Trick or treaty: Are Canadians next as IRS takes historic first step?

Moodys Tax
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Canadians know that their proximity to the US presents both risk and opportunity. One risk that has always been hard to quantify is the risk that the IRS and CRA will cooperate to enforce each others' tax laws with respect to assets and information on both sides of the border.[1] Recently, the likelihood of this cooperation increased significantly. For the first time, the US government has used a powerful device in support of a treaty-partner government to obtain financial data. At the request of the Norwegian taxing authority, the IRS (and Department of Justice) applied to US federal district court (in multiple jurisdictions) for leave to file a "John Doe" summons. This is a specialized summons authorized by the US Internal Revenue Code when the IRS is seeking otherwise unavailable information regarding a particular individual or group that are believed to have failed to comply with tax laws. Although tax treaties generally require the signatory countries to assist each other in data collection, the US has not previously extended this assistance to the issuance of a John Doe summons.

As they say in Norway, first time for everything. The IRS, in the US (Federal) District Court for the Western District of Pennsylvania, sought and obtained leave to serve "John Doe" summonses against PNC Bank and RBS Bank to obtain information about specific debit and credit card accounts. The patterns of use on these accounts indicated that the account holders were using the accounts to shelter gain from Norwegian taxation.

Of course, no one is surprised that the IRS wants to serve summonses on American banks that have issued payment cards to parties that the IRS has reason to believe are skirting the tax laws. But here the tax laws being skirted are the laws of . . . Norway. And the failures to report, file and/or pay are all breaches of Norwegian law. And the IRS **only** sought leave to file these summonses because the Norwegian Tax Administration requested assistance in identifying [Norwegian] tax scofflaws[2] making use of these cards to avoid their tax obligations.

The US Department of Justice acknowledges that this is the first time that "John Doe" summonses have been utilized to enforce the tax laws of a foreign sovereign.[3] However, the Department of Justice argues that since the US – Norway Tax Treaty (Convention) requires mutual assistance in collection of revenue as though such revenue were payable under the assisting country's laws, and since treaties are recognized as having the authority of federal law, the IRS is justified (if not obligated) in using the summons mechanism in its cooperation with Norwegian tax authorities.

Language similar to the language of the US-Norway tax convention can be found in many of the Tax Treaties to which the US is a party. Practitioners expect that international cooperation in revenue enforcement will continue to expand. Taxpayers should realize the potential for the taxing authority of one country to assist the taxing authority of other countries in identifying parties and/or assets subject to enforcement. Individuals and businesses have long been crossing borders to seek economic opportunity; governments are now doing the same.

1. Practitioners are generally barred from factoring the likelihood of effective enforcement into the tax advice they offer clients. However, the law

has yet to be passed which prevents clients from asking the question.

2. It is not known whether the proper term for Norwegian scofflaws is “Sköffenllautzen”.

3. Students of American history may find irony in an administrative branch of the US government providing tax enforcement on behalf of a European king.