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TAXATION—FEDERAL TAX LIENS—SECTION 6321 OF THE INTERNAL REVENUE CODE AS BASIS FOR INJUNCTION BINDING ASSETS OF FOREIGN BRANCH OF AMERICAN BANK—The Commissioner of Internal Revenue issued jeopardy assessments against the taxpayer, Omar, S.A., a Uruguayan corporation. To avoid payment, Omar began to liquidate its American-held assets by transferring receipts out of the country. Pursuant to its statutory right, under section 6321 of the Internal Revenue Code of 1954,[1] to impose a lien upon all property of a delinquent taxpayer, the United States brought suit against Omar and various New York banks in the domestic and foreign branches of which Omar's funds were deposited. The district court granted a preliminary injunction[2] restraining certain of the banks from transferring any property whether located in the United States or held by the banks for Omar in foreign branches. On appeal, *held,* injunction modified so as not to include property held by the foreign branches of the appealing American bank. Since a foreign branch bank is a separate entity from the parent bank, jurisdiction over the parent does not constitute jurisdiction over funds deposited in the branch. *United States v. First Nat'l City Bank,* 321 F.2d 14 (2d Cir. 1963).

The effect of section 6321 of the Internal Revenue Code of 1954 is to create a statutory attachment or garnishment without requiring court processes necessary in ordinary garnishment proceedings.[3] Where for some reason personal jurisdiction over the delinquent taxpayer is unobtainable, the Government is able to proceed in actions quasi in rem to enforce its lien on specific property[4] belonging to the taxpayer within the jurisdic-

1 INT. REV. CODE OF 1954, § 6321, provides: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." See also INT. REV. CODE OF 1954, §§ 6322, 6331, 6332.

2 The injunction issued pursuant to INT. REV. CODE OF 1954, § 7402(a), which grants jurisdiction to district courts "to make and issue in civil actions, writs and orders of injunction, and of *ne exeat republica,* orders appointing receivers, and such other orders and processes, and to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws." See also INT. REV. CODE OF 1954, § 7403.

3 See, *e.g.,* United States v. Eiland, 223 F.2d 118 (4th Cir. 1955), where the court held that "the effect of the federal taxing statutes . . . is to create a statutory attachment and garnishment in which the service of notice provided by statute takes the place of the court process in the ordinary garnishment proceeding." *Id.* at 121.

4 "Property" is here construed to include rights to property.

tion of the court.[5] In the principal case the court did not have in personam jurisdiction of Omar. Therefore, the crucial question was whether in personam jurisdiction of Omar's debtor, First National, conferred quasi in rem jurisdiction of Omar's funds. The Government argued that section 6321 has a global effect and therefore in personam jurisdiction of the bank's home office in New York was enough to establish quasi in rem jurisdiction of Omar's extraterritorial funds, since the home office could control the foreign branch. The majority of the court assumed that if it had no jurisdiction of Omar's funds outside the United States any injunction issued pursuant to the suit which purported to bind foreign-held assets was improper.[6] As a result, the majority examined the law of garnishment proceedings to determine whether the bank's debt to Omar was within the jurisdiction of the district court.[7] The nature of garnishment is such that the garnisher obtains no greater right against the garnishee than the garnishee's creditor has.[8] Thus, only if Omar could sue First National in New York to recover its deposits would the court have jurisdiction over the funds in the foreign branch. Omar's right to sue in New York depended on its right against First National arising out of a deposit made in the latter's branch. The nature of Omar's right to sue was to be determined by New York state law, for the federal tax lien statute creates no property rights, but merely attaches consequences to rights created under state law.[9] In holding against the Government the court relied on a line of New York cases which indicate that accounts in a foreign branch bank are not subject to attachment or execution by the process of a New York court served in New York on a main office, branch, or agency of the bank.[10] This

5 United States v. Balanovski, 236 F.2d 298 (2d Cir. 1956), *cert. denied*, 352 U.S. 968 (1957).

6 In the principal case Judge Hays dissented on the ground that the only issue involved was the propriety of the district court's order. Since the court had in personam jurisdiction over appellant it could order appellant to freeze Omar's funds. Judge Hays felt that the entire issue dealing with whether the Government's lien attached was to be left for the pending action against Omar; since the appeal was from the district court's order, the propriety of the order, not the attachment of the lien, was the only issue. Principal case at 325 (dissenting opinion).

7 See Hanson v. Denckla, 357 U.S. 235 (1958), where the Court said that a state has no right "to enter a judgment purporting to extinguish the interest of such a person [over whom it has no personal jurisdiction] in property over which the court has no jurisdiction." *Id.* at 250. For the original statement of this doctrine, see Pennoyer v. Neff, 95 U.S. 714, 733 (1877).

8 *E.g.*, if the garnishee and garnishee's creditor have a contract based upon a contingency, the garnisher cannot successfully sue the garnishee until the contingency has occurred because the garnishee's creditor cannot collect until then. Karno-Smith Co. v. Maloney, 112 F.2d 690 (3d Cir. 1940).

9 See Aquilino v. United States, 363 U.S. 509 (1960) (government tax lien could not attach to insurance policy unless taxpayer had property rights in the policy as defined by state law); United States v. Bess, 357 U.S. 51 (1958) (taxpayer's property rights under a contract to be determined by state law); Raffaele v. Granger, 196 F.2d 620 (3d Cir. 1952) (government lien upon taxpayer's bank account limited by taxpayer's state-defined rights in the account).

10 See Comment, 56 MICH. L. REV. 90 (1957).

line of cases follows the so-called "separate entity" theory, which holds that branches of a bank are to be treated as separate legal entities.

In general, the main office and branches are regarded as one legal entity. The branch bank is considered the agent of the parent bank, with the parent ultimately liable for debts of the branch.[11] Consideration of the main office and branches as one entity is based on obvious policy factors. The board of directors, located at the situs of the main office, has control over the various branches.[12] The bank, including its foreign and domestic branches, is taxable as a single corporate entity.[13] Moreover, federal law maintains the character of the banking operations as a single entity by requiring banks to operate abroad by means of branches rather than foreign subsidiary corporations.[14] Yet, despite these reasons for regarding the entire banking operation as a single entity, in certain situations generally characterized as "arm's-length relationships" foreign branch banks are deemed separate entities from the domestic parent.[15] Branches or agencies have been held to be independent entities in four major respects: deposits are payable to the depositor only at the branch where deposited;[16] checks made out to third parties need be honored only when drawn on the branch which is the situs of the deposit;[17] a subpoena duces tecum on a foreign branch bank's records is void;[18] and a foreign branch is separate with regard to the collection of forwarded paper.[19]

The important factor in any attempt to harmonize the cases is that a foreign branch in each of the above situations has been held a separate entity

[11] See Sokoloff v. National City Bank, 130 Misc. 66, 224 N.Y. Supp. 102 (Sup. Ct. 1927), *aff'd*, 223 App. Div. 754, 227 N.Y. Supp. 907, *aff'd*, 250 N.Y. 69, 164 N.E. 745 (1928). The *Sokoloff* case was decided prior to § 138 of the N.Y. BANKING LAW, which reads: "Any bank . . . which . . . shall have opened and occupied a branch office or branch offices in any foreign country shall be liable for contracts to be performed at such branch office or offices . . . to no greater extent than a bank . . . organized and existing under the laws of such foreign country would be liable under its laws." UNIFORM COMMERCIAL CODE § 4-106, recognizes the separate entity principle in providing that "a branch or separate office of a bank [maintaining its own deposit ledgers] is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders shall be given under this Article . . . ."

[12] The Board of Directors of First National City Bank is located in New York.

[13] Posades v. National City Bank, 296 U.S. 497 (1935).

[14] 38 Stat. 273 (1913), as amended, 12 U.S.C. § 601 (1958).

[15] For a general discussion of the separate entity doctrine, see Note, 48 CORNELL L.Q. 333 (1963).

[16] See Murtaugh v. Yokohama Specie Bank, Ltd., 149 Misc. 693, 269 N.Y. Supp. 65 (N.Y. City Ct. 1933); Bluebird Undergarment Corp. v. Gomez, 139 Misc. 742, 249 N.Y. Supp. 319 (N.Y. City Ct. 1931).

[17] See Chrzanowska v. Corn Exch. Bank, 173 App. Div. 285, 159 N.Y.S. 385 (1916), *aff'd*, 225 N.Y. 728, 122 N.E. 877 (1919).

[18] The separate entity theory was used in this respect in *In re* Harris, 27 F. Supp. 480 (S.D.N.Y. 1939); that part of *Harris* which involved the separate entity theory, however, was subsequently overruled in First Nat'l City Bank v. Internal Revenue Serv., 271 F.2d 616 (2d Cir. 1959), *cert. denied*, 361 U.S. 948, *rehearing denied*, 362 U.S. 906 (1960).

[19] See Pan-American Bank & Trust Co. v. National City Bank, 6 F.2d 762 (2d Cir.), *cert. denied*, 269 U.S. 554 (1925).

for a specific purpose. The separate entity doctrine is thus an exception to the usual single entity rule and is used when a court deems it necessary to insulate one office of a bank from liability incurred by another. It does not necessarily follow, therefore, that *in every instance* a branch is to be treated as a separate entity. The principal case is the first case to hold that branch banks are to be treated as separate entities so as to limit any global effect of section 6321. The court has thus chosen to take a rule having its genesis in policy considerations dealing with banking and to apply that rule so as to limit the collection of tax revenue. In so limiting the effect of the statute the court chose to reject the possibility of extending the doctrine of several cases where extraterritorial injunctions have been upheld.

The issuance of injunctions which have effect beyond the court's territorial jurisdiction is not a new concept, even when such effect takes place in foreign countries. In antitrust cases courts have gone so far as to issue injunctions prohibiting activity in a foreign country.[20] Moreover, extraterritorial injunctions involving tax liens were upheld specifically in two cases cited by the Government in the principal case. In *First Nat'l City Bank v. Internal Revenue Serv.*[21] the court upheld a subpoena duces tecum which required the bank to order its Panamanian branch to return books located in Panama. In that case it was determined that the main office definitely had the power to order such compliance by its branch.[22] The court in the principal case, however, limited *First Nat'l City Bank v. Internal Revenue Serv.* to its facts, finding that while extraterritorial actions could be sustained to order the production of a branch's books, such extraterritorial actions could not be sustained to order the branch to freeze a creditor's funds. In *United States v. Ross*[23] the court affirmed an injunction ordering Ross, the major stockholder and company president, to refrain from transferring property of two Bahamian corporations. The court had jurisdiction of Ross, but not of either corporation. The court held that jurisdiction of the defendant controlling the property is sufficient to order him to transfer property regardless of whether that property is within or without the court's territorial jurisdiction.[24] The crucial distinction between *Ross* and the principal case is that in *Ross* the court had jurisdiction of the delinquent taxpayer, while in the principal case the court had jurisdiction

[20] See Steele v. Bulova Watch Co., 344 U.S. 280, 282 (1952); Timken Roller Bearing Co. v. United States, 341 U.S. 593 (1951). See also Haight, *International Law and Extraterritorial Application of the Antitrust Laws*, 63 YALE L.J. 639 (1954); Whitney, *Sources of Conflict Between International Law and the Antitrust Laws*, 63 YALE L.J. 655 (1954); Note, 69 HARV. L. REV. 1452 (1956).

[21] 271 F.2d 616 (2d Cir. 1959).

[22] The issue in the principal case was not whether the New York office had the controlling power to order its branches to freeze an account; instead, the issue was whether defendant was legally obligated to do so.

[23] 302 F.2d 831 (2d Cir. 1962).

[24] See New Jersey v. City of New York, 283 U.S. 473 (1931); Marshall v. Turnbull, 32 Fed. 124 (C.C.E.D.N.Y. 1887); SEC v. Minas De Artemisa, S.A., 150 F.2d 215 (9th Cir. 1945). See also RESTATEMENT, CONFLICT OF LAWS §§ 97, 94, comment *a* (1934).

only of the delinquent taxpayer's debtor. Yet the court in the principal case, had it so desired, could have extended the *Ross* doctrine to cover the principal case. Both cases involved tax liens established under the Internal Revenue Code and not patently based on jurisdiction of the delinquent taxpayer. Rather than extend the *Ross* holding to sustain an extraterritorial injunction directed at the delinquent taxpayer's debtor, however, the court chose to apply the separate entity doctrine to limit the potential impact of *Ross*. Since the separate entity doctrine is a judicial tool used to reach a desired result, the policy considerations against giving section 6321 a global effect must have controlled the court's decision. In light of these considerations, the court's decision would appear convincing. The court pointed out the important factors which militate against giving section 6321 a global effect. The first is the problem of valuing foreign deposits in satisfaction of a tax claim stated in dollars. The multiple and fluctuating exchange rates of many countries compound this problem.[25] Second, foreign depositors, realizing that their funds could be frozen if put in branch banks having parent offices situated within American jurisdiction, would be discouraged from dealing with foreign branches of American banks.[26] This would tend to impair the competitive position of the American branches. The most compelling consideration before the court, however, was the potential conflict of laws problem.[27] Foreign branch banks are licensed under foreign law; the law of the situs governs. As a result, an injunction requiring foreign branch banks to freeze funds might subject the entire banking operation to double liability: once to the corporation (such as Omar) suing in the foreign country, which would probably not respect the American injunction; and again to the United States as a penalty for violating the injunction. Moreover, the issuance of an injunction as asked for by the Government would seem to mean that foreign courts would, in turn, be able to issue injunctions against the American branch which would affect accounts or activities of the head office in the United States. As the court in the principal case said, "The untoward difficulties and potential conflict between the laws of different nations that such a doctrine would produce militate against giving it support here."[28]

It would appear, therefore, that latent considerations form a sounder basis for the decision in the principal case than a rubber stamp application

[25] See Richard v. American Union Bank, 253 N.Y. 166, 170 N.E. 532 (1930). A useful standard for resolving this problem is UNIFORM COMMERCIAL CODE § 4-212(6), which provides a formula for adjustment to foreign currencies in regard to a bank's right of charge-back or refund: "If a credit is given in dollars as the equivalent of the value of an item payable in a foreign currency the dollar amount of any charge-back or refund shall be calculated on the basis of the buying sight rate for the foreign currency prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course."

[26] See principal case at 24.

[27] See Lauritzen v. Larsen, 345 U.S. 571 (1953); Foley Bros., Inc. v. Filardo, 336 U.S. 281 (1949).

[28] Principal case at 24.

of the separate entity doctrine. When the scope of section 6321 is adjudicated in future cases, the important question will be whether the holding in the principal case will be limited to cases dealing with international banking or will be extended to cover other uses of the tax lien power. Since international banking involves unique considerations, it would seem advisable to limit the principal case to its facts, and consider each new attempt by the Government to reach foreign-held assets on the basis of the particular policies involved.

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