Gerling International Insurance Company v. Commissioner, T.C. Memo. 1986-72 (1986)

A U.S. taxpayer cannot avoid discovery obligations by claiming inability to access records held by a foreign entity, particularly when the taxpayer has a treaty right to inspect those records and there is evidence of control over the foreign entity; failure to adequately comply with discovery can result in sanctions, including evidentiary preclusion.

Summary

Gerling International Insurance Company, a U.S. corporation, contested tax deficiencies related to reinsurance business with Universale, a Swiss company. The IRS sought discovery of Universale's books and records to verify Gerling's claimed losses and expenses. Gerling objected, citing lack of control over Universale and Swiss law restrictions. The Tax Court found Gerling's discovery responses inadequate and ordered production of Universale's documents. When Gerling failed to comply, the court imposed sanctions, precluding Gerling from introducing Universale's records or related evidence at trial. The court reasoned that Gerling, as a U.S. taxpayer, must comply with U.S. law, and its treaty with Universale provided a right to access the records. The court balanced U.S. law enforcement with Swiss secrecy laws but ultimately prioritized the U.S. tax system's integrity.

Facts

Gerling International Insurance Company (Petitioner), a U.S. corporation, reinsured 20% of the risks of Universale Reinsurance Co., Ltd. (Universale), a Swiss corporation.

The IRS (Respondent) determined tax deficiencies against Petitioner, disallowing deductions for losses and expenses related to the Universale reinsurance, while accepting reported premium income.

Robert Gerling, president and a director of Petitioner and Chairman of Universale's Board, owned 8.82% of Petitioner's stock.

A reinsurance treaty between Petitioner and Universale granted Petitioner (Retrocessionaire) the right to inspect Universale's files related to the treaty (Article 8).

Respondent sought Universale's books and records through interrogatories and document requests to verify Petitioner's claimed losses and expenses.

Petitioner claimed inability to access Universale's records, citing lack of control and Swiss law.

Procedural History

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Respondent filed motions to compel answers to interrogatories and production of documents in Tax Court.

Petitioner filed initial and supplementary responses to interrogatories, which Respondent deemed insufficient.

Petitioner objected to the document request, claiming lack of possession, custody, or control, undue burden, and irrelevance.

The Tax Court considered Respondent's motions.

Issue(s)

1. Whether Petitioner's responses to Interrogatories 45 and 81 regarding Robert Gerling's relationship with Universale were sufficient.
2. Whether Petitioner was required to produce documents from Universale, a foreign corporation, in response to Respondent's request for production.
3. Whether the sanction of evidentiary preclusion was appropriate for Petitioner's failure to comply with discovery.

Holding

1. No, because Petitioner's responses were evasive and did not fully disclose the extent of Robert Gerling's shareholding and management role in Universale, which were relevant to the issue of control.
2. Yes, because Petitioner had a treaty right to inspect Universale's records and Robert Gerling's position suggested Petitioner could exert control over Universale to obtain the documents.
3. Yes, because Petitioner failed to make sufficient good-faith efforts to produce the documents, and evidentiary preclusion was a balanced sanction to protect Respondent's ability to challenge Petitioner's claims without resorting to dismissal.

Court's Reasoning

The court found Petitioner's discovery responses inadequate, particularly regarding Robert Gerling's role. The court inferred control based on Gerling's positions in both companies and his significant (though unspecified) stock ownership in Universale, stating, "Robert Gerling was, and is, in a position to cause Universale to act favorably upon a request by petitioner to make available to respondent… any and all books and records of Universale…"

The court emphasized Petitioner's treaty right to inspect Universale's files (Article 8), undermining the claim of inability to access records.

Relying on *Societe Internationale v. Rogers*, 357 U.S. 197 (1958), the court considered sanctions for non-compliance due to foreign law but distinguished

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dismissal as too harsh given potential good faith efforts, though deemed insufficient here.

Instead, the court imposed evidentiary preclusion, barring Petitioner from introducing Universale's records or related evidence. This sanction balanced U.S. law enforcement with Swiss secrecy concerns, ensuring Petitioner would not benefit from non-disclosure while avoiding outright dismissal.

The court quoted *Societe Internationale, Etc. v. McGranery*, 111 F. Supp. 435, 444 (D. D.C. 1953): "A claimant must take the law as he finds it; and cannot place himself in a better position than other litigants by invoking the laws and procedures of a foreign sovereign."

The court noted Petitioner's choice to operate as a U.S. corporation subjects it to U.S. law, which takes precedence over foreign laws in this context.

Practical Implications

This case highlights that U.S. taxpayers cannot use foreign secrecy laws to shield relevant financial information from the IRS, especially when they have contractual rights to access those records and there is evidence of control over the foreign entity.

It clarifies that U.S. courts will enforce discovery requests for foreign documents when taxpayers have sufficient control or access, even if direct ownership is lacking.

The case demonstrates the Tax Court's willingness to impose sanctions short of dismissal, such as evidentiary preclusion, to compel discovery compliance while balancing international legal considerations.

Legal practitioners must advise clients with foreign business dealings to be prepared to produce foreign records during tax disputes, particularly when control or access can be demonstrated.

Later cases may cite this case for the principle that evidentiary sanctions are appropriate when taxpayers fail to produce foreign documents under their control, especially in the context of treaty rights and indications of management influence.

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