FINDING THE INFORMATION TRAIL
SOME EXPERIENCES IN INTERNATIONAL TAX ENFORCEMENT

Lee Burns[1]
Faculty of Law
University of Sydney

INTRODUCTION

A recent trend in Australia's fight against organised crime has been to attack the "money trail" by confiscating the proceeds of crime.[2] With the increased use of tax havens to launder the proceeds of criminal activities, the effectiveness of this policy will depend on the ability of enforcement agencies to obtain information concerning the proceeds of crime. The new measures provide for broad information collection powers, including in particular, the possibility of bilateral co-operation between law enforcement agencies pursuant to treaties on Mutual Assistance in Criminal Matters.[3] However, the treaties negotiated to date generally have not included assistance in relation to the recovery of the proceeds of crime.

If the experience in the tax area is anything to go by, enforcement agencies will face great difficulties in collecting information which is held offshore. Indeed, there is increasing acceptance among tax administrators that the only way of stemming the growing tide of international tax evasion and avoidance is through effective co-operation.[4] At this stage, most co-operation is bilaterally based, however there is a move, albeit slowly, towards greater multilateralism in international tax enforcement.

It is not the purpose of this paper to consider the policy underlying the *Proceeds of Crime* legislation.[5] Rather, the paper will detail some of the experiences of tax

1 This article draws on previous research performed jointly with Associate Professor Robin Woellner, University of Technology, Sydney

2 *Proceeds of Crime Act* 1987 (Cth); *Confiscation of Proceeds of Crime Act* 1989 (NSW); *Crimes (Confiscation of Profits) Act* 1986 (SA); *Crimes (Confiscation of Profits) Act* 1986 (Vic); *Crimes (Confiscation of Profits) Act* 1989 (Qd); *Crimes (Confiscation of Profits) Act* 1988 (WA); and *Crimes (Confiscation of Profits) Act* 1988 (NT). A similar approach was adopted in the US some years ago, see also *Racketeer Influenced and Corrupt Organisations Act* 1970 (US) and *Continuing Criminal Enterprises Act* 1970 (US)

3 Part VI of *Mutual Assistance in Criminal Matters Act* 1987

4 In the case of the Australian Taxation Office, see D'Ascenzo, M., "Developments in Transfer Pricing Enforcement and Complex Audit Strategy" (1988) 5 *Australian Tax Forum* 471 at 480

5 For critiques of the new legislation, see Fisse, B. "Confiscation of Proceeds of Crime: Funny Money, Serious Legislation" delivered at the 26th Australian Legal Convention, Sydney, August 1989 and Fraser, D., "Lawyers, Guns and Money" in this issue of *Current Issues in Criminal Justice*

administrators, particularly in dealing with the multinational taxpayer, so as to highlight the need for co-operation between law enforcement agencies if this legislation is to be effective.

BACKGROUND

It was observed by Professor Brian J. Arnold that the Revenue's "battle" with the multinational taxpayer is like a local under six soccer side taking on the national team.[6] Professor Arnold's observation related to the ease with which a multinational enterprise can shift profits between discrete entities within the enterprise, and in particular, to the use of tax havens as a means of avoiding tax. The point being that the more "organised" are a taxpayer's offshore activities, the greater are the difficulties confronting administrators in collecting the information necessary to enforce national tax laws.

While tax administrators generally have broad investigations powers, territorial limits render them inadequate to deal with international transactions. The principle of sovereignty means that a state is under no obligation at international law to recognise the taxation laws of another state. This prevents administrators from carrying out investigations offshore and from using the judicial process of other states to recover tax due. Indeed, John A. Calderwood, Director-General of the International Audits Division, Revenue Canada has noted that:

> Tax planners are very much aware that if the information is located offshore, not necessarily in a true tax haven, it is much more difficult for a 'revenue' to gather evidence to support income tax assessments.[7]

Of course, if tax havens are used the enforcement problem is greater. An important characteristic of tax havens is secrecy laws which invariably forbid the disclosure of banking and commercial information and which prescribe heavy penalties for breaches of such laws.[8] Consequently, for example, it is simply not possible for a national revenue to fully investigate on its own the "simple" flow of funds in payment of goods which is diverted through several interposed companies or "blind" trusts located in tax havens.

Effective tax enforcement at the international level can only be achieved through co-operation between tax administrators. In the past, the barriers of national sovereignty, secrecy laws, concerns about reciprocity, and competition for "tax dollars", has meant that

6 The observation was made in the course of delivering a paper entitled, "Future Directions in International Tax Reform", at the UNSW Taxation, Business, and Investment Research Centre International Tax Workshop, held at Terrigal on 26-28 August 1988

7 Calderwood, J.A. "Tax Havens: Concept, Magnitude of Problem and Methods Used", (1988) 28 *European Taxation* 330 at 330

8 See generally, Irish, C.R. "Tax Havens", (1982) 15 *Vanderbilt Jl of Transnational Law* 449

there has been little effective co-operation between tax administrators.[9]

There is now an increasing use of bilateralism in international tax enforcement. However, this has its limits when dealing with the multinational taxpayer. Tax administrators need to "organise" their enforcement activities in the same way that multinationals organise their tax affairs.

UNILATERAL INFORMATION COLLECTION

Investigation Powers

The Commissioner of Taxation (the "Commissioner") has broad investigation powers under the *Income Tax Assessment* Act (Cth) (the *Tax Act*). In particular, the Commissioner has a right of full and free access to all buildings, places, books, documents and other papers for the purposes of the *Tax Act*.[10] The Commissioner also has the power to require any person to:

- furnish information;
- attend and give evidence; and
- produce all books, documents and other papers in the person's custody or under their control.[11]

Further, the Commissioner may obtain a search warrant under s 10 of the *Crimes Act* (Cth) 1914.

It is noted that police officers have similar powers under the *Proceeds of Crime Act*. Where a person has been convicted of an indictable offence and a police officer has reasonable grounds for suspecting that a person has "possession or control" of a "property tracking document(s)"[12] in relation to the offence, the officer may apply to a Judge of the relevant Supreme Court for an order requiring the person to produce such documents.[13] A person is not excused from complying with such an order even though compliance may tend to incriminate the person, or expose the person to a penalty, or be a breach of a non-disclosure obligation.

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9 For further discussion on these barriers, see Woellner, R.H. and Burns, L. "International Information Flows — The Tax implications" (1989) 6 *Australian Tax Forum* 143 at 145-146. In the area of criminal matters, the traditional position has also been one of non-cooperation (see McClean, D. "Mutual Assistance in Criminal Matters: The Commonwealth Initiative", (1988) 37 *International and Comparative Law Quarterly* 177 at 178)

10 Section 263 of the *Tax Act*. For recent cases which discuss the scope of this power, see *FC of T v. Citibank Ltd* 89 ATC 4268; and *DFC of T v. Allen, Allen & Hemsley* 89 ATC 4294

11 Section 264 of *Tax Act*; see *Perron Investments Pty Ltd v. DFC of T* 89 ATC 5038

12 A "property-tracking document" is basically any document relevant to identifying, locating or quantifying the property of a person who has committed the offence or the proceeds of the crime: sec 4(1) of *Proceeds of Crime Act*

13 Section 66 of *Proceeds of Crime Act*. Note that an order may also be sought where an officer has reasonable grounds to suspect that such an offence has been committed.

There are also provisions for the obtaining of a search warrant in relation to a property-tracking document;[14] and special provisions for monitoring bank accounts.[15]

Application of the Taxation Investigations Powers in the International Context

While there are obvious limits on the use of formal investigations powers to obtain information and documents stored offshore, they may be of some assistance. It is usually the case that there is someone, either in-house or a third party adviser, who at least will have some knowledge of the contents of the documents. Consequently, the Revenue should be able to use its investigations powers to compel such persons to provide the information.

In-house personnel

It may be asked whether the investigations powers could be used against a director of an Australian company to compel the production of the books and records of its tax haven subsidiary.

This issue has not really been tested in the Australian courts. It would depend on whether the person had "control" over the books and records.[16] Certainly, the person would argue that the separate legal nature of the two companies would mean that the parent company could do no more than request that the books and records be handed over and that this would not be sufficient to amount to control. On the other hand, what authority there is supports an argument that we should look at "practical" control rather than legal rights to documents.[17]

In the US, it has long been accepted that a domestic corporation has "control" over the books and records of its foreign subsidiaries.[18] The issue which generally arises is whether the domestic corporation will be compelled to produce the books and records in circumstances where their production will infringe the secrecy laws of a foreign jurisdiction.

It has been held by the US Courts that the mere existence of such laws does not of itself prevent disclosure.[19] The Courts have approached the issue as basically one of balancing competing national interests, namely, the interest of the foreign jurisdiction as a sovereign state in enforcing its secrecy laws against the interest of the US in enforcing its tax laws. Not surprisingly, the Courts have generally found that the US's interest in enforcing its tax laws is the greater interest, particularly where the foreign jurisdiction is a tax haven.[20]

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14 *Proceeds of Crime Act* ss 70ff

15 *Proceeds of Crime Act* ss 73ff

16 Note that "control" is also used in s 66 of *Proceeds of Crime Act*

17 *FC of T v. The Australian and New Zealand Banking Group Ltd* 79 ATC 4039

18 *Societe Internationale Pour Participations Industrielles et Commerciales v. Rogers* (1958) 357 US 197

19 *United States v. Vetco Inc* 691 F 2d 1281 (9th Cir. 1981), cert denied, (1981) 454 US 1098

20 See generally, Crinion, G.P. "Information Gathering on Tax Evasion in Tax Haven Countries" (1986) 20 *The International Lawyer* 1209 at 1217-1225

Another problem faced by administrators has been that, while taxpayers have been unable to produce documents held offshore at the investigation stage, they have later been able to produce the documents to support an objection to an assessment of liability. To overcome this problem, US Internal Revenue Code section 982 establishes a formal document request procedure. If the taxpayer fails to substantially comply with the request, then the taxpayer is precluded from subsequently producing the documents to support its case against an assessment.

It is proposed to introduce a similar procedure in Australia.[21] Where a taxpayer refuses or fails to comply with an "offshore information notice", the information or documents sought by the Commissioner are only admissible in proceedings disputing the taxpayer's assessment with the consent of the Commissioner. In exercising his discretion, the Commissioner is to ignore the possible application of foreign secrecy laws.

Third parties

There will often be persons outside the corporate group who either have access to, or knowledge of, documents located offshore.[22] These persons include lawyers, accountants and bankers. The US experience in this regard is that the Courts have been less willing to compel disclosure where a third party is involved, particularly where the third party may be exposed to a penalty under the foreign law.[23]

Foreign secrecy laws are rarely absolute. For example, bank secrecy laws may be waived by the customer. The US Internal Revenue Service (IRS) has attempted to take advantage of this by obtaining Court orders compelling taxpayers to sign a consent form waiving all rights to the protection of the bank secrecy laws of the foreign jurisdiction. This "compelled consent" has been held by the US Supreme Court not to be a violation of the Fifth Amendment privilege against self incrimination.[24] However, it is not entirely clear what practical effect a compelled consent will have as the foreign jurisdiction is unlikely to view it as a "real" consent.

In the case of banks, it has been noted that many offshore financial institutions do not have substantial computer installations. This means that major data processing and storage has often been performed on-shore at head office installations.[25] Consequently, the fact that the hard copy may be in the Turks & Caicos Islands, for example, should not be a barrier to compelling the head office to produce the information.

Where the third party is a lawyer there is the additional barrier of legal professional privilege. Privilege attaches to documents created for the sole purpose of

21 See cl. 48 of Taxation Laws Amendment (Foreign Income) Bill 1990

22 Indeed, this is the theory of the *Cash Transactions Reports Act* 1987 (Cth).

23 Crinion, *supra* n 19, at 1217-1225

24 *Doe v. US* 88-2 USTC 9545

25 Kelman, A. "The Computer as Accomplice and Police Informer", (1988) *Offshore Investment* No 5 at 19

obtaining legal advice or for use in legal proceedings.[26] In *Baker v. Campbell*,[27] Gibbs J observed that privilege was granted:

> . . . to ensure that the client can consult his lawyer with freedom and candour, it being thought that if the privilege did not exist 'a man would not venture to consult any skilful person, or would only dare to tell half his case'.[28]

Two observations may be made concerning privilege. First, it is noted that the absence of privilege does not appear to have prevented taxpayers from "venturing" to consult an accountant for tax advice. Secondly, there has been a recent example of a law firm using privilege as a marketing tool in an attempt to lure clients away from accounting firms.[29] In these circumstances, it would seem appropriate to re-examine the role of legal professional privilege in the context of tax matters.

Innovative investigative techniques

The IRS has proved itself to be innovative when it comes to obtaining information which is held offshore. For example, in the early 1970s it carried out an investigation referred to as the "Swiss Mail Watch".[30] The aim of this was to identify US taxpayers with undisclosed Swiss bank accounts. It involved the IRS microfilming the exterior of all envelopes passing through the New York mail exchange which were believed to have originated from Swiss banks. The programme identified some 40,000 taxpayers with Swiss bank accounts.

Other investigation activities of the IRS read like something out of a John LeCarré novel. For example, in 1972 the IRS undertook "Project Haven" which investigated the dealings of a narcotics trafficker with a Bahamian bank and trustee company.[31] The IRS used an informant who had developed a close relationship with the vice president of the bank. The banker made regular visits to Miami. On one occassion, the informant arranged a date for the banker with a former policewoman. The banker left his briefcase at the woman's apartment while they dined out. The informant used a key to the woman's apartment to get access to the banker's briefcase which contained a list of the bank's clients. The document was delivered to an IRS agent who copied it. The information obtained disclosed sixty three cases of evasion. It also led to the criminal indictment of members of a Chicago law firm who aided and abetted tax evasion activities through the bank.

Leaving ethics aside, it is unlikely that the Australian Taxation Office would ever have the resources to use such investigative techniques.

26 *Grant v. Downs* (1976) 135 CLR 674
27 83 ATC 4606
28 At 4612
29 See the *Australian Financial Review*, 2 August 1989, p 1
30 Crinion, *supra* n 19, p 1228
31 The description of Project Haven has been summarised from Crinion, *ibid* at pp 1225-1228

CO-OPERATION BETWEEN ADMINISTRATORS

As stated at the outset, there is increasing acceptance among administrators that the only way of stemming the growing tide of international tax evasion and avoidance is through effective co-operation. At this stage, most co-operation is bilaterally based, however there is a move, albeit slowly, towards greater multilateralism in international tax enforcement.

Bilateral Exchange of Information

Double Tax Treaties[32]

Australia has entered into comprehensive double tax treaties with 27 nations. Each treaty provides for the exchange of information between the two tax administrations. The information exchange is not unlimited in operation. Each treaty defines the boundaries of the exchange. While the precise boundary varies from treaty to treaty, all but one of Australia's treaties provide for an "extended" exchange. Under an extended exchange, information may be exchanged not only for the purpose of carrying out the treaty, but also for the purpose of enforcing domestic laws which are the subject of the treaty. A "restricted" exchange only permits the exchange of information for the purpose of carrying out the treaty. The only Australian treaty which provides for a restricted exchange is the *Swiss Treaty.*

The definition of the boundaries of the exchange is important for two reasons: first, the obligation to exchange is mandatory; and secondly, if information is exchanged which is outside the scope of the exchange, then the administration may be in breach of secrecy laws.

Even within the boundaries of the exchange, certain classes of information may be excluded. Under most treaties, there is no obligation to exchange information which would disclose any trade, business, industrial, commercial or professional secret or trade process. Further, there is no obligation to exchange where disclosure would be contrary to public policy. While there is no obligation to exchange such information, most treaties give administrators a discretion to do so.

Generally, there is no obligation to exchange information which the requesting administrator could not obtain under its domestic laws. This is designed to prevent administrators exploiting the broader investigations powers of their treaty partners. Again, while there is no obligation to exchange such information, treaties usually give administrators a discretion to do so.

In most cases, the exchange is not limited to information already in the possession of the administration. The requested authority may be obliged to collect the information and this is the case regardless of whether or not the requested authority has any interest in the information.

32 See generally, Burns, L. and Woellner, R.H. "Bilateral and multilateral Exchanges of Information", (1989) 23 *Taxation in Australia* 656

Treaties leave the actual design of the exchange to be determined by agreement between the two administrations. In most cases, there is an informal agreement that information will be exchanged automatically, upon request or spontaneously. Some administrations, most notably the US, prefer to formalise the structure of the exchange by way of an agreement with the other administration.[33]

An automatic exchange involves the regular exchange of agreed classes of information. Such an exchange is generally limited to information which is routinely reported by taxpayers or third parties to the respective administrations. One of the main problems with the automatic exchange is that information is often received in an unusable form, for example, there is inadequate taxpayer identification, or the information may not be in English. This problem is being addressed through the introduction of a standard multi-lingual form. Another problem is that an automatic exchange may in fact generate too much information in that the receiving administration may not have the resources to use all the information received. It is common now for administarors to set tolerance levels (that is, minimum dollar amounts) or to alternate the classes of information exchanged from year to year.

Information may also be exchanged upon request. The quality of the information is very much a function of the terms of the request. One way to ensure the quality of the information exchanged is to have the requesting authority involved in its collection. For example, the IRS has exchanged representatives with the Canadian and German Revenues to, *inter alia*, facilitate the exchange of information.

Information may also be exchanged spontaneously. This usually occurs where information is discovered during an investigation which suggests non-compliance with the tax law of a treaty partner.

Treaties limit the use to which the information received may be put. Further, the confidentiality of the information is preserved by a requirement that the receiving authority treat the information as secret in the same way as it would treat domestically obtained information. However, problems may arise where the receiving authority is subject to secrecy laws which are not as strict as those to which the transmitting authority is subject.

Carribean Basin Initiative

Bilateralism is of limited assistance when tax havens are involved. Not surprisingly, there are very few bilateral treaties with tax havens. Even where there is, it rarely overrides the tax haven's bank and commercial secrecy laws.

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33 See for example, the "Working Arrangement Between the United States Inland revenue service and the Australian Taxation Office for the Conduct of Simultaneous Examinations Under the the Terms of the Exchange of Infromation Provisions of the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income" entered into on 2 November 1989

The US has attempted to use economic incentives to encourage Carribean tax havens to enter into information exchange arrangements. In 1983, the US Congress passed the *Carribean Basin Economic Recovery Act* (commonly known as the Carribean Basin Initiative, hereafter referred to as CBI).[34] The aim of the CBI was to encourage the Carribean tax havens to enter into information exchange agreements with the US which overrode the Carribean country's bank and commercial secrecy laws. The "carrot" offered for signing was that under US tax law the Carribean country would be given "North American Area status". This would mean that US residents would be entitled to deductions for the costs of holding and attending conferences in the Carribean country.

Of the 27 countries targetted, five such agreements have come into effect and a further five agreements have been signed. One of the first countries to sign such an agreement was Bermuda. It was reported recently that Bermuda was becoming a "legitimate offshore financial centre" rather than simply being an "offshore tax haven".[35] It was also reported that the agreement lead to 5 per cent of businesses leaving the island. The interesting statistic though, would be the dollar value which these businesses represented.

Besides being repugnant to the concept of sovereignty of nations, it must be questioned whether the CBI derives any real benefits for the US. Presumably, those US taxpayers holding conferences in the Carribean will do so in a country which has North America area status, while those US taxpayers wanting to use a tax haven will simply shift operations to a Carribean country which has not signed an agreement. From a revenue point of view this seems the worst possible position.

Given the financial benefits from being a tax haven, there will always be countries willing to make themselves available in this capacity. As more countries sign information agreements with the US, there is greater incentive for the other countries to remain as tax havens (competing with 17 tax havens for international business must be better than competing with 27).

It is unlikely, therefore, that Australia would adopt a similar policy in relation to, for example, the Pacific Island tax havens.

Mutual Assistance in Criminal Matters[36]

In 1987, the Commonwealth Parliament passed the *Mutual Assistance in Criminal Matters* Act 1987 (Cth) (the *Mutual Assistance Act*). The object of the *Mutual Assistance Act* is to facilitate the provision and obtaining of international assistance in criminal matters, including the obtaining of evidence, documents and other articles (s 5).

The *Mutual Assistance Act* applies to foreign countries with whom Australia has entered into a Treaty on Mutual Assistance in Criminal Matters. To date, Australia has

34 See generally, Sharp, William M. and Steel, Betty K. "The Carribean Basin Exchange of Information Draft agreement — A Technical Analysis" 19 (1985) *The International Lawyer* 949

35 "International Tax News — Bermuda", (1989) 44 *Tax Notes* 1243

36 See generally, McClean, *supra* n 10

signed Treaties with the United States, Japan, Vanuatu and Canada. Nothing in the *Mutual Assistance Act* is to affect the obtaining of assistance in other ways, for example under a tax treaty.

Under the Act, assistance may be provided in relation to, *inter alia*, the production of documents for the purposes of a proceeding in relation to a criminal matter (ss 12 and 13). In this context, criminal matter includes a taxation offence (s 3(1)). At this stage, there does not appear to have been much use of these treaties in relation to tax offences.

Multilateral Exchange of Information

While the information exchange articles in Australia's treaties provide the Commissioner with an important source of information concerning international transactions, their bilateral nature limits their effectiveness when dealing with the multinational taxpayer. A multi-lateral audit can only be carried out if there is an information exchange article in force between all countries involved. Further, the scope of each exchange must be the same for the audit to be carried out effectively.

Effective enforcement at the international level requires multilateral co-operation between tax administrators. A multilateral approach would allow administrators to organise their enforcement activities in the same way as multinationals organise their tax affairs. The latest attempt at achieving multilateralism in international tax enforcement is the Multinational Convention on Mutual Administrative Assistance in Tax Matters (the Mutinational Convention) which is a joint initiative of the OECD and the Council of Europe. Presently, three countries, Sweden, Norway and the United States, have indicated that they will sign. The Multinational Convention requires five signatories before it will come into force. Australia, Luxembourg, Switzerland, the United Kingdom and West Germany have indicated that they will not be signing the Multinational Convention. The main reason given in each case is the belief that the Multinational Convention is unnecessary having regard to the existing network of bilateral treaties.

In Australia's case, the decision not to sign was made at the time when the Government was attempting to have the tax file number and related privacy legislation passed through Parliament. It may have been that the decision not to sign was taken to "smooth the way" for the passing of that legislation. It is also interesting to note the reaction of the Australian business and professional community to the Multinational Convention. Basically, it was seen as the end of civilisation as we now know it. The reality was that it would merely allow what can be done now on a bilateral basis to be done on a multilateral basis.

It one sense it is not surprising that a number of countries have chosen not to sign the Multinational Convention. This is because this global attempt at international enforcement came at a time when many administrators (the Australian Taxation Office included) ar only beginning to effectively use bilateralism. Once networks of bilateral co-operation become more sophisticated, it would seem inevitable that multilateral co-operation on a global basis will be formalised.

CONCLUSION

The experience in the tax arena has been that administrators are severely limited in their attempts to obtain information concerning international transactions. Multinational taxpayers have held the upper hand through their ability to structure transactions in ways which effectively prevent national administrators from accessing key information about their activities. It would seem to be generally accepted now that there must be greater co-operation between tax administrators if there is to be effective enforcement at the international level.

While the *Mutual Assistance in Criminal Matters Act* provides for assistance between law enforcement agencies in relation to the recovery of the proceeds of crime (ss 32ff), to date only Australia's treaty with Canada provides for such co-operation. Given the tax experience, it is submitted that such co-operation will be essential to the success of the *Proceeds of Crime* legislation.

POST SCRIPT

Since this paper was written, the Federal Attorney General, Mr Duffy, announced that legislation would be passed enabling Australia's business regulators (in particular, the Australian Securities Commission and the Trade Practices Commission) to co-operate with overseas regulators in investigating corporate malpractice. The proposed legislation involves expanding the scope of Australia's treaties on Mutual Administrative Assistance in Criminal Matters so as to cover corporate matters. This continues the trend towards greater co-operation in enforcement activities.