

“ENFORCEMENT OF TAX LIABILITIES ACROSS BORDERS”

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“The art of taxation consists of so plucking the goose to obtain the largest amount of feathers with the least possible amount of hissing.” – J.B. Colbert, Comptroller General of Finance for Louis XIV.

Canada Goose (Branta canadensis) – The Canada Goose is well known for its V-shaped migrating flocks and characteristic honking.

Introduction

1. It is not given to many of us to comprehend our own legal or tax systems let alone the decisions of a foreign legal and tax systems. Fortunately, most systems have rules dealing with the impact of foreign decisions and their enforceability.
2. To what extent can foreign legal and tax decisions be enforced domestically? “Foreign” in this sense means a jurisdiction where you are not. “Domestically” refers to where you are (i.e. where it is cold and you pay taxes?). For example, a U.S. decision is “foreign” to Canada and a Canadian decision is “foreign” to the Turks and Caicos Islands.
3. Domestic legal and tax decisions are enforceable by virtue of domestic statutes and rules of practice and procedure for enforcement. Assets may be seized, and in some cases the non-compliant fined or imprisoned.

Enforcement of foreign decision - the basics

4. Foreign judicial and tax decisions have no direct operation in a domestic jurisdiction. The basic rule relating to judicial decisions is:

“A judgment of a court of a foreign country (hereinafter referred to as a foreign judgment) has no direct operation in England but may:

- (i) be enforceable by claim or counterclaim at common law or under statute; or***
- (ii) be recognized as a defence to a claim or as conclusive of an issue in a claim.” - see Dicey & Morris Rule 34.***

5. For “England” one can substitute “any common law jurisdiction” including Canada and the United States. In referring to “common law” only I am immediately restricting myself to those jurisdictions which are common law based. There are of course many non common law jurisdictions, and other major legal systems include “civil law” and “Shariah law”. They too have schemes for recognizing and enforcing foreign decisions, and each must be looked at on a case by case, jurisdiction by jurisdiction basis. This paper is presented from the author’s view point, namely a practitioner in an offshore jurisdiction. To what extent can the Canada Revenue authorities extend their grasp to an offshore jurisdiction?

6. For present purposes a “legal decision” means a judgment of a court for a money debt. Those decisions are binding and enforceable within the domestic jurisdiction. There are other types of “decision” (such as a decision requiring payment of a foreign tax) which can be problematic for trustees and will be looked at later.

“Recognition” and “enforcement” distinguished

7. There is a distinction between “recognition” on the one hand and “enforcement” on the other. For example, the judgment of a court of State A may be recognized by the courts of State B without State B necessarily enforcing it. State B will (at common law) recognize the decision of State A if State B considers that State A possessed jurisdiction (at common law) to render the decision. Some States are generous in the extent to which they consider they have jurisdiction over parties with little connection to the jurisdiction (i.e. they exercise a “long arm” jurisdiction). There needs to be an objective standard by which the issue of jurisdiction is assessed. The simplified test is that the foreign court is considered to have jurisdiction if;

- “(i) ***the judgment debtor was, at the time the proceedings were instituted, present in the foreign country.***
- “(ii) ***the judgment debtor was claimant, or counterclaimed in the proceedings in the foreign court.***
- “(iii) ***the judgment debtor, being a defendant in the foreign court, submitted to the jurisdiction of that court by voluntarily appearing in the proceedings.***
- “(iv) ***the judgment debtor, being a defendant in the original court, had before the commencement of the proceedings agreed, in respect of the subject matter of the proceedings, to submit to the jurisdiction of that court or of the courts of that country.”***

Dacey & Morris Rule 36.

8. Recognition may involve relying on a foreign judgment to establish a defence (as opposed to enforcing a foreign money judgment by seeking to collect the debt domestically). It is the enforcement of a foreign decision which is critical. To be enforced a foreign decision must obviously be recognized as well. It is only when the legal system of State B will lend its powers to enforce the decision of State A that State A’s decision has practical effect in State B.

Enforcement

9. Enforcement will be by one of two routes:
- (i) **Enforcement by statute** - each jurisdiction has its own rules. Statutes will be the result of and reflect international agreements by two or more States by treaty or convention. In some jurisdictions there may be no statutory scheme of enforcement. In that event, enforcement (at common law) applies;
 - (ii) **Enforcement at common law by cause of action** - In common law jurisdictions, a foreign judgment will ordinarily be recognized subject to certain restrictions.
10. The theory behind the enforcement rule under common law was stated by Baron Parke in Russell -v- Smyth [1842] 9 M.& W. 810.

“We think that . . . the true principle upon which the judgments of foreign tribunals are

enforced in England is . . . that the judgment of a court of competent jurisdiction over the defendant imposes a duty or obligation on the defendant to pay the sum for which judgment is given, which the courts in this country are bound to enforce; and consequently that anything which negates that duty or forms a legal excuse for not performing it is a defence to the action."

11. In more recent times it is said that common law foreign judgments are enforced, not through considerations of comity with respect to foreign courts, but on the basis of the principle that a legal obligation arises to satisfy a judgment of a court of competent jurisdiction (Adams -v- Cape Industries plc [1990] Ch 433).
12. **Enforcement Under Statute**
Each jurisdiction will have its own statute(s) and scheme for registration. In some cases there may be no statute or scheme at all, or merely a limited scheme. For example:
 - (i) Jersey has agreements with only the UK and Guernsey;
 - (ii) In England the Civil Jurisdiction and Judgments Act 1982 provides for the recognition and enforcement of judgments from Scotland and Northern Ireland and from European Community States which are parties to the "Brussels Convention" on jurisdiction and the enforcement of judgments in civil and commercial matters of 1968 and the EFTA countries which are parties to the similar "Lugarno Convention";
 - (iii) In the Turks and Caicos Islands there is an Overseas Judgments (Reciprocal Enforcement) Ordinance, but no countries are named under it, so there is *de facto* no statutory scheme.
13. Statutory schemes operate by registration of the foreign judgment. Once registered (and assuming the judgment cannot be set aside on technical or policy grounds e.g. Maronier -v- Larmer [2003] 3 All ER 848) the foreign judgment is "domesticated." It is then enforceable as if it were a domestic judgment.
14. The ability to register a foreign judgment means that if the foreign judgment ignores or disregards a domestic trust, trust assets may be liable to be seized domestically. In B -v- T (4 ITELR 523) a French judgment giving effect to a forced heirship claim would have been enforceable against trustees in the Bahamas if the Foreign Judgments (Reciprocal Enforcement) Act 1933 had applied in the Bahamas. In fact the Act had not been extended to the Bahamas and did not apply.

Enforcement and recognition at common law

15. The basic rule is;

"Subject to specified exceptions, a foreign judgment in personam given by the court of a foreign country with jurisdiction to give that judgment and which is not impeachable may be enforced by a claim or a counterclaim for the amount due under it if the judgment is

(a) for a debt or definite sum of money (not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty); and

(b) final and conclusive

but not otherwise" - again see Dicey & Morris.

The basic rule is longer and more complex, but is simplified here. Broken down, the rule can raise complex issues.

16. **“Debt or definite sum of money”**

Orders requiring performance will not be enforced - see *the comments on pre-action freezing relief below*. In that regard it may be necessary to bring a fresh action in the domestic jurisdiction to secure enforcement. If the foreign decision is recognized (as distinguished from enforced) it will give rise to binding determinations on many of the issues between the parties. Thus the domestic proceedings may be less complex than the original foreign proceedings.

17. **No taxes or penalties**

The sum of money must not relate to the direct or indirect payment of foreign taxes or penalties. Even in the current climate courts still adopt this line. However, the raft of legislation introduced in most jurisdictions leading to exchange of information on tax matters seems to be at odds with the basic rule. That however is a matter for the legislature. Damberg -v- Damberg 4 ITEL 65 involved an Australian Court considering the extent to which providing information to the German tax authorities to enable a tax liability to be calculated amounted to enforcement of a foreign tax law. The Court held that it had no power to order any terms leading to the direct or indirect enforcement of a foreign revenue law including merely providing notice and information of a liability. However, express statutory provisions overrule the common law rule.

18. There is a rich line of case law on the “no taxes or penalties” rule.

“There is a well recognized rule which has been enforced for at least 200 years or thereabouts, under which these courts will not collect the taxes of foreign states for the benefit of the sovereigns of those foreign states” - Re Visser [1928] Ch 877.

The rule is subject to contrary agreement by treaty or convention. For example one State may seek the extradition of its national for tax offences - R-v- Chief Metropolitan Stipendiary Magistrate ex parte Secretary of State for the Home Department [1988] 1WLR 1204 where the State of Norway sought the extradition of one of its nationals for revenue offences. There is a clear trend in modern legislation and regulation that statutory assistance will be given in the collection and payment of foreign taxes. Case law however maintains the long established rule and is only diminished by new statutes.

19. Where a liquidator, as nominee for a foreign state, seeks to indirectly collect a foreign tax, a domestic court will be precluded from enforcing the claim to indirectly collect the unpaid foreign tax - see QRS1 Aps -v- Frandsen [1999] 3 AllER 289.

20. Another recent example of the “no tax or penalties” rule arose in the long running Cook Islands’ saga of the “Orange Grove” case. The settlors of two Cook Islands’ trusts had been involved in a Ponzi scheme in the US. A large monetary Judgment was entered against the settlors in the US in favour of the Federal Trade Commission. The judgment was for *“equitable monetary relief, including but not limited to consumer redress”*. In a reasoned judgment the Chief Justice of the Cook Islands found that the claim brought in the Cook Islands based on the US judgment was to enforce the regulatory rights and powers of the Federal Trade Commission which were at least in part penal. The claim was struck out - United States of America on behalf of its agency the U.S. Federal Trade Commission -v- AsiaTrust Limited - Plaintiff 57/1999 Ruling December 4, 2001. The decision accorded with long established principles, but can easily be misinterpreted (in the Court of public opinion) as giving comfort to those who wish to hide assets in offshore havens.

21. The unenforceability of foreign tax claims often raises complex issues for trustees. For example, to what extent may foreign tax authorities levy distress against the beneficiaries or the settlor if they cannot secure payment from foreign trustees?
22. In Representation of I [4 ITEL] trustees applied to the Royal Court of Jersey for directions as to whether they should pay Dutch and Belgian taxes out of the trust fund. The taxes were unenforceable against the trustees in Jersey. The Court held that the proposed payment was within the trustees' powers. Merely because a foreign tax "decision" is unenforceable, does not mean it must be ignored. To the contrary the trustees may be under a duty to pay a foreign tax if there would be adverse consequences to a beneficiary, particularly if the payment is consistent with the settlor's intention.
23. In considering the question of whether or not to pay a foreign tax the trustee must consider:
 - (i) Is there any obligation to pay the foreign tax?
 - (ii) Will payment further the proper administration of the Trust?
 - (iii) Will payment be fair to the beneficiaries?
 - (iv) Can the foreign state enforce payment of the liability against the Trustee or beneficiary in their jurisdiction(s)?
24. It should be noted that there is a duty to pay the foreign tax if unfairness to a beneficiary would result and if the payment is consistent with the settlor's intention – see Scottish National Orchestra Society -v- Thompson's Executors (1969) SLT 325. The Trustee will have a right to be indemnified out of the trust fund, particularly if the foreign beneficiary is to receive trust property free of fiscal liabilities.

Final and conclusive

24. "Final and conclusive" means that the foreign court treats it as final and conclusive. Any decision under appeal or one which can be altered will not satisfy the test.

Exchange of Tax Information

25. It is the exchange of tax information between jurisdictions or more aptly the flow of information to taxing jurisdiction which is producing the greatest growth in legislation. Canada appears to be following the U.S. in its approach to taxing trusts, and possibly adopting an even more aggressive international approach. The U.S. has entered into "Tax Information Exchange Agreements" ("TIEA's), with Bermuda, the Cayman Islands, BVI and the Bahamas which provide a one way flow of information.
26. TIEA's do not address double taxation issues. They amount to agreements to provide tax information on request (by the U.S.). Now that the door has been opened (by the U.S. with its coercive powers) it is difficult to see why the Canadian authorities will not request similar TIEA's. Each TIEA varies in its terms. Some are restricted to criminal tax evasion inquiries in the requesting state. Others relate to civil matters (e.g. the U.S./Bahamas TIEA).
27. In the case of An application by Brasswell and others 4 ITLR 226 the Supreme Court of Bermuda considered a case involving an unauthorized disclosure by an employee of the United States legal advice rendered to a U.S. tax payor. Based on the disclosure, the IRS made a request to the Minister of Finance in Bermuda. The Court in Bermuda directed that the request be declined on the grounds that it involved disclosure of privileged communications that were barred by the relevant convention. The IRS was required to make a "full and frank disclosure" so that an informed decision could be made as to whether to exceed to the request.

28. It is notable that the new TIEA's relating to the Bahamas, the Cayman Islands and the BVI provide that claims of legal privilege under United States law must be raised in the Courts of the U.S., whereas claims of privilege under the domestic law must be raised in the overseas jurisdiction.
29. To the extent that foreign tax evasion becomes reportable under "Proceeds of Crime" legislation (for example as it is in England and Wales), the overseas practitioner is then under a duty to report to his domestic money laundering authority his suspicion of the evasion of a foreign tax. That information will then be passed to the foreign authority. Armed with that information the foreign authority can then investigate and seek to recover further information and thus the national barriers to the collection of tax from foreign subjects are significantly eroded.

Comments on Canada's approach to taxing Non-resident Trusts and emigrating Canadians in the light of tax treaties and the Vienna Convention

30. Having explored the approach to enforcement of tax liabilities across borders, it can readily be seen why taxing authorities in onshore jurisdictions have devised domestic legislation which provides for the imposition of tax burdens on any person remotely connected with a trust that remains within their grasp. Coupled with treaties, TIEA's and access to information from foreign jurisdictions, domestic taxing authorities are able to obtain information which previously was beyond their grasp.
31. Canada's proposed approach to taxing "non resident trusts" as set out in the 1999 budget proposals and repeatedly amended imposes joint and several liabilities in respect of Canadian tax on the Canadian settlor. The settlor may have no ability to control the trustee. What foreign trustee would willingly pay Canadian tax when it has no enforceable obligation to do so? The latest version of the draft proposals, if enacted (retrospectively) will place foreign trustees and/or foreign beneficiaries in an extraordinary position. It is plainly arguable that those provisions which seek to impose Canadian tax burdens on non resident in respect of non Canadian income cannot be enforced in the foreign jurisdiction. No foreign trustee or beneficiary would properly regard themselves as liable to pay those taxes. Yet, ironically, by willfully failing to pay such a tax in support of its inherent and express duty to preserve the trust fund, a foreign trustee might arguably be compelled in its own country to report itself (retroactively if the legislation is enacted retroactively) for breaching the Canadian tax statute. What happens if that foreign trustee ever happens to pass through Canada for travel purposes – would they face prosecution for willful tax evasion?
32. Foreign jurisdictions have been slow to spot the absurdity of the proposed legislation, even if Canadians have not (see STEP Canada's open letter to the Canadian Prime Minister Paul Martin at www.step.ca).
33. Canada is a signatory to the Vienna Convention on the Law of Treaties of 1969. Amongst other obligations, every (tax) treaty must be performed by Canada in good faith (article 26) and in respect of its territory. Logically therefore where tax treaties exist Canada should not legislate to nullify the effect of such treaties by seeking to tax foreigners in respect of foreign income. The legislation if enacted in its current form may be ripe for constitutional challenge.
34. The latest version of the three certainties in Canadian trust law now appears to be death, taxes and the honking and hissing of the Canada Goose. Tax collectors would be wise to recall the words of J.B. Colbert.