CASENOTES

Foreign Tax Violations May Be Prosecuted Here as Wire Fraud—A Significant Development for All Practitioners

Pasquantino v. United States, 125 S. Ct. 1766 (2005)

A recent U.S. Supreme Court decision could significantly increase the involvement of U.S. courts in foreign tax disputes and is arguably in tension with U.S. bilateral tax treaties. In *Pasquantino v. United States*, the Court held that the U.S. federal wire fraud statute, 18 U.S.C. § 1343, could apply to a fraudulent scheme to smuggle liquor into Canada, evading Canadian excise tax laws. It held that the wire fraud prosecution did not violate the common law "revenue rule," a long-standing legal principle that prohibits domestic courts from assisting in the collection of foreign tax liabilities. In that case, the defendants used a telephone to order liquor from another state, which they then transported to Canada without paying the appropriate Canadian taxes. The Court rejected the defendants' argument that the United States was effectively violating the foreign revenue rule because the United States would recover the Canadian taxes due and remit them to the Canadian government

The Court did not view this prosecution as a direct enforcement of foreign tax law in the United States. As such, the Court was able to harmonize the wire fraud statute with the revenue rule. It left open the question, however, of how direct the enforcement must be to be barred by the revenue rule. And soon after its decision, it directed the lower courts to provide further guidance on this question by vacating and remanding to the Fourth Circuit Court of Appeals for further consideration in light of *Pasquantino*, a case involving a civil action brought against tobacco companies by various foreign governments alleging violations of their customs laws.

The Court focused its attention on what Congress would have understood as the contours of the revenue rule when it enacted the wire fraud statute in 1952. The Court explained that the revenue rule was merely a corollary of the criminal law rule that the "Courts of no country execute the penal laws of another." The core of the revenue rule thus focuses on "the collection of tax obligations of foreign nations." The wire fraud prosecution, however, did not seek to recover a foreign tax liability; it was "a criminal prosecution brought by the United States in its sovereign capacity to punish domestic criminal conduct." The Court reached this conclusion notwithstanding that the conviction would lead to restitution of the lost tax revenue to Canada. Finally, the Court rejected the proposition that it was giving the wire fraud statute "extraterritorial effect," emphasizing that the conviction was punishing the "domestic element of [the defendants'] conduct" in committing wire fraud. The Court acknowledged that it is "an odd use of the Federal Government's resources to prosecute a U.S. citizen for smuggling cheap liquor into Canada," but it found no basis in the statute, the common law, or policy for preventing application of the wire fraud statute.

The four dissenting justices believed that the criminal prosecution was inconsistent with the revenue rule because the evasion of foreign taxes was the basis for the criminal prosecution. The dissenting justices also invoked the rule of lenity, which provides that an ambiguous criminal statute should be interpreted so as to result in less severe punishment. Two of the dissenting justices also argued that Congress never intended to grant the federal wire fraud statute extraterritorial effect. They noted that U.S. law specifically allows for the criminal enforcement of foreign customs laws only when the other country has a reciprocal commitment to enforce U.S. customs laws, which Canada does not have. They also pointed out that the United States and Canada have entered into a fairly detailed tax collection agreement as part of their income tax treaty, and such agreement would prohibit collection of the tax in this case.

The scope of the revenue rule as interpreted by *Pasquantino* raises several policy concerns. On the one hand, it is desirable to enforce revenue laws rigorously and encourage increased international cooperation in enforcement. On the other hand, foreign revenue laws may be confiscatory or lack due process, and it is arguably inappropriate for one sovereign to judge another sovereign's laws or to question another country's revenue policies. In addition, the ground rules covering international tax collection have been reserved to tax treaties, which specifically prescribe conditions under which one country will enforce revenue laws of another. And it is in the context of tax treaty negotiations that such conditions are best determined.

Pasquantino suggests that for the revenue rule to bar an action in a U.S. court there must be a strong relationship between the U.S. action and the foreign tax collection. Even where, as here, the statutory scheme (the Mandatory Victims Retribution Act of 1996, 18 U.S.C. § 3663A) requires that amounts recovered through the action be used to pay the foreign tax, the revenue rule is incapable of interfering with the enforcement of the action. Ironically, although this seems to strengthen the ability of governments to collect taxes in other countries, it may undermine to some extent the vitality of the tax treaty provisions that govern most international tax collec-

tion coordination efforts. Such provisions are predicated on the inability of governments to enforce their tax laws abroad in the absence of such agreements. If, however, this predicate is eroded, treaty negotiators could find it more difficult to obtain the consent of their treaty partners to these reciprocal tax collection pacts.

Finally, *Pasquantino* raises questions about the type of conduct that now can be viewed as criminal. Although this case involved smuggling, it raises the question whether practitioners may be at risk by engaging in more mainstream conduct in the United States, if that conduct has the effect of avoiding foreign taxes and the foreign tax avoidance is later asserted to be fraudulent by the revenue authorities of the other country. Presumably, practitioners would not want to rely solely on prosecutorial discretion for comfort on this point.

It is possible, however, that some additional comfort will be forthcoming as the lower courts develop the law in this new area. The Court has already remanded one case in light of *Pasquantino*, where the European Community and the Republic of Colombia sued U.S. tobacco manufacturers for damages under the Racketeer Influenced and Corrupt Organizations Act for alleged conspiracies to smuggle contraband cigarettes into Europe and Colombia. *See European Community v. RJR Nabisco*, 125 S. Ct. 1968 (2005).

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