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OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE
THE SUPREME COURT
OF THE
UNITED STATES

CAPTION: UNITED STATES, Petitioner V. PHILIP GEORGE
STUART, SR., ET AL.
CASE NO: 87-1064
PLACE: WASHINGTON, D.C.
DATE: December 5, 1988
PAGES: 1 - 47

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IN THE SUPREME COURT OF THE UNITED STATES

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UNITED STATES, ;
Petitioner, ;
v. ; No. 87-1064
PHILIP GEORGE STUART, SR., ET AL., ;
-----x

Washington, D.C.
Monday, December 5, 1988

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:01 o'clock a.m.

APPEARANCES:
LAWRENCE G. WALLACE, Deputy Solicitor General,
Department of Justice, Washington, D.C.;
on behalf of the Petitioner.
CHARLES E. PEERY, Seattle, Washington;
on behalf of the Respondents.

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C O N T E N T S

<u>ORAL ARGUMENT OF</u>	<u>PAGE</u>
LAWRENCE G. WALLACE	
On behalf of the Petitioner	3
CHARLES E. PEERY	
On behalf of the Respondents	20
<u>REBUTTAL ARGUMENT OF</u>	
LAWRENCE G. WALLACE	
On behalf of the Petitioner	44

1 P R O C E E D I N G S

2 CHIEF JUSTICE REHNQUIST: We'll hear argument
3 first this morning in number 87-1064, United States
4 versus Phillip George Stuart.

5 Mr. Wallace, you may proceed whenever you are
6 ready.

7 ORAL ARGUMENT OF LAWRENCE G. WALLACE
8 ON BEHALF OF THE PETITIONER

9 MR. WALLACE: Thank you, Mr. Chief Justice,
10 and may it please the Court:

11 This is a proceeding to enforce Internal
12 Revenue summonses for bank records in a bank in
13 Bellingham, Washington, that reflect accounts of two
14 Canadian nationals.

15 The summonses were issued pursuant to a
16 request by Canada under a tax treaty between Canada and
17 the United States that provides, among other things, for
18 exchanges of information to assist each other in the
19 administration of their tax laws.

20 The United States has such treaties in force
21 currently with 34 countries. They're collected in
22 Footnote 17 on page 41 of our brief. And these treaties
23 play an important role in the Internal Revenue Service's
24 broad authority to investigate compliance with our
25 Internal Revenue laws by providing the IRS, through

1 reciprocal exchanges with foreign source, information
2 that would not otherwise be available to the IRS.

3 The two most pertinent articles of the treaty
4 are set forth at the beginning of the appendix to our
5 brief on, on page 1A of the appendix following page 48
6 of our brief, and the Court will note that Article XIX
7 provides that the competent authorities, the executive
8 branch officials designated to administer the treaties,
9 will exchange information that is at their disposal or
10 that they are in a position to obtain, and information
11 may be exchanged directly between the competent
12 authorities of the two contracting states.

13 And Article XXI says that the Commissioner may
14 upon request furnish our treaty partner with information
15 that the Commissioner is entitled to obtain under the
16 revenue laws of the United States.

17 These are fairly typical, and they obviously
18 contemplate in appropriate cases, the use of process to
19 obtain records that are not already in the possession of
20 the tax authorities in each state and, indeed, the
21 legislative history of the particular treaty involved
22 here, as we set forth on page 29 of our brief, shows
23 that during the confirmation process, and that's in
24 footnote 11 and the accompanying text, it was
25 contemplated in the Senate that a process such as an

1 Internal Revenue summons would be used to secure
2 information for each treaty partner.

3 And the specific reference that was made there
4 was to the obtaining of bank records. And in 1975 --

5 QUESTION: Mr. Wallace, excuse me. May, may I
6 interrupt for a moment. Maybe, maybe I'm not seeing
7 something here, but the, the treaty says "information
8 which its competent authorities are in a position to
9 obtain under its revenue laws," right, and, and you rely

10 --

11 MR. WALLACE: That is correct.

12 QUESTION: -- on Section 7602. But as I read
13 7602, it only authorizes summons for purposes of
14 determining United States tax liability.

15 MR. WALLACE: Well, that is a --

16 QUESTION: So, how can you say that you're in
17 a position to obtain it under our revenue laws when
18 you're not seeking to ascertain United States tax
19 liability?

20 MR. WALLACE: That is a -- certainly a
21 possible reading of 7602, and that very question was
22 debated and decided in the 1975 Second Circuit case that
23 we have cited in our brief, United States against A. L.
24 Burbank Company, in which this court denied certiorari.

25 The contention was made there that the summons

1 authority conferred by Congress was not sufficiently
2 broad to obtain information of, of -- regarding
3 compliance with the treaty partner's revenue laws,
4 notwithstanding the broader perspective that I tried to
5 give the court that this -- looked at overall becomes a
6 means of getting reciprocal information that the IRS
7 could not otherwise get about compliance with the
8 American tax laws.

9 And the Second Circuit held in that case that
10 7602 should not be interpreted more narrowly. Not only
11 did this court deny certiorari, but Congress since has
12 amended 7602 without disturbing that provision, and a
13 large number of these treaties have since been entered
14 into in presumed reliance on this interpretation.

15 At the time of the Burbank decision, the
16 Second Circuit stated that there were 19 such treaties
17 then in effect. There are now 34 such treaties in
18 effect. So, the Burbank decision, we submit, was not
19 only a correct interpretation at the time, but it has
20 built into the fabric of the law and as, in many other
21 instances, if possible, a statute should be interpreted
22 in a way that helps to effectuate the purposes of a
23 treaty, which is also the supreme law of the land.

24 And --

25 QUESTION: You don't have any language that

1 would allow that, though, do you? I mean, the language
2 seems quite clear.

3 MR. WALLACE: We have no language.

4 QUESTION: What's the closest phrase you have
5 that would allow it to be read this way?

6 MR. WALLACE: I, I don't have a phrase that
7 looks specifically to investigation of compliance with
8 Canadian or other countries' revenue laws, but I, I do
9 think the broader perspective that I have mentioned,
10 that these reciprocal obligations are a method by which
11 the Internal Revenue Service is enabled more
12 successfully to conduct its own investigations is highly
13 pertinent, along with what we submit is congressional
14 acquiescence in this interpretation, not only reflected
15 in amendments of 7602, but in the confirmation of these
16 numerous treaties that look toward the use of compulsory
17 process.

18 QUESTION: If you did not have the summons
19 authority, the treaty wouldn't necessarily be a nullity,
20 would it?

21 MR. WALLACE: Not necessarily.

22 QUESTION: Because the government still has
23 information that it can furnish.

24 MR. WALLACE: It has information, although a
25 similar argument could be made about the Service's

1 authority to conduct any investigation or engage in any
2 operations. It's all part of Chapter 78 of the Internal
3 Revenue Code, which includes Chapter 7602. And, of
4 course, all authority that the Service has to
5 investigate is replete with references to our revenue
6 laws. So, I'd have to say that a similar argument could
7 be made about furnishing any information under the
8 treaty. That a question could be raised about the
9 Service's statutory authority.

10 So, the summons question is not unique in that
11 respect.

12 QUESTION: Did the Ninth Circuit expressly
13 consider the summons question in its opinion in this
14 case?

15 MR. WALLACE: It did not expressly discuss
16 this question, but it accepted the holding in the
17 Burbank case. Its, its holding is that a summons can be
18 used for this purpose if the Service complies with the
19 requirement that it added with respect to a -- an analog
20 to a referral to the U.S. Department of Justice. So,
21 implicit in its holding is acceptance of the Burbank
22 decision.

23 And, indeed, one could argue that in the
24 absence of a cross-petition, that question is not open
25 because it would change the relief in a manner more

1 favorable to the Respondents here, because the Ninth
2 Circuit ordered a remand that does not preclude
3 enforcement of the summons if that condition can be
4 complied with by the Revenue Service.

5 So, as a technical matter, the question really
6 is not open before the court in this case, but we do
7 submit that the Burbank decision is part of the fabric
8 of the law now that should not be repudiated by this
9 court, and, and it it plays an important role in our
10 foreign relations.

11 What the Court of Appeals did do in this case
12 was put itself in conflict with a later 1983 Second
13 Circuit decision called United States against
14 Manufacturers & Traders Trust Company by holding, that
15 is, the Ninth Circuit's holding, that the supporting
16 affidavits in this case did not make a prima facie
17 showing that the summonses were issued for a legitimate
18 purpose because they failed to state that the Canadian
19 investigation had not reached a stage analogous to
20 referral to the U.S. Justice Department for a, a, a
21 grand jury investigation or for criminal prosecution.

22 And Section 7602(c) prohibits the issuance of
23 a summons by the IRS when such a referral to the U.S.
24 Justice Department is in effect.

25 Now, in adding this requirement, we think that

1 the Court of Appeals here erred on two principal
2 grounds. The first is that the treaty clearly
3 contemplates that the question whether the treaty
4 partner has made a proper request is to be, be
5 determined by the executive branch official designated
6 to administer the treaty, referred to in the treaty as
7 the "competent authority."

8 As we have explained in our brief, most of the
9 information that is actually exchanged under these
10 treaties is provided directly by the competent authority
11 without any other entity, judicial or otherwise, of the
12 government being involved.

13 A typical example is compilations of dividend
14 payments by various American corporations to foreign
15 nationals and reciprocal information from the foreign
16 country. In many instances, the rate of withholding is
17 lower for dividend payments to foreign nationals than it
18 would be under the Internal Revenue Law for a dividend
19 payment to an American. And the corporations will
20 provide the IRS with a list of the foreign nationals for
21 whom the lower withholding rate provided for by treaty
22 has been utilized, and the IRS without any particular
23 request, even, from our treaty partner will provide
24 compilations of that information to the treaty partner.

25 Much of the information that is exchanged is

1 exchanged without any particular request and without any
2 use of process.

3 Now, in those instances where a summons is
4 used to secure information not already in the hands of
5 the IRS, the summons enforcement proceeding, we submit,
6 which is summary in nature this Court has emphasized
7 many times, should not inject the courts into this
8 aspect of treaty administration in making or
9 second-guessing the determination ordinarily made by the
10 competent authority and by the executive branch about
11 whether the request by the treaty partner is a proper
12 request under the treaty.

13 This is the kind of question that involves
14 sensitive foreign policy considerations. There quite
15 obviously would be sensitivity to having a court inquiry
16 focusing on the good faith of the treaty partner in
17 making a request for information under the treaty in
18 which the courts would be reexamining and perhaps
19 second-guessing the determination made by the executive
20 branch official charged with that.

21 QUESTION: Mr. Wallace, I don't know whether --

22 QUESTION: May I interrupt you, Mr. Wallace?
23 I don't really understand that argument because if you
24 have an, an objective test, whether there's been a
25 reference to prosecution or not, why does that involve

1 any inquiry into good faith?

2 MR. WALLACE: Well, it, it, it, it -- this
3 Court starting with United States against Powell has
4 characterized the inquiry to be made in the summons
5 enforcement proceedings as an inquiry into the IRS' good
6 faith in issuing the summons, and good faith is largely
7 translated into whether it's for a legitimate statutory
8 purpose, whether the proper procedures have been
9 followed, whether the information may be relevant as the
10 court said to compliance with the Internal Revenue laws,
11 whether there is a collateral purpose, such as harassing
12 the taxpayer or trying to put pressure on the taxpayer
13 to settle a collateral dispute.

14 Those are elements of good faith which
15 arguably could arise in, in inquiring into the
16 legitimacy of the treaty partner's request.

17 QUESTION: Why couldn't you just presume that
18 there was good faith in all matters of that kind and
19 still say you've got to follow the American rule that
20 there has been no reference for criminal purposes yet?
21 Just have a simple black letter rule to that effect.
22 That wouldn't question the motives of the foreign treaty
23 partner, would it?

24 MR. WALLACE: Well, it would question the
25 legitimacy of their normal investigative process.

1 QUESTION: No, it would just say that's our
2 rule on subpoena enforcement. We have this rule, and it
3 doesn't. Therefore, the treaty isn't complied with.

4 MR. WALLACE: If the treaty or statute had
5 specified that -- you know, I can't argue that that
6 would be an open-ended invitation for the courts to
7 examine good faith. But what this court's line of
8 decisions has indicated is that it is the good faith of
9 the IRS in asking that a summons be enforced that is the
10 proper subject of investigation in a summons enforcement
11 proceeding, not the merits of the investigation.

12 The Powell decision, which is the seminal
13 decision in 379 U.S. made that very clear with respect
14 to two issues that the taxpayer sought to have
15 reexamined that went to the merits of the investigation,
16 two rather discrete issues. One, because the statute of
17 limitations had expired except for fraud, whether there
18 was a sufficient basis to conduct the investigation
19 because there was a sufficient basis to suspect fraud,
20 and the other was whether the Commissioner had properly
21 certified that a, a, a -- an additional inspection of
22 records was necessary which had to be certified under
23 the statute when there had already been one inspection
24 of records.

25 And the Court held that neither of those

1 aspects of the merits of the investigation is something
2 to be raised in the summons enforcement proceeding; that
3 instead, it has to be limited to the kinds of issues
4 that I had averted to a bit earlier and as recently as
5 the Court's unanimous decision in the Tiffany Fine Arts
6 case in Volume 469 U.S., the Court again reemphasized
7 when the taxpayer complained that the IRS was
8 unnecessarily investigating too many licensees under the
9 scheme that was at issue there, and I may quote the
10 Court, "The decision of how many and which licensees to
11 contact is one for the the IRS, not Tiffany to make."
12 And one might add, not the court in the course of a
13 summons enforcement proceeding.

14 QUESTION: Mr. Wallace, you're, you're really
15 -- you're suggesting that this statute would apply
16 against a United States citizen as well; it's not just a
17 citizen of a foreign country, right? I mean, the treaty
18 would cover the United States citizen who was asserted
19 to be liable for foreign taxes, correct?

20 MR. WALLACE: Yes, it would.

21 QUESTION: So, a United States citizen who is
22 being harassed by a , by a foreign government, that
23 foreign government can enlist our government in that
24 harassment without any possibility of our courts
25 stopping it?

1 MR. WALLACE: With respect to the summons
2 enforcement proceeding, what could be shown is that the
3 IRS was not acting in good faith because the IRS did not
4 consider this a proper request under the treaty, but was
5 lending itself to a scheme of harassment concerning
6 information that has no possible relevance to tax
7 information.

8 QUESTION: But you're taking a position the
9 IRS doesn't have to, have to inquire into that. That's,
10 that's part of your whole point, that you don't want our
11 IRS to have to inquire into whether there is harassment
12 going on or the good faith of the foreign government.
13 Do you want the IRS to have to do that?

14 MR. WALLACE: I, I, I, I would not want to
15 mislead the court into thinking that the IRS
16 rubber-stamps every treaty request for information, even
17 information that is on hand. But under the treaty, it's
18 the competent authority at the IRS who makes the
19 determination of whether that is a proper request. But
20 --

21 QUESTION: I think that's an extraordinary --
22 I think that's extraordinary to have the United States
23 courts engaging in that, and I think it's a hard
24 question. Maybe if Congress had passed a statute
25 covering this matter, it might have given some thought

1 to that question.

2 MR. WALLACE: Well --

3 QUESTION: But since it hasn't, you're really
4 sort of asking us to make it up.

5 MR. WALLACE: If I, if I may say so, Mr.
6 Justice, what makes it seem less extraordinary to us, is
7 that the summons enforcement proceeding, the, the
8 attempt to interfere with the investigation is not the
9 ordinary place in which the merits of summonses for
10 third-party records is debated. It's usually debated
11 not in that summary context, but later on when there's
12 an effort to use the information against an individual.

13 And here if there is something that does not
14 comply with the rights of Canadian taxpayers, the
15 defense would ordinarily be raised in the Canadian
16 courts. That's where Canadian law would ordinarily be
17 debated.

18 In, in, in Donaldson against the United States
19 in Volume 400, the court held that the taxpayer did not
20 even have standing to intervene in a summons enforcement
21 proceeding in which the IRS was trying to get
22 third-party records relating to the taxpayer's
23 liability, in that case records of his former employer.

24 It is sometimes mistakenly thought that
25 Congress overruled the Donaldson case. Congress has

1 left that holding in Donaldson entirely untouched for
2 the category of third-party records that was involved
3 there, employer records or records of a former
4 employer. There is -- that is still good law.

5 The taxpayer cannot even be heard during the
6 summons enforcement proceeding.

7 QUESTION: And I'm somewhat puzzled, however,
8 because in your answer to Justice Scalia's question, you
9 said well, the IRS does make -- give itself some
10 assurance that the other country is acting in good
11 faith, yet I thought that's exactly what you're telling
12 us we can't require you to do.

13 MR. WALLACE: You can -- in the summons
14 enforcement proceeding, the question is the IRS' good
15 faith rather than the --

16 QUESTION: I understand that that's your
17 position.

18 MR. WALLACE: Yes.

19 QUESTION: But the question was put to you
20 suppose a country is harassing someone, say, for his
21 political views, and the IRS is in good faith. It knows
22 that the country wants the material, but you say the IRS
23 does make some investigation on the merits of the
24 request?

25 MR. WALLACE: It, it does consider whether the

1 request is a proper one under the treaty, that is
2 correct. But in most instances --

3 QUESTION: Well, is it a proper request under
4 the treaty if the country is harassing someone for their
5 political views?

6 MR. WALLACE: That would -- that would depend
7 on whether there is also a legitimate basis for the
8 request that complies with the terms of the treaty. Not
9 every country with which we have a treaty has our system
10 of government.

11 You'll notice that among the 34 countries,
12 there are several communist states, and the political
13 branches of our government have determined they will
14 exchange information.

15 QUESTION: Well, it's still not clear to me
16 when you examine into the motives of another country and
17 when you don't. And if you indicate that you do, I
18 thought that's exactly what you're -- what the Ninth
19 Circuit held that you should do and that you're arguing
20 against.

21 MR. WALLACE: Well, the Ninth Circuit held
22 that the enforcement court should examine those
23 motives. In determining whether to honor a request
24 under a treaty, we're dealing with a sensitive area of
25 foreign relations that is ordinarily a, a matter for the

1 executive branch, and those conducting our foreign
2 relations and not a matter to be debated courtroom by
3 courtroom.

4 And in most instances, this determination
5 whether to furnish the information or not is
6 dispositively made by the executive branch officials.
7 There is no mechanism whereby the courts could
8 ordinarily interfere with the furnishing of that
9 information, regardless of whether some people might
10 think that the particular government might be harassing
11 particular people.

12 That has been something taken into account in
13 negotiating and determining to comply with these
14 treaties.

15 I just want to advert very briefly to our
16 second major point, which is that neither the treaty nor
17 the statute contains the substantive restriction that
18 the Court of Appeals here added, this search for an
19 analog to reference to the United States Justice
20 Department, and we submit that it is a wholly
21 inappropriate addition because that search reflects
22 considerations entirely of domestic law that do not fit
23 very well, if at all, to any of the foreign systems of
24 law enforcement that we're involved with here.

25 And a little -- in a way, this is a little

1 like arguing to the court that the sun does not revolve
2 around the earth. Foreign systems are quite different,
3 and what was reflected in the series of cases in which
4 this was developed was an effort by the court and then
5 by Congress to reconcile the IRS's broad investigative
6 authority with the normal rules governing criminal
7 discovery and grand jury subpoenas so as to not have a
8 different rule in criminal cases applying for criminal
9 tax cases and the normal rule applying for other
10 prosecutions. I would like --

11 QUESTION: Mr. Wallace, you, you remember what
12 the earliest treaty like this was?

13 MR. WALLACE: I, I, I could not say, Mr.
14 Justice. I'd like to reserve the balance of my time, if
15 I may.

16 QUESTION: Very well, Mr. Wallace.
17 Mr. Peery, we'll hear now from you.

18 ORAL ARGUMENT OF CHARLES E. PEERY
19 ON BEHALF OF THE RESPONDENTS

20 MR. PEERY: Mr. Chief Justice, and may it
21 please the Court:

22 The issue here, Respondents submit, is whether
23 domestic law limits upon IRS summons authority are
24 expanded by the treaty with Canada, which is the subject
25 of these cases. Should the IRS be required to comply

1 with domestic revenue laws of the United States when it
2 asks the courts to lend their process and their
3 authority to enforce an IRS summons for the purpose of
4 obtaining information for a foreign government?

5 Under a specific treaty which incorporates and
6 -- by reference -- and defers to the revenue laws of the
7 United States of America, Respondents submit that the
8 answer properly is the one given by the Ninth Circuit in
9 these consolidated cases below.

10 QUESTION: Mr. Peery, the subsections, I
11 guess, you're talking about, 7602(c) and so forth, speak
12 of the Justice Department which surely refers to the
13 United States Justice Department, doesn't it?

14 MR. PEERY: Yes. There are cross-references
15 in Articles XIX and XXI to the departments of the two
16 governments. Revenue Canada is referred to
17 specifically, and the Commissioner of the Internal
18 Revenue in the United States is, is referred to
19 specifically. But, both of them -- both of those
20 sections, XIX and XXI of the treaty, refer to the
21 domestic laws, revenue laws of each of the countries,
22 and that's what gets us to Section 7602.

23 QUESTION: Yes. But how do you get from
24 Section 7602's reference to the Justice Department to
25 kind of a renvoi-type reference to Canadian procedure.

1 we don't know that the Canadian procedure. we don't
2 know that the Canadian justice department plays the same
3 role in collection of Canadian taxes that our Justice
4 Department does.

5 MR. PEERY: Actually, in these cases I believe
6 we do now know something about the method and approach
7 of the Canadian tax authority and their
8 interrelationship with the Canadian Department of
9 Justice, and it is very much like the system in the
10 United States, so that the burdensome inquiry that the
11 government has raised I submit really does not apply to
12 this case.

13 In the, the supplemental brief that we filed,
14 we refer to an, an international tax article which
15 appeared just last month which quotes from a section of
16 the operations manual of Revenue Canada instructing its
17 agents specifically how to act with respect to requests
18 for information from the IRS in the United States.

19 And in that instruction it specifically says
20 that the summons authority of the IRS in the United
21 States may not be used after a referral to the
22 Department of Justice for prosecution, and further
23 instructions its revenue agents that if they want
24 information from the United States, they must ask for it
25 under summons prior to their own referral to their own

1 Justice department.

2 QUESTION: And you think our interpretation of
3 our law should be governed by Revenue Canada?

4 MR. PEERY: No, sir, I was just saying --

5 QUESTION: I mean, why -- why? I'd much
6 rather have it governed by our Justice Department than
7 Revenue Canada, if it comes to that.

8 MR. PEERY: It ought to be governed by the
9 totality of the revenue laws of the United States, which
10 is what the treaty requires and which incorporates,
11 certainly, 7602 and its procedures and the other
12 treaties.

13 QUESTION: You bring before us one, one case
14 out of however many treaties Mr. Wallace said there were
15 in which it may be easy to analogize the, the, the
16 revenue system of the country in question with that of
17 the United States, but I, I doubt whether, whether it's
18 possible with a lot of the other countries.

19 And, and certainly in determining whether the
20 rule you're urging upon us is, is a rule that can
21 possibly have been intended, it's relevant whether we
22 know anything about the internal revenue systems of
23 these other countries. Just because you pick one
24 country that we might doesn't, doesn't justify us in
25 adopting the rule you're, you're suggesting.

1 MR. PEERY: Well, Your Honor, we have a
2 specific factual situation in this case, and I, I intend
3 to address the broader rule that this Court is certainly
4 interested in.

5 But we have a specific treaty with Canada.

6 QUESTION: The Philippines, for example. Do
7 we have a, a treaty with the Philippines?

8 MR. PEERY: I don't know that.

9 QUESTION: Oh, I see. They're all listed in
10 the book.

11 Let's pick the most exotic country that's,
12 that's listed in Mr. Wallace's footnote.

13 MR. PEERY: Probably a Communist country as
14 counsel --

15 QUESTION: Right. Now, how are we supposed to
16 behave with respect to a referral requirement from such
17 a country?

18 MR. PEERY: We point to the treaty with that
19 country which refers specifically to the domestic tax
20 revenue law of the United States, and we tell that
21 country or have the IRS to tell that country that when
22 you make a request of the IRS for information which may
23 require our summons power, then tell us, certify to us
24 that you do not presently have a criminal prosecution
25 matter pending in this instance for which you, you are

1 asking for this information.

2 I think we can reduce it to, if we need to, to
3 one question. The Ninth Circuit below posed two
4 questions because they were dealing with a specific
5 treaty and a specific country, Canada, and the
6 government had said and admitted before the Ninth
7 Circuit below that it had that information and could
8 have supplied and would have --

9 QUESTION: What -- but, but, you see, you, you
10 have two different organizations in this country. One
11 does the IRS investigation and the other does the
12 criminal investigation. What if you're dealing with a
13 country where there's just one unit that does all
14 investigations?

15 If it, it, it conducts the investigation and
16 if it digs up enough stuff to prosecute criminally, it
17 prosecutes criminally. It's meaningless to have this,
18 this referral distinction. In such a country you could
19 never say there's no criminal investigation pending
20 because there's, there's no distinction between a
21 criminal investigation and an IRS investigation.

22 MR. PEERY: Perhaps I misspoke, Your Honor. I
23 believe I said criminal prosecution. I make that
24 distinction as a very important one.

25 The functions of criminal investigation and

1 civil investigation are mixed in our system, and they
2 are abroad. They certainly are in Canada.

3 But then, the distinction really should be
4 between investigation and prosecutorial function, and
5 the test, the question that the Ninth Circuit has posed,
6 the two questions which I've reduced perhaps to one, is
7 certification of whether or not there's a pending
8 criminal prosecution matter.

9 QUESTION: But what, what does that mean when,
10 when you come to apply? Does it mean that a, a
11 complaint or whatever -- indictment, whatever, might be
12 filed in the Philippines has been filed in court?

13 MR. PEERY: Well, I'm not asking the court
14 system or the IRS to investigate, although they say that
15 they do look into the motivations of the requesting
16 country. Perhaps that's question for another case.

17 QUESTION: But what, what I mean to ask you
18 was you say is there a criminal prosecution. You put
19 that, it seems to me, as if that's a very definite type
20 of standard. But, really, what does it mean? Does it
21 mean are authorities investigating with the possibility
22 of, of filing, filing what would correspond to an
23 indictment or is there an indictment already filed?
24 Which of those?

25 MR. PEERY: Well, we -- we not only have

1 problems of differences in countries' approach to these
2 matters, but differences in language, and what -- I
3 think that a treaty partner asking us for information in
4 this country ought to educate themselves about the
5 difference between prosecution and investigation and
6 should be able to comply with that request.

7 QUESTION: Well, what -- in this country it's
8 one function is in one division and another function is
9 in another division. But as Justice Scalia points out,
10 in a country where they don't have that separation of
11 functions, the, the question really would be very
12 difficult to answer, I would think.

13 MR. PEERY: well, I believe it is. There are
14 difficulties in administering treaties, but the focus
15 here, as these cases arise procedurally and come before
16 this Court is that the courts of this country, the
17 federal district court in this case is being asked to
18 lend its process and its authority to the enforcement of
19 a summons to get information from another country under
20 a treaty which specifically refers to the domestic
21 revenue laws of the United States.

22 And I think the answer is that we tell our
23 treaty partners that these are the requirements under
24 the domestic revenue laws of the United States; that
25 there not be a pending criminal prosecution matter for

1 which this information is requested.

2 And they should comply. We must do the same
3 with respect to asking for information from Canada.

4 The briefing indicates that we, we defer to
5 Canada's interpretation of their own procedural
6 requirements and comply with it when we -- when the IRS
7 asks for information from Revenue Canada.

8 QUESTION: What, what would the Canadians or
9 the Philippine government -- say, the Philippine
10 government do if they have a single unit that
11 investigates both civil and criminal matters and they
12 are simply studying the file? Is that a pending
13 prosecution?

14 MR. PEERY: It doesn't sound like it to me.
15 But, again, I would require the treaty partner to
16 comply --

17 QUESTION: But it's -- but it's your test, and
18 if you can't even explain to us how the government
19 should answer under its test, then it's not a very
20 strong test.

21 MR. PEERY: Well, it is because the entire
22 body of United States law makes a very important
23 distinction between civil and criminal, criminal matters.

24 There are protections available to the
25 individuals in our country in criminal matters that

1 don't exist in civil. It's an important concept in, in
2 the law of the United States, and the law of the United
3 States is incorporated into the treaty.

4 I think we have a right because the language
5 is there in the treaty to require the treaty partner to
6 understand enough about our system to be able to use
7 that distinction in its request for information.

8 I admit, it's not an easy test. But I think
9 the way to do it is to refer to the domestic revenue law
10 of the United States, as the treaty does.

11 QUESTION: Mr. Peery, I guess you are not
12 arguing to us here that under this treaty that the only
13 information sought can be information relevant to an
14 inquiry concerning an Internal Revenue tax of the United
15 States? You're not making that argument?

16 MR. PEERY: Well, I think there was, was
17 support at the time the Burbank case was, was argued for
18 the position that absent a specific authorization to the
19 IRS to acquire information for a foreign government,
20 none exists. I think that restriction was made --

21 QUESTION: But you are not making that
22 argument to us? That's not --

23 MR. PEERY: I'm not. I'm not, because of --
24 my understanding was that a certiorari was denied in the
25 Burbank case, and we've not raised that specific

1 argument, although I believe, I believe there's merit to
2 it.

3 QUESTION: And the court below did not, of
4 course, rest its holding on that matter?

5 MR. PEERY: No. It assumed, as Mr. Wallace
6 has pointed out, that under the Burbank case and others
7 that the summons authority of the IRS could be used to
8 meet its obligations under the -- under the treaty.

9 QUESTION: Of course certiorari denied doesn't
10 mean we agree with it, necessarily.

11 MR. PEERY: That's true, Your Honor. Again,
12 I, I feel there are substantial arguments in support of
13 the proposition that absent a specific authority to use
14 the summons for this purpose, none exists. But
15 certainly where -- that gets us into the interpretation
16 of treaties to effectuate their purpose.

17 QUESTION: You're, you're not raising the
18 argument -- you're just, just in case I might disagree
19 with Burbank, you're asking me to imagine what kind of
20 authority I think the United States would have if the
21 United States had authority. That's what you want me to
22 tell you?

23 MR. PEERY: Well, the question was asked
24 earlier by the Court of Mr. Wallace, would the treaty be
25 a nullity without the summons authority of the IRS, and

1 I believe Mr. Wallace answered no. So, the issue is, is
2 raised in, in questioning by the Court.

3 Respondents submit that the Ninth Circuit's
4 opinion below in these consolidated cases is supported
5 by the language of the treaty contract, the actual
6 practice of the treaty partners and the language and
7 purposes of the subsequent tax treaties between the
8 United States and Canada; that is, the 1980 treaty and
9 the 1985 treaty specifically for the purpose of aid in
10 criminal tax matters. All of them require the
11 application of the domestic United States revenue laws.

12 Secondly, a legitimate purpose showing is
13 required under United States revenue laws and, thirdly,
14 use of an IRS summons for the specific purpose of
15 criminal prosecution is specifically rejected by the
16 courts in, in the cases and by Congress in the TEFRA
17 amendments, making that, that use not a legitimate
18 purpose.

19 The fourth point that I would like to make is
20 that the IRS has admitted that it is its customary
21 practice in domestic cases in applying to the courts for
22 enforcement of their summons to state that there has
23 been no referral for criminal prosecution.

24 So, it's a matter of customary practice in
25 domestic cases and, again, the treaty refers to the

1 domestic law and practice in the United States.

2 Fifth, I submit that, that the results of the
3 Ninth Circuit's holding is fair with respect to the
4 balancing of the interests between the individuals and
5 the IRS, it's practical in application, it's efficient
6 and it promotes uniformity between domestic practice and
7 the tax treaty case information requirements.

8 I submit that the --

9 QUESTION: May I ask on your view of the
10 matter, do you think it requires an inquiry into the
11 good faith of the Canadian taxing authorities?

12 MR. PEERY: No, sir, not at -- at this stage,
13 although this Court in LaSalle certainly for domestic
14 purposes has left open the area of institutional good
15 faith. Again, domestic cases and I 'm not --

16 QUESTION: If we're talking about a domestic
17 matter and we were persuaded there was bad faith on the
18 part of the IRS even though the matter had not yet been
19 referred for prosecution --

20 MR. PEERY: Some other kind of bad faith.

21 QUESTION: -- that would defeat the summons
22 enforcement, would it not?

23 MR. PEERY: Yes, and it should, and that's a
24 proper area of inquiry.

25 QUESTION: Well, then, why should it not also

1 defeat it in the Canadian context?

2 MR. PEERY: Well, I, I believe that --

3 QUESTION: If you're saying the same law
4 applies to both.

5 MR. PEERY: Sure. And I believe that's true.
6 It should.

7 QUESTION: So, therefore --

8 MR. PEERY: I think it's a proper area of
9 inquiry if there's, there's a showing which fairly
10 raises the issue of, of bad faith.

11 QUESTION: You'd require -- I see. But if
12 there were, you --

13 MR. PEERY: I'm saying --

14 QUESTION: -- if the burden is on the taxpayer
15 or the, the, the person resisting the summons, why has
16 that burden been discharged in this case, then?

17 MR. PEERY: Because I think there's a
18 difference. The clearly prohibited purpose of using IRS
19 summons for -- in support of criminal prosecution is a
20 different matter. I mean, it has been discussed by
21 Congress, it's been discussed by this court and other
22 courts repeatedly, and everybody agrees. It's
23 unanimous, that use of the IRS summons for criminal
24 prosecution purposes is prohibited.

25 QUESTION: Then why shouldn't it be on the

1 taxpayer's burden or the, the person raising the issue's
2 burden to say it is being used for such a purpose in
3 Canada? There's no showing either way, as I understand
4 it?

5 MR. PEERY: That's right. We have no
6 information, and the Ninth Circuit, I think, pointed out
7 the real problem. It's a dilemma. It's a Catch-22 for
8 the taxpayer at that point because there's no discovery
9 available to get the kinds of information which would be
10 necessary to meet that burden of proof on the taxpayer,
11 whereas the IRS said below that it had that
12 information. It was given an opportunity to amend its,
13 its summons, its affidavit in support of summons
14 application, and, and it chose not to do that.

15 This case would have been long over had the
16 IRS gone back, amended its affidavit to show the answer
17 to those two, two questions that the Ninth Circuit posed.

18 Has it been referred in Canada to the
19 Department of Justice in Canada or is Revenue Canada
20 asking for this information on behalf of the Department
21 of Justice, the criminal prosecution arm?

22 QUESTION: Mr. Peery, does the record show why
23 these Canadian citizens have the American bank accounts?

24 MR. PEERY: No, sir, and I have no idea. I
25 was not involved at that point.

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QUESTION: There is --

MR. PEERY: And there's no record. There is no record to show why. But, of course, American --

QUESTION: They're your clients, aren't they?

MR. PEERY: Yes, sir.

QUESTION: But you have no idea?

MR. PEERY: No. Of course, there is no prohibition against Americans having bank accounts in Canada, either. It happens frequently and, of course, there's a great deal of commerce between the two countries. Corporations have accounts in, in both countries.

QUESTION: Well, they might have been doing business in this country at one time, set up an account, and just kept it.

MR. PEERY: That's what I would assume.

QUESTION: Nothing like that in the record?

MR. PEERY: No, but there's a lot of commerce between Washington State and British Columbia, which is where this, this factual situation arises, and I would assume that these were commercial matters at one time and may still be.

QUESTION: But you don't know?

MR. PEERY: I do not know that, sir.

I submit that the Ninth Circuit's rating of

1 the language of the specific tax treaty, 1942 treaty,
2 which it found applies here, is the correct one; that
3 Article XIX refers specifically to the revenue laws of
4 the two contracting states, the United States and
5 Canada. It does not refer to the criminal tax laws or
6 the criminal case law of either country. It's
7 specifically aimed at the revenue laws of the two
8 nations.

9 Article XXI specifically describes the
10 procedures for requests by the Canadian Minister of the
11 Department of Natural -- National Revenue and
12 specifically talks about the kind of information which
13 may be furnished by the Commissioner of the Internal
14 Revenue Service of the United States in the following
15 language: "Such information as the Commissioner is
16 entitled to obtain under the revenue laws of the United
17 States of America."

18 I submit that that language could not be
19 plainer; that the intent when Department of Revenue or
20 Revenue Canada asks the IRS for information is
21 controlled by what is available to the IRS Commissioner
22 under the revenue laws of the United States of America.

23 They include Section 7602, which was the basis
24 for the IRS petition below for summons enforcement in
25 these consolidated cases. And 7602 sub (c) prohibits

1 issuance of a summons and the beginning of any action to
2 enforce any summons if a Justice Department referral is
3 underway.

4 This is a codification by Congress in the
5 TEFRA amendments in 1982 of that bright line test that
6 the minority suggested in the LaSalle National Bank case
7 from this court in 1978.

8 It was intended, I submit, to distinguish
9 between the civil revenue purposes which are proper
10 areas for investigation by the IRS, a legitimate
11 purpose, and criminal prosecution, which is not a
12 legitimate purpose.

13 QUESTION: Why is it the United States is
14 concerned as to how Canada goes about investigating tax
15 delinquencies there?

16 MR. PEERY: Well, I, I think it need not be
17 concerned at this point, certainly, in these cases. It
18 only is appropriate to apply the domestic revenue laws
19 of the United States when the treaty partner, Canada,
20 asks for information.

21 And it's been very important in the
22 development of the case law and the, and the code by
23 Congress for guidance of the Internal Revenue Service
24 that there be a clear dichotomy in the Revenue Service's
25 activities between criminal prosecution, which is not

1 authorized, and civil investigation.

2 QUESTION: Well, that dichotomy has obviously
3 been enacted in the TEFRA amendments. But why should it
4 carry over to our concern for the relationship between a
5 Canadian -- the Canadian government and a Canadian
6 taxpayer?

7 MR. PEERY: I'm not urging that we be
8 concerned except insofar as Canada might be harassing a,
9 a United States citizen with respect to the use of its
10 revenue department in asking the IRS to lend its weight
11 to that. I'm not -- that is not the focus of the
12 Respondents' argument and point here.

13 The focus is that the domestic revenue laws of
14 the United States apply, and if a treaty partner asks
15 for something within the United States and the IRS to
16 get it with its summons authority, it has to comply with
17 domestic United States revenue law.

18 QUESTION: So you say that that language can
19 be only read in one way?

20 I, I think that my point is that if the
21 language isn't quite as clear as you think, it doesn't
22 make much policy sense to, to adopt your suggestion if
23 the other one is equally plausible under the language.

24 MR. PEERY: Well, I think we certainly ought
25 to be reluctant to make an inquiry into the domestic

1 affairs of a, of a foreign government, a treaty
2 partner. I agree with Mr. Wallace about that.

3 But, I'm saying that the test and approach
4 applied by the, by the Ninth Circuit does not require
5 that, and that's not this case.

6 The Revenue Service admitted below that it had
7 information from Revenue Canada that they had not
8 referred the matter to the Department of Justice in
9 Canada and that they were not asking for the information
10 on behalf of the Department of Justice. So, it would
11 not, in these cases, have require any kind of
12 investigation into the internal workings of Revenue
13 Canada or its Department of Justice.

14 I submit that the 1980 treaty, which was
15 ratified somewhat after the LaSalle case, actually
16 served to apply the judicial gloss -- that is, the
17 entire body of the revenue laws of the United States,
18 and referred to it quite specifically.

19 The government concedes in its brief on page
20 4, footnote 3, that the language and purpose of the 1980
21 treaty are essentially identical to the language and
22 purpose of the 1942 treaty, and its purpose is to obtain
23 information for each of the parties in the same way as
24 if its own taxation were involved. So, there's another
25 referral specifically in the 1980 treaty to the domestic

1 revenue law of the country who is being requested to
2 provide the information.

3 Subsection 3 of Article XXVII provides with
4 respect to the, the process that -- of construction of
5 that treaty that the preceding paragraphs are to be
6 construed so as to impose an obligation -- they're not
7 to be construed, I'm sorry, so as to impose an
8 obligation to supply information not obtainable under
9 the laws or in the normal course of administration of
10 either of the contracting states.

11 QUESTION: Mr. Peery, can I interrupt you
12 there for just a second?

13 MR. PEERY: Surely.

14 QUESTION: These banks that have the
15 information, the one bank I guess, isn't it, somewhere
16 in Washington, is an American bank.

17 MR. PEERY: Yes, sir.

18 QUESTION: And the Canadian citizens have an
19 account in the American bank?

20 MR. PEERY: Yes, sir.

21 QUESTION: Now, isn't it possible that those
22 Canadian citizens would have an income tax obligation in
23 the United States by reason of interest earned on that
24 account or something like that?

25 MR. PEERY: It is possible, but there was no

1 domestic revenue purpose indicated.

2 QUESTION: Well, but at least it would be
3 permissible, would it not, for IRS to say I'd like to
4 check the bank records there to see if these foreign
5 citizens might owe some federal taxes.

6 MR. PEERY: Certainly.

7 QUESTION: And if so, that information would
8 be obtainable purely for domestic purposes pursuant to
9 the, to the United States statute.

10 MR. PEERY: And it can even be a mixed purpose.

11 QUESTION: Why isn't that the whole answer to
12 the case?

13 MR. PEERY: Well, it's not, because of the
14 court's concerns and the Congress' concerns that the
15 important dichotomy between civil and criminal.

16 QUESTION: But there's no criminal -- if
17 they're just looking at the American purposes, there is
18 not even a suggestion that there has been any American
19 referral for -- to the Department of Justice.

20 MR. PEERY: That's true. And if that had been
21 the basis for the inquiry, looking at --

22 QUESTION: Well, it hadn't been the basis, but
23 it was -- it could be done pursuant to American law is
24 what I'm saying.

25 MR. PEERY: Yes, it could.

1 QUESTION: For just that limited purpose.

2 MR. PEERY: The problem arose because the
3 information was furnished indicated clearly that the
4 authority for the inquiry that the IRS was using was the
5 tax treaty with Canada and Section 7602, and there was
6 an indication that Revenue -- that Canada was
7 investigating for criminal purposes creating, certainly,
8 an ambiguity that needed to be explored.

9 And we, we only asked for the information that
10 the Ninth Circuit required the IRS to provide on remand.

11 I submit that another reason for the
12 interpretation -- in support of the approach of the
13 Ninth Circuit is that -- and against the Manufacturers
14 Trust holding by the Second Circuit -- is that, that
15 there's no justification in the body of the law or the
16 treaty or in reason to create a separate set of
17 entitlements for, for the IRS commissioner to use -- a
18 legal fiction, I submit, in order to get information
19 from a -- for a foreign country in the United States in
20 a manner which exceeds the authority for domestic
21 purposes.

22 In our supplemental brief we've referred to
23 the 1985 Treaty on Mutual Legal Assistance in Criminal
24 Matters, and I submit that that evidences the
25 acknowledgment by the treaty partners, Canada and the

1 United States, of the important distinction between
2 criminal prosecution matters and civil tax revenue
3 matters, and that treaty is now before the United States
4 Senate for, for ratification.

5 It sets up a separate system and approach for
6 the sharing of information in those matters which are,
7 are criminal tax matters, and I submit quite
8 appropriately. It uses the Departments of Justice to
9 exchange information, and it is within the context and
10 framework of the criminal law protections that exist for
11 the citizens of this country.

12 And I think I would urge -- what we see from
13 that is that the executive, at least on one hand,
14 agreeing with Congress and with the opinions of the
15 courts is now saying that if it's a criminal prosecution
16 matter, we ought to call it that, have a separate
17 procedure for handling it as a criminal prosecution and
18 proceed that way.

19 The Ninth Circuit's approach and the
20 requirement on the IRS to make a prima facie showing of
21 a legitimate purpose including the absence of the
22 prohibited purpose of criminal prosecution I submit is
23 fair, and it's to -- in the allocation of the
24 responsibilities and information available to the two
25 parties. It's practical because it, it complies with

1 the practice of the parties, the Revenue Service and
2 Revenue Canada. It's efficient because it requires the
3 information to be supplied by the, the party which has
4 best access to the that information, and that's the IRS,
5 and it's uniform in that it promotes an identity of
6 approach for the courts to use when they're considering
7 petitions for enforcement of IRS summons, whether they
8 arise in the domestic setting or by means of a, of a
9 request under a treaty.

10 QUESTION: Mr. Peery, do you know what the --
11 what would happen if the situation were reversed and our
12 government was asking Revenue Canada to investigate
13 American accounts up in British Columbia? Would they
14 look at this dichotomy prevalent in the United States
15 between a civil investigation and a criminal one, a
16 criminal referral?

17 MR. PEERY: They look at their own, Your Honor.

18 QUESTION: They look at their own?

19 MR. PEERY: I believe the government's brief
20 has pointed that out. That is the actual procedure, and
21 certainly it's, it's reflected in the, in the recent law
22 review article that I --

23 QUESTION: And does it parallel ours entirely?

24 MR. PEERY: Not entirely, but there is that
25 dichotomy and distinction between prosecution and

1 investigation, and so there's no problem in compliance
2 in Canada with, with that distinction.

3 QUESTION: Is it true in Pakistan or the
4 Philippines?

5 MR. PEERY: I would just have to say they have
6 to understand enough about our domestic revenue laws
7 which, which control their rights to information under
8 the treaty, Your Honor.

9 CHIEF JUSTICE REHNQUIST: Thank you, Mr. Peery.
10 Mr. Wallace, you have two minutes remaining.

11 REBUTTAL ARGUMENT OF LAWRENCE G. WALLACE

12 ON BEHALF OF THE PETITIONER

13 MR. WALLACE: If I may refer the court to the
14 pertinent statutes at the end of our brief, pages 2a and
15 3a, first of all, Section 7602(b) at the bottom of 2a
16 says that a permissible purpose for the issuance of a
17 summons is to get information about a criminal offense.
18 That is not the limitation that Congress has placed.

19 The limitation is in subsection (c) about
20 Justice Department referrals being in effect, and the
21 line drawn there is not a line about whether a
22 prosecution is pending. It is the question whether
23 Treasury has recommended to Justice that it undertake a
24 grand jury investigation or a prosecution or whether
25 Justice has requested information from Treasury

1 regardless of whether a prosecution is actually pending.

2 And the reason for this limitation on the
3 summons enforcement authority was explained by the
4 Senate report in language set forth on page 17 of our
5 brief. It was so as to not to broaden the Justice
6 Department's right of criminal discovery or to infringe
7 on the role of the grand jury.

8 It was a reason that had to do with the
9 division of functions between domestic institutions in
10 this country and reflected the language of this court's
11 LaSalle decision.

12 QUESTION: Well, but if we adopted that, Mr.
13 Wallace, I assume we would have to adopt (b) as well; I
14 mean, that is to say we would not -- if we adopted your
15 opponent's argument, we would have to say you also can't
16 use the IRS' power if the foreign country is conducting
17 a criminal investigation, even though there's no
18 criminal prosecution pending. You can't use it for the
19 purpose of inquiring into a criminal offense.

20 MR. WALLACE: Well, (b) says you can use it
21 for the purpose of inquiring into a criminal offense,
22 Mr. Justice. Congress specifically authorized the use
23 of an IRS summons for that purpose and put an end to
24 inquiry about whether the IRS had --

25 QUESTION: I see.

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MR. WALLACE: -- had the purpose of inquiring into a criminal defense, and instead drew the bright line about whether a referral is in effect.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Wallace. The case is submitted.

(Whereupon, at 11:03 o'clock a.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

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87-1064 - UNITED STATES, Petitioner V. PHILIP GEORGE STUART, SR., ET AL.

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