RECIPROCAL ENFORCEMENT OF TAX CLAIMS THROUGH TAX TREATIES

*Alan R. Johnson**
*Lawrence Nirenstein***
*Stephen E. Wells****

I. BACKGROUND

A. *The Common Law.*

In 1775, Lord Mansfield stated, in dictum in *Holman v. Johnson,*[1] that no country ever takes notice of the revenue laws of another. More than two hundred years later, it is apparent that Lord Mansfield's dictum still correctly states the law, at least in common law nations.

In 1955, in *Government of India v. Taylor,*[2] the British House of Lords squarely faced the issue of whether one nation's tax claims would be enforced by the courts of another, and held that the Indian government could not enforce a judgment in Great Britain against a corporation, which had engaged in business in India, for a capital gains tax realized upon the nationalization of the corporation's Indian assets. In 1963, the rule established by the House of Lords in the *Taylor* case was applied by the Supreme Court of Canada in *United States v. Harden*[3] to deny a tax claim by the U.S. government. In that case, the United States obtained a stipulated judgment in a federal district court for approximately $640,000 of taxes and interest against Mrs. Harden, whereupon she fled to Canada with all of her assets. The Canadian courts refused to enforce the American judgment, citing the unbroken line of precedent in English jurisprudence.

A foreign government has never attempted to enforce a tax claim in United States courts. However, there was much litigation concerning the

---

*Alan R. Johnson (A.B., University of Rochester, 1965; LL.B., Harvard Law School, 1968) is a member of the New York Bar and of the firm of Fox Glynn & Melamed, New York, New York.

**Lawrence Nirenstein (B.A., Cornell University, 1952; LL.B., Cornell University, 1954; LL.M., New York University, 1959) is a member of the New York Bar and of the firm of Barrett Smith Schapiro Simon & Armstrong, New York, New York.

***Stephen E. Wells (B.S., University of Maryland, 1971; J.D., Georgetown University Law Center, 1975) is a member of the District of Columbia Bar and is associated with the firm of Lee Toomey & Kent, Washington, D.C.

[1] 98 Eng. Rep. 1120 (1775) (contract made in France which violates French tax law but not English law is enforceable in England).

[2] 1955 A.C. 503.

[3] 41 D.L.R.2d 721, 63-2 USTC ¶ 9768, 12 AFTR 2d 5736 (1963). The U.S. Government's strategy to circumvent the non-enforcement rule was stated in Solicitor's Memorandum 1156, 1 C.B. 243 (1919). The *Harden* decision showed that it would not work.

enforceability of a tax claim of a sister state and the majority view was that, in accordance with the international rule, such claims could not be enforced extraterritorially.[4] Although the issue of interstate enforcement ultimately was settled by the Supreme Court in *Milwaukee County v. M. E. White Co.*,[5] the holding there—that the full faith and credit clause of the Constitution applied to tax judgments—has no application in the international sphere.

The common law rule recognizes the many substantive and procedural problems which would arise from international enforcement of tax liabilities. The usual reasons given in the cases for refusal to enforce foreign tax judgments can be summarized as follows:

(1) Efforts by one sovereign to enforce its taxes within the territory of another constitute an extraterritorial intrusion.

(2) Enforcement may not be reciprocal.

(3) Enforcement leads to an inquiry into the policies behind the taxes.

(4) There may be an adverse effect on foreign relations as a result of the successful defense against enforcement.

(5) Tax impositions are akin to penal exactions which may not be enforced in a foreign court.

(6) Local courts should not be burdened with the enforcement of foreign tax claims for which they have no background or expertise.

The merits of these arguments are subject to debate. There is little point, however, in engaging here in a critique of *Holman v. Johnson* and the cases following it.[6] The common-law rule seems far too well-entrenched to change. If there is to be a change it will be by way of treaties. The objections to a common law rule of treaty enforcement, however, are a useful beginning point for testing the advisability of altering the rule by treaty.

B. *Enforcement By Treaty.*

Most of the arguments against common law enforcement of another nation's taxes do not apply in the case of bilateral treaties. First, a mutual agreement to permit extraterritorial enforcement of another nation's laws does not represent a loss of sovereignty. Indeed, enforcement of a tax claim would seem to be a minor matter when compared with extradition

---

[4]*See, e.g.*, Colorado v. Harbeck, 232 N.Y. 71, 133 N.E. 357 (1921) (New York courts will not collect the tax debts of the State of Colorado).

[5]296 U.S. 268 (1935).

[6]A critique can be found in a number of articles. *See, e.g.*, Albrecht, *The Enforcement of Taxation under International Law*, 1953 BRIT. Y. B. INT'L L. 454, 462-5; Robertson, *Extraterritorial Enforcement of Tax Obligations*, 7 ARIZ. L. REV. 219 (1966); Stoel, *The Enforcement of Foreign Non-Criminal Penal and Revenue Judgments in England and the United States*, 16 INT'L AND COMP. L. Q. 663 (1967); Comment, United States v. Hardin, 77 HARV. L. REV. 1327 (1964). *See also* Oklahoma Tax Comm'n v. Rogers, 193 S.W.2d 919 (Mo. App. 1946) (tax debt incurred in Oklahoma is enforceable in Missouri). *Rogers* rejects the non-enforcement rule in a U.S. state context.

for prosecution under another nation's penal laws, yet extradition treaties are common (far more common than tax treaties of any sort, let alone tax treaties providing for enforcement). Further, rights under treaties are reciprocal; thus, presuming continuing good faith compliance with the treaty the enforcing state is freed from concerns that the taxing state may not enforce its taxes when the roles are reversed.

The third issue—inquiry into the propriety or justice of the tax to be enforced—is not so easily countered. An enforcing state would not—and should not be expected to—enforce another nation's taxes that violate the enforcing state's conceptions of elemental fairness. Judge Learned Hand, in his concurring opinion in *Moore v. Mitchell,*[7] expressed this concern well:

> Even in the case of ordinary municipal liabilities, a court will not recognize those arising in a foreign state, if they run counter to the "settled public policy" of its own. Thus a scrutiny of the liability is necessarily always in reserve, and the possibility that it will be found not to accord with the policy of the domestic state. This is not a troublesome or delicate inquiry when the question arises between private persons, but it takes on quite another face when it concerns the relations between the foreign state and its own citizens or even those who may be temporarily within its borders. To pass upon provisions for the public order of another state is, or at any rate should be, beyond the powers of a court; it involves the relations between the states themselves, with which courts are incompetent to deal and which are intrusted to other authorities. It may commit the domestic state to a position which would seriously embarrass its neighbor. Revenue laws fall within the same reasoning; they affect a state in matters as vital to its existence as its criminal laws. No court ought to undertake an inquiry which it cannot prosecute without determining whether those laws are consonant with its own notions of what is proper.

This concern is a serious one, however, only with regard to laws enacted by the taxing state after entry into a treaty; if the current laws of the taxing state are repugnant to a potential treaty partner, there would be (and should be) no treaty. But most (although not all) treaties contain a provision that enforcement is not required contrary to the public policy of the enforcing state. While use of this provision could be awkward, nevertheless it provides an important safety valve. Finally, if (*e.g.*, as the result of a radical change of government) a nation's tax policies become wholly unacceptable, the treaty can be abrogated.

The foreign relations issue is related to the public policy issue. As noted above, a refusal to enforce a particular tax on public policy grounds could be awkward from a foreign relations viewpoint. (A termination of the treaty presumably would be less awkward, since this would likely be the

[7]30 F.2d 600, 604 (2d Cir. 1929), *aff'd,* 281 U.S. 18 (1930) (Indiana tax debt not enforceable in New York courts).

result of a change sufficiently radical to cause a general realignment of the relationship between the two countries.) Apart from the public policy exception, there would not appear to be serious foreign relations problems caused by reciprocal enforcement treaties. Certainly a foreign nation may find its claim for taxes subject to an aggressive defense (on whatever issues are open under the treaty) and ultimately the collection effort may be unsuccessful. But surely this would be foreseen when the treaty is concluded and, in any event, representatives of sovereign nations regularly contest commercial claims without any strain on foreign relations.

The purported equivalence of taxes and penalties probably was the most important basis for the common law non-enforcement rule. Thus, in *Colorado v. Harbeck,*[8] Judge Pound of the New York Court of Appeals refused to enforce a Colorado tax claim in New York, stating, "But taxes are not debts or contracts. . . . The enforcement of revenue laws rests not on consent but on force and authority. Liability to pay is a consequence imposed by fiat." While this is true,[9] it hardly seems a fruitful beginning point for a contemporary analysis. Taxes are universal and normal and, while each person may resent the amount of tax which he must pay, few now would deny that some taxation is necessary to support essential services. Thus, the notion that taxes are equivalent to penalties has lost much of its force.

A narrow view of the scope of taxation seems particularly inappropriate in a world where so much economic activity is international in character. If a tax is reasonably imposed (being, in effect, levied on activities which are facilitated by government functions which the taxes support), why should taxes be less enforceable than commercial claims arising out of the same activities?

Finally, as long as a treaty does not permit litigation on the merits of a tax claim in a forum of the enforcing state, any burden on the courts of the enforcing states should not be great. And if enforcement is solely by administrative action, the courts would be burdened only when court review of that administrative action is sought. Both of these matters are discussed further below.

It appears, then, that the reasons given for the common law non-enforcement rule do not have sufficient force in a treaty context to make entry into a treaty inadvisable. As will be discussed below, however, there are a number of other issues which must be considered.

II. EXISTING U.S. TREATIES

Treaty provisions relating to mutual assistance in collection of taxes are found in most U.S. tax treaties. These provisions are of two types:

---

[8]232 N.Y. 71, 82, 133 N.E. 357, 359 (1921).

[9]Although the word "fiat" carries with it the notion of arbitrariness, or at least the notion of imposition without the indirect participation of those who are taxed.

(1) A provision that, with certain exceptions, each state will collect taxes imposed by the other; this type of provision will be referred to as a "general enforcement" provision;

(2) A provision that each state will collect taxes of the other to the extent necessary to prevent persons not entitled to the benefits of that particular treaty from receiving them; this type of provision will be referred to as a "limited enforcement" provision.

A. *General Enforcement Provisions.*

Only the treaties with Denmark,[10] France,[11] the Netherlands,[12] and Sweden[13] contain general enforcement provisions. The texts of the treaties with Greece[14] and the Union of South Africa[15] also contain general enforcement provisions, but Senate reservations to ratification in effect turned the provisions into limited enforcement provisions.[16]

Article 27 of the current French treaty, which is virtually identical to Article 23 of the French treaty entered into in 1939, provides as follows:

> (1) The two Contracting States undertake to lend assistance and support to each other in the collection of the taxes to which the present Convention relates, together with interest, costs, and additions to the taxes and fines not being of a penal character according to the laws of the State requested, in the cases where the taxes are definitively due according to the laws of the State making the application.
>
> (2) In the case of an application for enforcement of taxes, revenue claims of each of the Contracting States which have been finally determined will be accepted for enforcement by the State to which application is made and collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes.
>
> (3) The application will be accompanied by such documents as are required by the laws of the State making the application to establish that the taxes have been finally determined.

---

[10]Convention with Denmark, art. XVIII, Dec. 1, 1948, 62 Stat. 1730, 1736, T.I.A.S. No. 1854.

[11]Convention with France, art. 27, Aug. 11, 1968, 19 U.S.T. 5280, 5314-15, T.I.A.S. No. 6518.

[12]Convention with the Netherlands, art. XXII, Dec. 1, 1948, 62 Stat. 1757, 1766, T.I.A.S. No. 1855. The article is part of the original convention with the Netherlands, and hence is effective with respect to the Netherlands Antilles.

[13]Convention with Sweden, art. XVII, Nov. 14, 1939, 54 Stat. 1759, 1770-71, T.S. 958.

[14]Convention with Greece, art. XIX, Dec. 30, 1953, 5 U.S.T. 47, 75-77, T.I.A.S. No. 2902.

[15]Convention with South Africa, art. XV, Dec. 13, 1946, 3 U.S.T. 3821, 3829, T.I.A.S. No. 2510.

[16]CONG. REC. 11442-45, 11460-62 (1951).

Prior to the exchange of instruments of ratification of the Greek treaty on December 30, 1953, note 14 *supra*, the reservation was embodied in a Protocol of April 20, 1953. *See* 5 U.S.T. 81-84. Since these reservations, no general enforcement provision has been included in a new treaty, although existing general enforcement provisions have been continued.

> (4) If the revenue claim has not been finally determined, the State to which application is made will take such measures of conservancy (including measures with respect to transfer of property of nonresident aliens) as are authorized by its laws for the enforcement of its own taxes.
>
> (5) The assistance provided for in this Article shall not be accorded with respect to citizens, corporations, or other entities of the State to which application is made[17].

The language quoted is typical of that found in the general enforcement provisions of the four treaties containing such provisions. Despite the relatively broad language, its availability is limited in a number of respects. First, under the French, Danish and Dutch treaties, collection cannot be made against citizens or corporations of the country whose assistance is requested,[18] and under the Swedish treaty enforcement is limited to nationals of the taxing state. This prohibition is an important limitation on the potential utility of the provision, since the most usual source of tax evasion, whether inadvertent or not, surely must be where a foreign individual or corporation derives income in a foreign country and returns to his home country without payment of applicable taxes. This situation would appear to be far more common than the expatriation of a citizen without his meeting his tax obligations, or a third-country national incurring tax liability in one country and settling (or at least having property) in a country with which the first country has a treaty.

Enforcement under the French treaty is subject to an additional restriction. Pursuant to an understanding with France,[19] France may not utilize the enforcement provisions until all of the taxpayer's property in France has been exhausted to satisfy the tax claim. The delay inherent in such a provision must discourage the utilization of the mutual enforcement procedures.

The general enforcement provisions of each treaty predate 1950, and represent an effort at providing for tax enforcement through treaties that apparently has been abandoned. In fact, it is clear that the United States for some time has been unenthusiastic about general enforcement provisions. The Memorandum on the Convention with France signed in 1967 prepared by the Joint Committee on Internal Revenue Taxation stated:

> The assistance in the collection provision of the proposed convention is significantly broader in one respect than comparable provisions in

[17]Convention with France, art. 27, Aug. 11, 1968, 19 U.S.T. 5280, 5314-15, T.I.A.S. No. 6518. The text of the 1939 treaty with France, which entered into force Dec. 30, 1944, may be found at 59 Stat. 893, T.S. 988. The 1939 treaty was terminated by the current treaty with France, cited *supra*.

[18]Note that the French treaty was once negotiated without the exception for nationals of the enforcing state but objections by the U.S. Senate resulted in the replacement of the exception by protocol. *See* S. Exec. Rep. No. 7, 80th Cong., 2d Sess. 2 (1948).

[19]*See* Memorandum of the Joint Committee on Internal Revenue Taxation, S. Exec. Report No. 5, 90th Cong., 2d Sess. 28 (1968), *reprinted in* 1 Tax Treaties (CCH) ¶ 2838 at 2819-10.

> most other U.S. income tax treaties. Generally, the assistance in collection provisions contained in U.S. income tax treaties have either contained the express limitation that assistance is to be provided only to insure that the reduced rates of, and exemptions from, tax provided by the treaty are not enjoyed by persons not entitled to these benefits or have been ratified by the Senate subject to an understanding expressing such a limitation. The proposed convention, however, requires assistance with respect to the collection of a country's income taxes generally, as does the existing convention.[20]

The Senate Foreign Relations Committee's report on the treaty states:

> Although the provisions of Article 27 are not new in the case of France, they do go further than most other United States treaties presently in force. Such being the case, the Committee wishes to emphasize that it approved this Article only because similar language is contained in the 1939 treaty with France, and it should not be considered as a precedent for future treaties.[21]

B. *Limited Enforcement Provisions.*

In addition to the four general enforcement provisions in the U. S. treaties with Denmark, France, the Netherlands and Sweden, most U. S. tax treaties, including recently-negotiated ones, provide for collection assistance for the purpose of ensuring that exemptions and reduced tax rates provided by the treaties are not enjoyed by unintended beneficiaries.[22] A typical provision is contained in the treaty with Iceland.

---

[20]APPENDIX TO S. EXEC. REPORT NO. 5, 90th Cong., 2d Sess. 40 (1968), *reprinted in* 1 TAX TREATIES (CCH) ¶ 2838 at 2819-19.

[21]S. EXEC. REPORT NO. 5, 90th Cong., 2d Sess. 5 (1968), *reprinted in* 1 TAX TREATIES (CCH) ¶ 2838 at 2819-10.

[22]Conventions with: Australia, art. XVI, Dec. 14, 1953, 4 U.S.T. 2274, 2284, T.I.A.S. No. 2880; Belgium, art. 27, Oct. 13, 1972, 23 U.S.T. 2687, T.I.A.S. No. 7463; Finland, art. 30, Feb. 28, 1971, 22 U.S.T. 40, 75-6, T.I.A.S. No. 7042; W. Germany, art. XVI(2), Dec. 20, 1954, 5 U.S.T. 2768, 2802, T.I.A.S. No. 3133; Iceland, art. 30, Dec. 26, 1975, 26 U.S.T. 2004, 2108-10, T.I.A.S. No. 8151; Italy, art. XVIII, Oct. 26, 1956, 7 U.S.T. 2999, 3014, T.I.A.S. No. 3676; Japan, art. 27, July 9, 1972, 23 U.S.T. 967, 1007-8, T.I.A.S. No. 7365; Korea, art. 30, Oct. 30, 1979, ___ U.S.T. ___, ___, T.I.A.S. No. 9506; Luxembourg, art. XVIII(2), Dec. 22, 1964, 15 U.S.T. 2355, 2367, T.I.A.S. No. 2355; New Zealand, art. XVII, Dec. 18, 1951, 2 U.S.T. 2378, 2388, T.I.A.S. No. 2360; Norway, art. 29, Nov. 29, 1972, 23 U.S.T. 2832, T.I.A.S. No. 7474; Romania, art. 26, Feb. 26, 1976, 27 U.S.T. 165, 199, T.I.A.S. No. 7047; Trinidad and Tobago, art. 25, Dec. 30, 1970, 22 U.S.T. 164, 185, T.I.A.S. No. 7047. In addition, the Convention with Switzerland, art. XVI(2), Sept. 27, 1951, 2 U.S.T. 1751, 1760-61, T.I.A.S. No. 2316, provides for enforcement, but only with respect to the reduction of tax on dividends, interest, royalties and pensions. The Convention with the United Kingdom, art. XIXA, Sept 9, 1966, 17 U.S.T. 1254, 1263-64, T.I.A.S. No. 6089, follows the typical pattern except that the United Kingdom's obligation is only to continue arrangements designed to ensure that relief from U.S. taxes is not received by persons not entitled thereto; it need not actually collect U.S. taxes. Only the conventions with Austria, Oct. 10, 1957, 8 U.S.T. 1699, T.I.A.S. No. 3923; Canada, Jan. 1, 1941, 56 Stat. 1399, T.I.A.S. No. 983; Ireland, Dec. 20, 1951, 2 U.S.T. 2303, T.I.A.S. No. 2356; Pakistan, May 21, 1959, 10 U.S.T. 984, T.I.A.S. No. 4232; Poland, July 23, 1976, 28 U.S.T. 891,

This treaty, which did not replace a prior treaty, was signed and entered into force in 1975. Article 30 of the treaty states:

> (1) Each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such taxes imposed by that other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by that other Contracting State shall not be enjoyed by persons not entitled to such benefits. The competent authorities of the Contracting States may consult together for the purpose of giving effect to this article.
>
> (2) In no case shall this article be construed so as to impose on a Contracting State the obligation to carry out administrative measures at variance with the regulations and practices of either Contracting State or which would be contrary to the first-mentioned Contracting State's sovereignty, security, or public policy.[23]

Thus, these articles were included in the treaties to cure problems that would not exist but for the treaties themselves.

Initially, it would appear that these provisions have narrow application. They are all worded quite specifically to apply only if a person not within the class of intended beneficiaries would enjoy a benefit *provided by the treaties*. These articles are not broad enough to counter garden-variety tax evasion, *i.e.*, a taxpayer simply does not pay taxes which are due to the taxing state and removes all his assets from that state. Collection assistance could not be provided because the benefit secured by the taxpayer—nonpayment of a tax liability—had nothing to do with the treaty.

In fact, however, the coverage of the limited enforcement provisions is extensive—probably considerably more extensive than appears at first blush, and perhaps as a practical matter more extensive than the general enforcement provisions. At the first level, the type of problem solved by a limited enforcement provision is obvious. To illustrate a typical application of a limited collection assistance article: Article 12 of the treaty with Iceland reduces the U.S. tax rate on U.S. source portfolio dividends received by an Iceland resident from 30 percent to 15 percent. If in order

---

T.I.A.S. No. 8486; and the U.S.S.R., Jan. 29, 1976, 27 U.S.T. 1, T.I.A.S. No. 8225; have no enforcement provisions of any kind. The Convention with Hungary, Sept. 18, 1979, ____ U.S.T. ____ , T.I.A.S. No. ____ also contains no enforcement provision but an exchange of notes, Feb. 12, 1979, provides for limited enforcement.

The United States has signed a number of tax conventions which have not yet been ratified. Two of these contain typical limited enforcement provisions. Egypt, art. 29, 2 TAX TREATIES (CCH) ¶ 8005; Philippines, art. 27, 2 TAX TREATIES (CCH) ¶ 6603. The treaty with the United Kingdom, art. 26(2)-(4), as of the date of this writing ratified by the United States but not the United Kingdom, 2 TAX TREATIES (CCH) ¶ 8103A, continues the scheme of the existing U.K. treaty. The proposed treaties with Israel, 1 TAX TREATIES (CCH) ¶ 4203, and Morocco, 1 TAX TREATIES (CCH) ¶ 5603, have no enforcement provisions.

[23]Convention with Iceland, art. 30, Dec. 26, 1975, 26 U.S.T. 2004, 2108-10, T.I.A.S. No. 8151.

to take advantage of the reduced tax rate a resident of a non-treaty country hires a resident of Iceland to receive the dividend and then pass it on to the owner, the additional 15 percent of the U.S. withholding tax (the difference between the reduced rate and the full rate) may be collected for the United States by Iceland under Article 30 of the treaty, quoted above.

Several variations on the above theme make clear the breadth of such provisions. First, there is no requirement for fraud. Thus, if a person reasonably believed that he was entitled to the benefits of a treaty but subsequently was determined not to be, the collection provisions still would apply. This could be the case, for example, if a person erroneously believed himself to be a resident of a treaty country, and hence entitled to a reduced rate of withholding on a particular type of income. To give another, more likely, example, an enterprise of a treaty country may reasonably believe that it does not have a U.S. permanent establishment, and hence that its U.S. source industrial and commercial profits (*e.g.*, from shipments of goods to the United States) are exempt from U.S. tax. Should the enterprise ultimately be held to have a permanent establishment to which industrial and commercial profits are attributable, the U.S. tax on those profits could be collected by the treaty partner.

This leads to an important point about the limited enforcement provisions: unlike the general enforcement provisions, there is no stated exclusion for nationals of the enforcing state. A literal reading of these provisions—*i.e.*, they do apply to nationals of the enforcing state—is strongly reinforced by the general enforcement articles in the treaties with Denmark and the Netherlands. These articles state that collection assistance will not be provided with respect to citizens, corporations or other entities of the enforcing country "except as is necessary to insure that the exemption or reduced rate of tax granted under the convention . . . shall not be enjoyed by persons not entitled to such benefits."[24] Thus, in the examples given above, the tax could be collected by the treaty country from the assets there of the person mistaken about his residence, even if he is a citizen,[25] and from the treaty country enterprise mistaken about its lack of a U.S. permanent establishment. Therefore in one important respect—the ability to use enforcement proceedings against those who are most likely to owe a tax—the limited enforcement provisions are considerably broader than the typical general enforcement provisions.[26]

The fact that a country can be asked to collect foreign taxes from its own citizens, however, raises some difficult problems. These stem from

---

[24]Convention with Denmark, art. XVIII, Dec. 1, 1948, 62 Stat. 1730, T.I.A.S. No. 1854; Convention with the Netherlands, art. XXII, Dec. 1, 1948, 62 Stat. 1757, T.I.A.S. No. 1855. An identical article was included in the Convention with Greece but, as previously noted, this article was changed to a limited enforcement provision.

[25]This result is not surprising when it is considered that virtually no country except the United States imposes worldwide taxation on a citizenship basis.

[26]To the extent that, as with Denmark and the Netherlands, the general provision in effect

the fact that the enforcing state can be expected to be concerned with whether a tax actually is due, either because of understandable feelings of protectiveness toward its citizens, or because payment of a foreign tax will give rise to a foreign tax credit and thereby reduce the revenues of the enforcing state. Thus, for example, if in a close case the United States determines that an Iceland corporation, contrary to its assertion, had a U.S. permanent establishment, it would not be surprising if Iceland were to resist enforcement, particularly if Iceland had decided that a foreign enterprise with substantially the same contacts with Iceland as the Iceland corporation had with the United States does *not* have a permanent establishment in Iceland.

There is general agreement that in any international tax enforcement system the enforcing state ordinarily should accept the taxing state's substantive determinations as to the taxing state's own tax laws. However, where enforcement is requested under a limited enforcement provision of a tax treaty, the pertinent substantive provisions of the treaty apply to both states. The enforcing state may be disinclined to accept the taxing state's determination as to a treaty provision if it is different from the enforcing state's determination as to the same treaty provision, but if the enforcing state does not accept the taxing state's determination, it is unlikely that a limited enforcement provision can be made to work. Perhaps this type of problem could be handled under the mutual agreement procedure of Article 30 (1) (last sentence). At best, however, this means that enforcement, rather than being essentially a mechanical procedure, becomes one of discussion and delay. At worst, Iceland could continue to reject the U.S. position and deny enforcement.

Problems of this nature can become quite complex, particularly where a rejected claim of treaty exemption depends upon the status of more than one party. These problems, as well as the reach of and limitations on enforcement provisions, can be demonstrated by an analysis of the application of these provisions to the fact patterns in two well-known cases involving entitlement to treaty benefits, *Johansson*[27] and *Aiken Industries*.[28]

In the former case, the Swedish boxer asserted Swiss residence and had himself "employed" by a Swiss corporation in order to obtain the benefits of the Swiss treaty for his U.S. fight against Floyd Patterson. It was held that Johansson was not a Swiss resident, that the Swiss corporation was a

---

contains within it a limited provision, of course there would be no difference in this regard.

[27]Johansson v. United States, 62-1 USTC ¶ 9130, 8 AFTR 2d 6001 (S.D. Fla. 1961), *aff'd*, 336 F.2d 809 (5th Cir. 1964). For the Service's view of the treaty effect of somewhat different "loan-out" arrangements, see Rev. Rul. 74-330, 1974-2 C.B. 278, and Rev. Rul. 74-331, 1974-2 C.B. 281.

[28]Aiken Industries, Inc. v. Commissioner, 56 T.C. 925 (1971), *acq.*, 1972-2 C.B. 1.

sham,[29] and therefore that Johansson was subject to U.S. tax on his income. Johansson then owed a substantial U.S. tax which, *ex hypothesi,* was uncollectable from anybody's assets within the United States.

What jurisdictions may the United States ask to collect its tax, and against whose assets? Sweden, regardless of the type of treaty it might have, would not be of help. If, as is actually the case, the treaty with Sweden has a general enforcement provision, it would not require collection of tax from a Swedish citizen. If the treaty had a limited enforcement provision, Sweden would have no obligation to collect because Johansson has asserted, and received, no benefits under the U.S.-Sweden treaty.

Switzerland would be an appropriate jurisdiction from which to request collection assistance. If the treaty with Switzerland had a general enforcement provision, Johansson would not be exempt from collection procedures because he is not a Swiss citizen; for these purposes, his residence is irrelevant. The assets of the Swiss corporation, however, normally could not be reached under a general enforcement provision. This raises the question of whether the Swiss are bound not only by the U.S. decision that U.S. taxes are due, but also by the precise reasoning (which included the finding that the Swiss corporation was a sham) so that the corporation's assets can be reached on the theory that they really are those of Johansson.[30]

If we assume that the treaty with Switzerland, instead of having a general enforcement provision, had a typical limited enforcement provision,[31] the above problem, plus some others, are raised. As before, Switzerland could seize Johansson's Swiss assets to satisfy his U.S. tax obligation, since the U.S. had held that he claimed and received, but was not entitled to, the benefits of the U.S.-Switzerland treaty. Under a limited

[29]It is not entirely clear from the court's decision whether the *corporation* or Johansson's *use of it* was the "sham." Such a nice distinction probably is meaningless when dealing with a conception as imprecise as "sham" but, for what it is worth, the balance of discussion assumes that the *corporation* was a "sham."

[30]Note that the Fifth Circuit in *Johansson* specifically states that the United States was not bound by Switzerland's determination of Johansson's tax residence.

The same question can, of course, arise in a purely domestic context. For the present purposes, the domestic "alter ego" cases provide the more useful comparison, although transferee liability cases also could be relevant depending on the particular situation. In general, if *X* corporation is found to be the "alter ego" of another corporation or of an individual, *X* corporation's assets can be used to satisfy the tax liability of the other corporation or individual. It appears, although it is not completely certain, that in this regard the Service is in the same position as any other creditor. *See* Avco Delta Corp. Can. Ltd. v. United States, 540 F.2d 258 (7th Cir. 1976), and the cases cited therein; G.M. Leasing Corp. v. United States, 514 F.2d 935 (10th Cir. 1975), *rev'd on another issue,* 429 U.S. 338 (1977).

[31]Switzerland does have a limited enforcement provision but, as noted in note 22 *supra,* it is unique in applying only to the reductions in tax on dividends, interest, royalties, and pensions.

(unlike a general) enforcement provision, the corporation also can be the subject of enforcement, but whether its assets actually can be reached involves some complex questions. As with a general enforcement situation, the United States could assert that the corporation's funds belong to Johansson, but the obligation of the Swiss to accept this finding is no clearer in a limited than in a general enforcement situation. If the Swiss reject the contention that the corporation's funds may be reached because they really belong to Johansson, can they be reached on any other theory? It would appear that if the corporation's funds are to be reached it must then be because the corporation (and not Johansson or any other person) has an unpaid U.S. tax liability.[32] Because the United States had held the corporation to be a sham, naturally it would be difficult for the United States to prove that the corporation has such a liability. Having rejected this contention, however, it would appear that the Swiss should be open to alternative arguments under which the corporation is a U.S. taxpayer. But how are such arguments to be presented? Since the basis for any such argument is inherently factual (*e.g.*, that the corporation had a U.S. permanent establishment) it would appear that basic fairness would require that the United States be required to present, and the corporation be given the opportunity to rebut, the evidence supporting the case for taxation. This raises the problems of attempting to litigate the merits of one state's assertion of tax in the courts of the other (a matter discussed further within).

Aiken Industries provides another example of the uses and limitations of enforcement provisions. The situation in that case involved a back-to-back assignment of a note of a U.S. corporation from a non-treaty country corporation (the Bahamas) to a then-treaty country corporation (Honduras). The case held that the Bahamian corporation was the true owner of the interest, and therefore that the exemption from U.S. taxation of U.S. source interest under the Honduran treaty did not apply. The taxpayer there was the U.S. corporation—the withholding agent—but if the tax could not be collected from the withholding agent, either because the withholding agent was not liable for it[33] or because it did not have sufficient assets to pay the tax, from whom should Honduras collect the tax? It appears that Honduras should collect from any assets of the Bahamian corporation located in Honduras. Assuming that Honduras accepts the U.S. position that the Bahamian, rather than the Honduran, corporation

[32]If the stock of the corporation could be reached, its assets would be available to satisfy the stockholder's tax liability. In the *Johansson* case, however, it appears that the stock of the corporation was not owned by Johansson. Further, as a general matter, the laws of the country involved may make it difficult or impossible to levy on stock of an absent shareholder merely because the corporation is incorporated in the jurisdiction.

[33]If a withholding agent in good faith relies on a Form 1001 submitted to it, it should not be liable for any tax subsequently found to be due. Rev. Rul. 76-224, 1976-1 C.B. 268.

was the owner of the interest,[34] the Bahamian corporation would appear to be squarely within the language and intent of typical limited enforcement provisions: through its agent, the Honduran corporation, it asserted and received treaty benefits to which it was not entitled.

Honduras' obligation also to collect from assets of the Honduran corporation is less clear. That corporation has indeed claimed a benefit under the Honduras treaty, but if the income belonged to it, it would be entitled to treaty benefits. However, the Honduras corporation is a U.S. withholding agent vis-a-vis the Bahamian corporation[35] and one whose defense to liability for failure to withhold is questionable.[36] Further, the typical limited (or general) enforcement provision contains no distinction between the liabilities of the owner of income and the withholding agent. Nevertheless, only in a rare situation would there be a specific finding of liability as a withholding agent on the part of the Honduras corporation, and hence it is unlikely that Honduras properly could collect from the Honduras corporation.

III. STRUCTURING A TREATY: PROBLEMS AND RECOMMENDATIONS

As shown by the immediately preceding discussion, the operation of enforcement provisions, at least in certain contexts, is far from clear. Further, these problems only scratch the surface; there are problems which are far more basic, and are inherent in all U.S. reciprocal enforcement treaties. There is little evidence of awareness, let alone adequate consideration, of these problems.

A. *General Considerations.*

In the broadest possible terms, the problem is to structure provisions which are both effective and fair. This implies a finely-tuned balance, for obviously there is a tension between the two requirements. A subsidiary

---

[34]It would appear that this would be considerably less likely than would rejection of a "sham" finding. In this connection, note that the Tax Court's opinion carefully states that the existence of the Honduran corporation may not be disregarded.

It should be noted that acceptance of the U.S. position results in the note, and any interest on it still held by the Honduran corporation, being property of the Bahamian corporation and therefore available for seizure by Honduras. Unfortunately, in most cases it would appear that the Honduran corporation easily could transmit the note (and any interest collected on it) to the Bahamian corporation in the Bahamas, thereby making impossible collection by seizure of the note itself.

[35]Section 1441(a) states "all persons, in whatever capacity acting . . . having the control, receipt, custody, disposal or payment of [specified types of income, including interest] of any nonresident alien individual or foreign partnership shall . . . deduct and withhold from such items a tax equal to 30 percent thereof . . . ." Section 1442 imposes the same obligation for payments to foreign corporations. Under section 1461, the withholding agent is liable for the amount required to be withheld. An agent of the recipient, as well as the payor of the income, is within the requirement of section 1441, and if the payor does not withhold, the agent must. *See* Rev. Rul. 70-468, 1970-2 C.B. 171.

[36]*Cf.* note 33 *supra*.

requirement, necessary in order to achieve the desired balance, is clarity. That is, on reading the applicable treaty provisions the governments concerned should be able to determine immediately what taxes may be enforced, against whom they may be enforced, when they may be enforced, and exactly how they are enforced; the taxpayer should be immediately able to determine whether proper procedures have been followed, whether he has a remedy against enforcement and, if so, how to pursue it. This would entail a set of fairly specific mechanical instructions. Equally important, it would entail a proper choice of words, and the treaty should, to the extent possible, incorporate the precise words which appear in the relevant taxing statutes. A useful negative model is provided by sections 17(a) and 64(a) of the Bankruptcy Act prior to its recent revision,[37] which used the words "legally due and owing" to describe certain taxes. This caused a great deal of confusion which could have been avoided. If, for example, it has been agreed that country *X* will enforce tax claims of the United States which are administrative in nature, the treaty should state that country *X* will take whatever procedures have been decided upon with regard to "taxes assessed" by the United States. Similarly, if it is determined that only judgments will be enforced, it should be stated that collection procedures will begin on presentation of a "final judgment." In both cases, the operative words can be readily determined by reference to the laws of the United States.[38]

The requirement of clarity presupposes a treaty carefully tailored to the structures of the treaty partners' internal collection procedures. While a "model" article[39] or a "model" treaty[40] can be a useful beginning point for negotiations, it is almost inconceivable that the treaty partners' procedural laws would so resemble each other that generalized provisions of the type found in existing U.S. treaties will be sufficiently clear.

The necessity for individualized provisions goes well beyond the requirement of clarity. By reason of the legal structure of one or both treaty partners, a "model" reciprocal enforcement provision may produce an unintended result. For example, there is a serious flaw in the existing French treaty. Under the French doctrine of separation of powers, French civil courts never deal with tax matters, which are regarded as administrative. The administrative courts, on the other hand, have declined to hear matters dealing with enforcement of foreign taxes because

---

[37] 11 U.S.C. §§ 35(a), 104(a), applicable to cases commenced before October 1, 1979.

[38] The act constituting an "assessment" is defined in section 6203. The words "final judgment" are not specifically defined in any one place, but it is clear that a judgment becomes "final" when all available appellate review has been taken or the time to request such review has expired. *Cf.* 28 U.S.C. § 1963.

[39] *See, e.g.*, Article 26(4)-(6) of the United States Treasury's Model Income Tax Treaty (May 17, 1977).

[40] *See, e.g.*, League of Nations Fiscal Comm., London and Mexico Model Tax Conventions (1946). It is understood that a Working Party of the OECD currently is considering a draft of a model treaty concerning enforcement of taxes.

such matters have been characterized as foreign relations, with which the administrative courts do not deal.[41] When a U.S. assessment is sought to be enforced in France, therefore, a taxpayer has no method of challenging the assessment, no matter how egregious a violation of due process may have taken place.

The balancing of effectiveness and fairness is by no means an easy task. A procedure which provides adequate protection to the taxpayer may, under certain circumstances, involve delays which permit a dishonest taxpayer to evade collection in the enforcing state as he had in the taxing state. In addition, fair procedures may be somewhat more troublesome administratively and therefore, as a practical matter, result in treaty provisions being used less often than they might. There is, however, no reason to assume that a taxpayer, simply because he resides outside the taxing state, is less honest than taxpayers who reside within that state. Similarly, administrative inconvenience and expense many times have been held to be no justification for a denial of due process.[42] Administrative inconvenience and expense would seem to be equally inadequate reasons for denying a taxpayer the benefit of procedures guaranteeing fairness which exceed the minimum standards for due process. In this regard, a good guiding principle would be that a taxpayer should have no fewer rights merely because he is not residing within the taxing state. "No fewer rights" in this context should include not merely rights which he theoretically possesses but those rights which, in light of his foreign residence, practically may be exercised. Thus, for example, the treaty must provide a mechanism whereby a taxpayer can test the jurisdiction of the taxing state in a local forum, for the right to contest jurisdiction in a forum of the taxing state may, in light of the distance of the taxing state from the enforcing state, the amount involved, and other factors, be a worthless right.

It cannot be overemphasized that, as the name implies, the obligations and benefits of reciprocal enforcement treaties run in two directions. If the United States is to have the benefit of enforcing its taxes within country *X*, it will also be enforcing country *X*'s taxes within the United States and, unless specifically excluded, in all likelihood primarily against U.S. citizens. The United States must be sure that it does not pay too high a price for obtaining the right to enforce its taxes abroad. If the agreement concluded resulted in a violation of due process, it would, of course, be unconstitutional and void. But the meaning of due process in an international context is extremely vague, and the taxpayer's rights in this context should be no less than those which exist relating to the enforcement of U.S. taxes domestically. Probably it would be best for the treaty itself to enumerate essential rights, such as notice, the right to an impartial hearing

[41] Judgment of Dec. 23, 1966, [1966] Rec. Con. d'Et. 693.
[42] *See, e.g.*, Reed v. Reed, 404 U.S. 71 (1971).

and the right to representation. In the context of treaties with certain nations it may not be possible, however, to structure a system which grants U.S. taxpayers the full extent of rights to which they are accustomed. In these situations, at a minimum U.S. taxpayers should be exempted from enforcement, and it would be preferable for all taxpayers except nationals or entities of the taxing state to be exempted. In fact, as previously noted, one of these solutions is taken by each of the four existing treaties which contain general reciprocal enforcement provisions.

B. *Mechanics of Enforcement.*

The primary technical concerns of treaty draftsmen fall into two basic areas. First, what is the source of liability to be enforced: may it be purely administrative or must it be a judgment? Second, will the liability be enforced administratively or through the courts of the enforcing state?[43]

With regard to the source of the liability, administrative action appears to be generally favored.[44] While this certainly has something to be said for it in the way of simplicity, it is not necessarily the best method. It is quite important that the taxing state have adjudicatory jurisdiction over the taxpayer before its taxes are enforced. This is the most basic protection of defendants (whether in tax or ordinary civil cases) and a strong deterent to abuse of assessment procedures. While it is certainly possible to structure a treaty so that an assessment will be enforced only if a court of the taxing state could have obtained adjudicatory jurisdiction over the taxpayer, it seems more fitting simply to use the courts. This would provide the added benefit of having the courts of the taxing state make an initial determination of adjudicatory jurisdiction, thereby saving the enforcing state from shouldering the burden in the first instance. Obtaining a judgment is an extra step in the collection of taxes, but should be neither difficult nor expensive and the protection thereby afforded would be worthwhile. It should be noted in this connection that the U.S. government can[45] and from time to time does[46] go to the federal courts to collect taxes, so the concept is not a novel one.

In some countries the choice is not open. In France, for example, the taxing authorities never go to the courts. In such cases, a treaty would of course provide for the enforcement of administrative assessments, and other means of testing adjudicatory jurisdiction would have to be worked out. The most important point here is that each nation should do what it can to arrange a system which is both effective and fair in light of the two

[43]For a more detailed discussion of these questions, see Johnson, *Systems for Tax Enforcement Treaties: The Choice Between Administrative Assessments and Court Judgments,* 10 HARV. INTL. L. J. 263 (1969).

[44]*See, e.g.,* Note, *International Enforcement of Tax Claims,* 50 COLUM. L. REV. 490 (1950).

[45]I.R.C. §§ 7401-06.

[46]*Johansson,* note 27 *supra,* for example, was such an action, and *Harden,* note 3 *supra,* began with such an action.

legal systems. There should be no *a priori* rejection of different arrangements in each state due to differences in legal systems. Indeed, when dealing with different legal systems, an attempt to achieve surface uniformity is likely to result only in a functional lack of reciprocity. As noted previously, the only cure for this problem is carefully to draft each treaty to reflect unique provisions of the local laws of the states involved. A model treaty, or a treaty with another country, naturally can provide helpful examples, but there is very little room for boilerplate in a treaty of this nature.

The method of enforcement by the enforcing state would depend to a large extent on the source of the liability in the taxing state. If the source is a judgment, it would be natural and simple for enforcement to be by way of an action on that judgment in the courts of the enforcing state. As with any other action on a judgment, the merits could not be re-litigated but it always would be permissible to raise the issue of the rendering court's jurisdiction over the defendant.[47]

If the source of the liability is administrative, the best method of enforcement would probably be by administrative action taken by the enforcing state, with the taxpayer specifically given the right to petition a court of the enforcing state to enjoin collection based on a lack of jurisdiction of the taxing state. The same result could be achieved by having an action based on the assessment brought in a court of the enforcing state, but this would be somewhat more cumbersome with nothing gained in return.

One of the things on which most writers on the subject[48] agree is that whatever the system chosen, there should not be litigation on the merits of the tax claim in the courts of the enforcing state. Taxation (certainly in the United States and presumably elsewhere) has become an enormously complicated matter. To burden a court of another nation with trying to understand an entirely different system of taxation seems unfair to it as well as to both taxing authority and taxpayer, for the result reached may well be wrong. This is even more likely to be the case where the countries involved do not use the same language. On the other hand, in certain situations depriving a taxpayer of the right to litigate the merits of his case in the enforcing state could result in a serious injustice. This is particularly

[47]A system by which tax judgments of one nation are enforced by an action on that judgment in another nation resembles the system of comity by which money judgments of private parties may be enforced in nations other than that in which they were rendered. Thus the statutes (*e.g.*, the Uniform Foreign Money Judgments Act) and case law (*e.g.*, Hilton v. Guyot, 159 U.S. 113 (1894), and Somportex Ltd. v. Philadelphia Chewing Gum Corp., 453 7.2d 435 (3d Cir. 1971), *cert. denied,* 405 U.S. 1017), relating to enforcement of private judgments, while they are not likely to provide a complete answer to problems of international enforcement of tax judgments, would prove quite helpful.

[48]*See, e.g.*, Leflar, *Extrastate Enforcement of Penal and Governmental Claims,* 46 HARV. L. REV. 193, 218 (1932); A. VON MEHREN & D. TRAUTMAN, THE LAW OF MULTI-STATE PROBLEMS 797 (1965).

likely where in light of the amount involved it is unreasonable to expect the taxpayer to return to the taxing state to contest the matter there. This problem, at least, might be solved by placing a substantial minimum amount (*e.g.*, $50,000) of tax which the enforcing state can be asked to collect. While it is possible to characterize such an approach as sanctioning international tax evasion for lesser amounts, an appreciation of the problem to which this is a response leads to the conclusion that this is not the case.

Finally, a word should be said about conservancy measures, such as are provided for in Article 27(4) of the French treaty (quoted on page 474, above). These measures obviously can be disastrous to a taxpayer, for tying up of all his assets could put him out of business instantly. Further, unlike an ordinary collection case where the taxpayer would at least have been given the opportunity to contest the merits of the tax before a court of the taxing state, conservancy measures, by definition, are taken before a final decision of the taxing state adverse to the taxpayer. Because of this, it is vital that if conservancy measures are permitted at all, a taxpayer who is to be the subject of such measures be granted immediate access to a local court of the enforcing state to contest the measures, and that the taxing state have the burden of proving that the conservancy measures are necessary, *i.e.*, that if they are not taken the taxing state is likely to be unable to collect its claim. While this may, in some cases, enable a dishonest taxpayer to evade his obligations, such a prospect is inadequate justification for an inherently unfair system.

IV. CONCLUSION

Reciprocal enforcement treaty provisions are a response to an obvious problem. It is open to question, however, whether the cure is worse than the disease. As shown above, existing enforcement provisions have numerous flaws. None is sufficiently clear, none gives the taxpayer protections to which U.S. taxpayers, at least, are accustomed, and at least one treaty, that with France, has an serious gap. It should be emphasized that limited enforcement provisions, where enforcement by the United States against its citizens is available, suffer from many of the same deficiencies as general enforcement provisions, where such enforcement is not available.

Further, although the problem of international tax evasion is obvious, it is not clear that reciprocal enforcement provisions are an effective means of combatting it. The fact that there is no reported instance of enforcement under a treaty, while certainly not conclusive, does raise the issue. Perhaps the *in terrorem* effect of the provisions is significant, but this, of course, would be extremely difficult to measure.

Under current circumstances, the Senate's lack of enthusiasm for general enforcement provisions seems fully justified. The existing general enforcement provisions have sufficient problems so as to make them, on

balance, unacceptable. The current limited enforcement provisions also have sufficient problems to make them unacceptable, particularly in light of the potential for enforcement against Americans.

It is difficult to write any generalized prescriptions for future action. Both types of enforcement provisions need substantial improvement, but this will not come easily. If the United States and its potential treaty partners are not willing to commit the resources necessary to work out fair and effective procedures, it would be entirely appropriate to abandon any further efforts regarding general enforcement provisions. Indeed, in the absence of any demonstration of their effectiveness, it is highly questionable whether the provisions are worth any further effort.

The situation regarding limited enforcement provisions is more difficult. First, unlike the general enforcement provisions, limited enforcement provisions are a well-accepted part of the treaty scene. Further, the feeling that when a treaty benefit is granted there ought to be some mechanism to ensure that the benefit is not abused is entirely understandable. Nevertheless, the limited enforcement provisions seem to be no more effective in actual practice than the general enforcement provisions. Thus there would appear to be a choice: the limited enforcement concept could be retained, but in a substantially improved form; alternatively, the concept could be scrapped, and replaced by mechanisms to make it less likely that the treaty will be abused in the first place. The latter choice is, in effect, the position taken by the United Kingdom in its treaty with the United States.[49] Without a detailed study of anti-abuse measures—a matter beyond the scope of this article—it is not possible to assess the relative merit of the two approaches. It appears, however, that anti-abuse measures have the potential for both greater ease of implementation and greater effectiveness than limited enforcement provisions.

[49] *See* note 22 *supra* for a brief description of the provisions of this treaty.