.
    - The U.S. court ruled that the collection of lost tax revenue was barred by the Revenue Rule.
    - The remaining claim was bifurcated.
      - The Court ruled that recoupment of profits lost as a result of the defendants’ tax evasion actions would be akin to “indirect enforcement of Colombian tax law” and would be barred under the Revenue Rule.
      - However, the recoupment of the portion of lost profits attributable to money laundering was not barred by the Revenue Rule because awarding it required only the recognition of Colombian tax laws and was not a collection action under Colombian tax laws.
- Abrogation of the Revenue Rule by treaty
Penal Rule

• The doctrine
  o “...settled principles of private international law preclude one state from acting as a collector of taxes for a sister state, and from enforcing its penal or revenue laws as such. The revenue laws of one state have no force in another.” Moore v. Mitchell, 30 F.2d 600, 602 (2d Cir. 1929)

• Upholding a tax judgment can amount to penal enforcement of tax laws
  o See United States v. Pasquantino, 305 F.3d 291, 296 (4th Cir. 2002)

• RICO cases
  o Attorney Gen. of Can. v. R.J. Reynolds Tobacco Holdings, Inc., 268 F.3d 103 (2d. Cir. 2001)

• Wire fraud cases
  o United States v. Boots, 80 F.3d 580 (1st Cir. 1996)
Act of State Doctrine

- Longstanding principle of U.S. common law grounded in constitutional separation of powers principles
  - "Every sovereign state is bound to respect the independence of every other sovereign state, and the courts of one country will not sit in judgment on the acts of the government of another done within its own country." *Underhill v. Hernandez*, 168 U.S. 250 (1897)
- "Act of state"
  - Includes executive and administrative exercise of sovereign power by an independent state or by its duly authorized agents or officers
- The penal rule and the revenue rule form part of the act of state doctrine
- Closely related to the international conflicts of laws principles of comity
  - Enforcement of judgments are generally a matter of comity
    - "Comity,’ in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.” *Hilton v. Guyot*, 159 U.S. 113, 163-164 (1895)
Standing Issues

• A foreign tax authority must have standing to file a suit in the U.S.
• The Supreme Court has stated that the “irreducible constitutional minimum” of standing consists of three elements:
  o The plaintiff must have (1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision. *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540 (2016).
• A foreign government will claim it suffered a financial injury.
• As a tax authority of a foreign government may be deemed to be an agency or ministry of a foreign government, it may have standing to bring suit on behalf of the government.
Other Inbound International Collection Devices

- Foreign-equivalents of:
  - Liens, levies, garnishments, etc.
  - Repatriation orders
  - Use of receivers
  - Writ ne exeat republic actions
  - Customs orders and prevent departure orders