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**In the Matter of a Grand Jury Supoena to Marc Rich & (and) Company, A. G.:
Preventing Evasion of U.S. Tax Laws by Foreign Companies**

Keywords

Jury, Documents, States, Defendants, Jurisdiction

***In The Matter of a Grand Jury
Subpoena to Marc Rich & Company, A. G.:
Preventing Evasion of U.S. Tax Laws
By Foreign Companies***

A federal grand jury recently investigated an alleged tax evasion scheme whereby a Swiss-based commodities concern, Marc Rich & Company, A.G. (hereinafter AG), allegedly attempted to evade U.S. tax law by diverting income from its wholly-owned U.S. subsidiary, Marc Rich & Company International, Ltd. (hereinafter International) to the parent firm.¹ A grand jury subpoena duces tecum was served on the U.S. subsidiary, International, on March 9, 1982.² International complied with the subpoena and began to produce the business records requested.³

On April 15, 1982, a subpoena duces tecum was served upon the counsel of International for the production of documents held by AG.⁴ Counsel for International accepted the service on behalf of International but did not purport to accept service for AG.⁵ AG's board of directors determined that compliance with the subpoena would violate Swiss law and resolved not to comply and instead sought to establish the ineffectiveness of the subpoena.⁶

I. THE UNITED STATES DISTRICT COURT'S DECISION

On June 4, 1982, AG filed a motion to quash the subpoena, for lack of in personam jurisdiction, in the United States District Court for the Southern District of New York.⁷ On August 25, 1982, the motion to quash was denied.⁸ In denying AG's motion, United States District Judge Leonard Sands determined that the court had jurisdiction to enforce the subpoena despite claims by AG to the contrary. AG contended that its business was deliberately structured so as to avoid any contact with the United States and that it was therefore not subject to the court's jurisdiction.⁹ The government, however, asserted that AG's wholly owned subsidiary, International, provided a sufficient basis for an assertion of jurisdiction.¹⁰

1. See Wall St. J., Aug. 22, 1983, at 17, col. 3.

2. Brief for the United States of America at 2, In the Matter of a Grand Jury Subpoena Directed to Marc Rich & Co., A.G., No. 82-6226 (2d Cir. 1983) [hereinafter cited as Brief].

3. *Id.*

4. In the Matter of a Grand Jury Subpoena Directed to Marc Rich & Co., A.G., No. M-11-188 at 2 (S.D.N.Y. Aug. 25, 1982) [hereinafter cited as District Court Opinion].

5. *Id.*

6. *Id.* at 2-3.

7. Brief, *supra* note 2, at 3.

8. District Court Opinion, *supra* note 4, at 19.

9. *Id.* at 1.

10. *Id.*

In determining that there was in fact a proper assertion of jurisdiction, the court first considered the problem via a "burden of proof" analysis.¹¹ Noting the difference between a grand jury proceeding and a civil case, the court found that "the appropriate allocation of the burden of proof is as follows: once the moving party raises the issue of jurisdiction, the Government must show that it has a good faith basis for asserting jurisdiction; thereafter, the burden of proof shifts to the party challenging jurisdiction."¹² Then, applying New York law, the court determined that "if the subject matter of the investigation is related to the contact with the jurisdiction, the grand jury's exercise of its subpoena power should not be invalidated by the court."¹³

In deciding that the subject matter of the investigation *was* related to the contact with the jurisdiction, the court considered an *ex-parte* affidavit submitted by the government.¹⁴ In answer to AG's protest concerning the unfairness of an *ex-parte* affidavit, the court noted the government's allegation that disclosing the name of the informant would jeopardize the investigation, and stated:

The Court is thus placed in the position of having to balance the Government's need to maintain in secret the identity of the informant and the movant's need to know the asserted grounds for jurisdiction in order to refute them. AG's need for the information is heightened since the Court has imposed the burden of proof on it. Under the circumstances presented in this case, we will consider the *ex-parte* affidavit, because the Government has generally revealed its contents and demonstrated the significance of the secret information, and because the need for secrecy appears to be genuinely invoked. In order to mitigate the possible unfairness to the AG, we will only hold AG to a burden of proof which addresses the general disclosure made to AG.¹⁵

Finding that AG had not met its burden of proof,¹⁶ the court went on to consider whether or not a Swiss statute barring disclosure of a "busi-

11. *Id.* at 8.

12. *Id.* at 10. The circumstances which the court referred to included the fact that ordering discovery to permit the government to substantiate its assertion would necessarily force production of the documents in question. The court also noted that it would be particularly important for the Government to reach the documents if it was to bear the burden of proof.

13. *Id.* at 16. It is interesting to note that both the Brief for the United States and the Opinion of the Second Circuit Court of Appeals criticized the application of New York law by Judge Sands. See Brief at 9 and *In Re the Matter of a Grand Jury Subpoena Directed to Marc Rich & Co., A.G.*, No. 82-6226 at 7 (2d Cir. May 4, 1983) [hereinafter cited as Second Circuit Opinion].

14. District Court Opinion, *supra* note 4, at 7. The *ex-parte* affidavit revealed that International structured its resales to direct \$20,000,000 in domestic income overseas to the parent company, so as to avoid U.S. taxation.

15. *Id.* at 13.

16. *Id.* at 17. In so finding, the court noted that AG had failed to explain the massive losses incurred by International.

ness secret' to a foreign government"¹⁷ would require the subpoena to be quashed.¹⁸ Noting that AG had shown by affidavit that the delivery of the requested documents would violate Swiss law,¹⁹ the court balanced the interests of the United States and Switzerland ²⁰ and decided:

[T]he interest of the United States in investigating violations of its tax laws outweighs the Swiss interest in avoiding possible disclosure of business secrets in this case. The Government has made a substantial showing indicating that AG used its United States subsidiary to convey income to it overseas in circumvention of United States tax laws. To permit AG to shield this conduct from the scrutiny of the grand jury would be a "travesty of justice."²¹

Subsequent to this decision, AG continued to refuse to produce the business records and on September 13, 1982, a judgment of civil contempt was entered against AG in the United States District Court for the Southern District of New York.²²

II. THE SECOND CIRCUIT OPINION

Marc Rich & Company, A.G. appealed the contempt order in the United States Court of Appeals for the Second Circuit. The court noted:

It would be strange, indeed, if the United States could punish a foreign corporation for violating its criminal laws upon a theory that the corporation was constructively present in the country at the time the violation occurred [citation omitted], but a federal grand jury could not investigate to ascertain the probability that the crime had taken place.²³

The court then stated that the issue involved was whether or not the District Court had such personal jurisdiction over AG that it could enforce

17. *Id.*

18. *Id.*

19. *Id.* at 20 n.2. The *Schweizerischer Strafgesetzbuch*, *Code pénal suisse*, *Codice penale svizzero*, art. 273, provides in part:

a person who discloses a manufacturing or business secret to a foreign governmental authority or to a foreign organization or to a foreign private enterprise or their agents, shall be punished with prison, in severe cases with jail. The imprisonment may be combined with a fine.

20. In balancing the interests of each country the court considered:

- (a) vital interests of each of the states,
- (b) the extent and nature of the hardship that inconsistent enforcement actions would impose upon the person,
- (c) the extent to which the required conduct is to take place in the territory of the other state,
- (d) the nationality of the person, and
- (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.

Id. at 18, citing *United States v. First National City Bank*, 366 F.2d 897, 902 (2d Cir. 1968).

21. District Court Opinion, *supra* note 4, at 18.

22. Brief, *supra* note 2, at 1.

23. Second Circuit Opinion, *supra* note 13, at 5.

obedience to the grand jury subpoena.²⁴

Referring to *McGee v. International Life Insurance Company*,²⁵ the court stated that it subscribed to the notion that "where a person has sufficiently caused adverse consequences within a state, he may be subjected to its judicial jurisdiction so long as he is given adequate notice and an opportunity to be heard."²⁶

Commenting that if, in fact, there was a conspiracy between AG and International to evade the tax laws, both a conspiracy and at least part of the conspiratorial acts would have occurred within the United States. The court went on to state that service upon AG's officers within the territorial boundaries of the United States was sufficient to warrant judicial enforcement of the subpoena.²⁷

The Second Circuit concluded its opinion by affirming the decision of the lower court and stating that "in a case such as this, if the Government shows that there is a reasonable probability that ultimately it will succeed in establishing the facts necessary for the exercise of jurisdiction, compliance with the grand jury's subpoena may be directed."²⁸

III. CONCLUSION

In light of the above decisions on the *Marc Rich* case, it is clear that case law is beginning to strengthen the idea that a federal grand jury should have access to overseas documents.²⁹ Just how far these decisions will reach, however, and to what extent they will prove effective against foreign companies seeking to evade U.S. tax laws remains to be seen. For example, despite the decisions of the federal district and circuit courts, the United States has yet to receive the requested documents from Marc Rich & Company, A.G. As of June 29, 1983, fines of \$50,000 per day were being assessed against AG for its refusal to comply with the subpoena served upon it by U.S. District Court for the Southern District of New York.³⁰ After finally agreeing to comply with the subpoena, AG attempted to ship documents to Switzerland, maintaining that they had to be shown to a Swiss lawyer.³¹ Although the documents which the company attempted to ship were seized by federal agents at Kennedy International

24. *Id.* at 7.

25. 355 U.S. 220 (1957).

26. Second Circuit Opinion, *supra* note 13, at 7.

27. *Id.* at 9.

28. *Id.* at 14.

29. See the statement of U.S. attorney John Smietanka, *quoted in* Wall St. J., Aug. 22, 1983, at 17, col. 3.

30. Denver Post, Sept. 20, 1983, at F1, col. 2. It is also interesting to note that a 51-count indictment was handed down Sept. 19, 1983, by the grand jury charging that Marc Rich evaded \$48 million in taxes and "traded with the enemy" by purchasing \$200 million worth of oil from Iran during the Iranian hostage crisis. *Id.* at F1, col. 1-2.

31. *Id.* at F1, col. 3. U.S. Attorney R. Guillano has said that the Government is currently seeking to confiscate the stock in AG held by an affiliate and plans to attempt to extradite defendants who have fled the country.

Airport, some of the other subpoenaed documents were impounded in Switzerland by Swiss police. International negotiations have been entered into concerning the dispute.³²

The *Marc Rich* decisions of the United States District Court for the Southern District of New York and the U.S. Court of Appeals for the Second Circuit should serve greatly to improve the ability of U.S. officials to enforce United States tax laws against foreign corporations maintaining subsidiaries in the U.S. As long as a foreign company operates a wholly-owned subsidiary in the U.S., in personam jurisdiction can be exercised by U.S. courts to obtain essential financial records of any foreign company suspected of evading U.S. tax laws. While this legal tool will promote the effective enforcement of U.S. tax laws overseas, it may also jeopardize significantly the future of international business transactions. Only time will tell whether foreign companies will be prompted to decrease or abandon U.S. operations as a result of the *Marc Rich* decisions.

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32. *Id.*