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TAX LITIGATION ISSUES

Expert Analysis

Closed for Business: Shutting Down The US as an Offshore Tax Haven

By
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For more than a decade, the Department of Justice and Internal Revenue Service have devoted substantial resources to eradicating the use of offshore accounts to evade U.S. tax obligations. This column has chronicled these efforts, which have included criminal prosecutions and significant civil penalties imposed on taxpayers who failed to avail themselves of one of the IRS's Offshore Voluntary Disclosure Programs. But the United States is not the only country whose citizens use offshore vehicles to cheat on their taxes, and while U.S. taxpayers think of Switzerland and Caribbean islands as tax havens, many foreign nationals use U.S.-based vehicles to evade their own tax obligations. A recent filing seeking "John Doe summonses" based upon a treaty request from Finland serves as a reminder that offshore tax evasion is not a uniquely American problem.

Financial Transparency In the United States

In 2018, the United States ranked second—behind only Switzerland and one spot ahead of the Cayman Islands—in the Tax Justice Network's Financial Secrecy Index of tax havens based on an assessment of the level of secrecy provided by each country's laws in light of the jurisdiction's overall importance in the global markets.

One common means of avoiding transparency in the United States is the Delaware LLC, which need not identify its owners publicly. Last year, however, the Delaware Secretary of State endorsed proposed legislation that would put the federal government in charge of overseeing corporate ownership, thereby limiting the availability of shell companies created under state laws. Samuel Rubenfeld, Delaware Backs Overhaul of Shell-Company Rules, Wall St. J. (June 25, 2018). That legislation—which harkens back to Ralph Nader's effort in the 1970s to form a Federal Chartering Agency—has been proposed on a number of occasions in the past decade without ever making it out of committee. Samuel Rubenfeld, U.S. Congress Tries, Again, on Corporate Transparency, Wall St. J. (June 28, 2017).

A recent filing seeking "John Doe summonses" based upon a treaty request from Finland serves as a reminder that offshore tax evasion is not a uniquely American problem.

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Whether Delaware's support will make a difference this time around is yet to be seen, but as of this writing, no such legislation is pending. Meanwhile, none of the various amendments to Delaware's General Corporation Law that were passed last August required greater transparency by corporations. See Louis G. Hering & Melissa A. DiVincenzo, Insight: 2018 Amendments to Delaware's General Corporation Law and Alternative Entity Statutes, Bureau of Nat'l Affairs (Aug. 10, 2018). By contrast, following increased attention to the possible use of U.S. real estate (especially in New York and Miami) to launder money, the Financial Crimes Enforcement Network (FinCEN) recently expanded a requirement that beneficial owners of shell companies buying residential real estate for cash be identified. FinCEN, Geographic Targeting Orders Involving Certain Real Estate Transactions (Nov. 15, 2018).

The John Doe Summons

While legislative and regulatory fixes seek to increase transparency, the IRS is using its investigative arsenal, including John Doe summonses, to help other countries pursue tax evasion by their citizens.

In *United States v. Bisceglia*, 420 U.S. 141 (1975), the Supreme Court authorized the IRS to issue a summons on a bank where it had reason to believe an unidentified bank customer was not complying with his tax obligations. Congress codified *Bisceglia*'s holding at §7609(f) of the Internal Revenue Code, which authorizes the IRS to issue so-called John Doe summonses where it can show (1) that the summons relates to "a particular person or ascertainable group or class of persons," (2) that there is "a reasonable basis for believing" that the person(s) may have failed to comply with "any internal revenue law," and (3) that the information sought and the identities of the person(s) are not readily available from another source.

On April 23, 2019, the IRS filed a petition in the Western District of North Carolina (*United States v. John Does*, Case No. 3:19-mc-00067) seeking leave to serve John Doe summonses on three banks. Like summonses that the IRS obtained in the early 2000s requiring American Express, MasterCard and Visa to produce records of transactions using debit and credit cards issued in tax havens, see Offshore Credit Card Program (OCCP), the summonses presented to the court in North Carolina sought information regarding cards issued by the three banks in question. Unlike with the earlier summonses, however, the cards in question were not used by U.S. taxpayers. Instead, the cards had been used at ATMs or in other transactions in Finland over an extended period of time and in discernible patterns, leading the Finnish Tax Authority to conclude that they were likely being used by Finnish taxpayers who had not properly reported their income in Finland. Thus, the application for the John Doe summonses was predicated on a request made under the United States-Finland tax convention seeking the identities of the individuals who had acquired the cards in question.

Potential Legal Obstacles To Tax Treaty Summonses

While §7609(f) does not expressly authorize the issuance of John Doe summonses to aid foreign governments, in its application the government asserted that Congress's inclusion of the requirement that such summonses seek information regarding persons who failed to comply with "any internal revenue law" permits their use to assist other countries. Because the government's submission in *John Does* was made ex parte and granted in a summary order with no opposition briefing, this issue was not contested, and there does not appear to be any case law addressing it. In its application, however, the government identified a series of John Doe summonses obtained on behalf of Norway in 2013 and another John Doe summons obtained on behalf of the Netherlands in 2017. Each of those prior matters involved similar

allegations that foreign individuals were storing money in the United States and using bank cards to make purchases abroad as a way to avoid foreign taxes. Unfortunately, the only reported order to come out of the prior applications did not address any legal obstacles to the summonses, and targets of John Doe summonses have little ability to challenge their issuance. See Jeremy H. Temkin, "Tax Enforcement, John Doe Summonses and Digital Currency," New York Law Journal (Jan. 19, 2017).

Moreover, Circuit Courts of Appeals have consistently concluded that IRS summonses apply equally to a foreign tax investigation even where no U.S. audit exists. In *United States v. A.L. Burbank & Co.*, 525 F.2d 9, 13-14 (1975), the U.S. Court of Appeals for the Second Circuit found that a narrower interpretation would frustrate the purpose of the various tax conventions to which the United States is party. Following *Burbank*, in *Lidas v. United States*, 238 F.3d 1076, 1081 (2001), the Ninth Circuit observed that limiting the IRS summons power to domestic tax liabilities would conflict with the fact that tax treaties, upon ratification, become part of the law of the United States and thereby impose obligations on the IRS. Thus, even though courts have not specifically addressed the use of John Doe summonses to gather information on behalf of tax treaty partners, the practice appears to rest on solid legal ground.

This does not mean summonses issued on behalf of foreign countries pursuant to treaty requests are immune from legal challenge. In *Mazurek v. United States*, 271 F.3d 226 (5th Cir. 2001), the IRS issued a summons seeking financial records on behalf of the French Tax Authority. Mazurek, the target of the French investigation, moved to quash the summons on the grounds that the French proceedings were invalid inasmuch as he was not a resident of France during the relevant periods and thus the summons did not serve a legitimate purpose. The U.S. Court of Appeals for the Fifth Circuit rejected that challenge because it improperly "focuse[d] on the legitimacy of the [French] investigation, not on the legitimacy of the IRS's compliance with the [French Tax Authority's] request." Id. at 231. To show that the *IRS* had no legitimate purpose, Mazurek would have needed to show it was acting in bad faith in complying with the treaty request. The court left open the possibility that a successful challenge could be brought if the IRS summons sought information to which the foreign tax authority was not entitled to under its domestic law.

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Conclusion

After years of seeking other countries' aid in investigating offshore tax evasion, the United States is (slowly) moving towards requiring increased transparency as well. While such legislation and regulation may take time, the case law appears to impose few limitations on the IRS using its summons authority on behalf of foreign countries seeking evidence that their citizens are using vehicles available in the United States to conceal their income and assets. Given the widespread concerns that the United States serves as a tax haven for citizens of other countries, the recent John Doe summonses discussed in this article may be a sign that foreign countries are becoming increasingly aggressive in seeking the IRS's assistance in shutting down offshore tax evasion by their citizens and that the IRS is committed to providing that assistance.