New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
NOVEMBER 17, 2021

TAX LITIGATION ISSUES

The Revenue Rule and International Tax Collection

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Governments seeking to recoup tax liabilities outside their borders often face a substantial hurdle in the form of the "Revenue Rule" which, as summarized by Lord Mansfield, provides that "no country ever takes notice of the revenue law of another." *Holman v. Johnson*, 98 Eng. Rep. 1120, 1121 (1775). Courts in the United States have largely followed this long-standing common law doctrine. As a result, nations seeking to collect taxes from individuals or assets located within the United States have precious few avenues for relief. This column reviews the Revenue Rule and considers the apparent lack of enthusiasm for non-judicial Mutual Collection Assistance Requests designed to bypass the Rule, all pointing to the obstacles encountered by foreign governments pursuing tax revenues in the United States.

Rationale for the Revenue Rule

Under principles of international comity, courts typically permit foreign money judgments to be enforced against persons and assets in the United States. The Revenue Rule represents an important exception to this general approach, and the model Uniform Foreign Money Judgments Recognition Act, which has been substantially adopted by a majority of states, expressly excludes judgments for taxes. See Samuel D. Brunson, *The U.S. as Tax Haven? Aiding Developing Countries by Revoking the Revenue Rule*, 5 Colum. J. Tax. L. 170, 182 (2014).

The Revenue Rule promotes national sovereignty by preventing countries from pursuing their interests within the borders of another country, and it shields the judiciary from engaging in the difficult and politically-sensitive task of determining which sovereign revenue interests warrant relief. See *Att'y Gen. of Can. v. R.J. Reynolds Tobacco Holdings*, 268 F.3d 103, 111-12 (2d Cir. 2001). In a concurring opinion in *Moore v. Mitchell*, 30 F.2d 600, 604 (2d Cir. 1929), Judge Learned Hand articulated the principal underlying the Revenue Rule by noting that, "[t]o pass upon the provisions for the public order of another state … should be[] beyond the powers of a court; it involves the relations between the states themselves, with which courts are incompetent to deal, and which are [e]ntrusted to other authorities," particularly the Executive branch of government.

Cases Applying the Revenue Rule

In *Her Majesty Queen in Right of Prov. of B.C. v. Gilbertson*, 597 F.2d 1161 (9th Cir. 1979), the Canadian Province of British Columbia brought an action in federal court in Oregon to recover on a Canadian judgment issued against Oregon citizens who failed to pay taxes on income earned from British Columbian logging operations. Noting that the case represented "the first time that a foreign nation [] sought to enforce a tax judgment in the courts of the United States," the Ninth Circuit attributed the scarcity

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of relevant case law to the broad acceptance of the Revenue Rule. Id. at 1164. The court affirmed the dismissal of the case, pointing to the existence of a tax treaty between the United States and Canada, and the apparent decision by the political branches of both countries to forego any provision limiting the Revenue Rule, as weighing in favor of its application. Id. at 1165-66.

In 2001, the Canadian government tried a different approach. Rather than seeking to enforce an existing tax judgment by a Canadian court, Canada brought a civil RICO action asserting that R.J. Reynolds Tobacco and related companies had engaged in a years-long scheme to evade Canadian cigarette excise taxes. See *R.J. Reynolds Tobacco*, 268 F.3d at 107. Affirming the district court's dismissal of the compliant, the Second Circuit applied the Revenue Rule, finding that "Canada's object is clearly to recover allegedly unpaid taxes," amounting to "an indirect attempt to have a United States court enforce Canadian revenue laws." Id. at 131.

'Pasquantino v. United States'

A few years later, the Supreme Court decided *Pasquantino v. United States*, 544 U.S. 349 (2005), which arose out of a wire fraud prosecution of U.S. citizens for having purchased liquor from Maryland for resale in Canada without paying Canadian excise taxes. On appeal, the defendants argued that, in keeping with the Revenue Rule, the wire fraud statute must be construed as excluding frauds designed to evade foreign taxes.

Though finding that the defendants had deprived Canada of the "right to uncollected excise taxes" on imported liquor, the Court nonetheless rejected the argument that the prosecution was barred by the Revenue Rule, finding that it was "not a suit that recovers a foreign tax liability." Id. at 355, 362. Rather, the court affirmed the convictions on the grounds that the prosecution advanced the independent U.S. interest in enforcing its criminal code, deeming irrelevant the fact that Canada stood to recover the lost excise taxes through operation of the Mandatory Victims Restitution Act. Id. at 350. Addressing the sovereignty concerns traditionally informing the Revenue Rule, the Court found that "by electing to prosecute, the Executive has assessed this prosecution's impact on this Nation's relationship with Canada, and concluded that it poses little danger of causing international friction." Id. at 351.

The Revenue Rule After 'Pasquantino'

The Supreme Court in *Pasquantino* expressly declined to offer a view on whether *a foreign government* may bring a civil RICO action predicated on a scheme to defraud it of taxes through violations of the mail and wire statutes. See id. at 355 n.1. Following *Pasquantino*, the Supreme Court remanded to the Second Circuit a civil RICO suit against RJR Nabisco predicated on essentially the same cigarette scheme alleged in *R.J. Reynolds Tobacco*. On remand, the Second Circuit reaffirmed dismissal of the complaint under the Revenue Rule, noting that "the involvement of the United States government was a key factor in determining the outcome of *Pasquantino*." *Eur. Cmty. v. RJR Nabisco*, 424 F.3d 175, 181 (2d Cir. 2005); see *Rep. of Colom. v. Diageo N. Am.*, 531 F. Supp. 2d 365, 399 (E.D.N.Y. 2007) (dismissing, as barred by the Revenue Rule, the Colombian government's civil RICO suit to recover "taxes and other damages suffered in [its] sovereign capacity" and for "damages in [its] commercial capacity resulting from Defendants' tax evasion").

At least one court, however, has declined to apply the Revenue Rule and allowed a foreign government to invoke its jurisdiction in a matter touching upon its tax laws. Thus, in *In re SKAT Tax Refund Scheme Litig.*, 356 F. Supp. 3d 300, 307-08 (S.D.N.Y. 2019), the court denied a motion to dismiss an action brought by the Customs and Tax Administration of the Kingdom of Denmark (SKAT) alleging that defendants had obtained millions of dollars by falsely claiming ownership of shares in Danish companies that had paid dividends net of taxes that were refunded under a double taxation treaty. In rejecting application of the Revenue Rule, the district court concluded that the claims, as alleged, "are not ones for tax revenue but for money stolen from the plaintiff by fraud," where SKAT "has not alleged a single instance of tax evasion," but rather that defendants improperly received "refunds" of amounts they never owed nor paid. Id. at 311, 318.

Tax Assistance by Treaty

Despite the continued relevance and broad application of the Revenue Rule, foreign sovereigns may be able to avoid its scope by requesting the assistance of the U.S. government

in collecting foreign tax revenue pursuant to a treaty. See *Retfalvi v. United States*, 335 F. Supp. 3d 791, 801 n.1 (E.D.N.C. 2018), aff'd, 930 F.3d 600 (4th Cir. 2019). A treaty agreement to assist in the collection of foreign tax liabilities ameliorates concerns over the judiciary's improper intrusion into the delicate realm of international relations, by clearly expressing the Executive branch's view that such assistance is advisable.

Thus, foreign governments can seek administrative assistance from the Internal Revenue Service through a Mutual Collection Assistance Request, or MCAR, a mechanism that relies upon reciprocal treaties "contain[ing] broad provisions for mutual assistance in [tax] collection." See Internal Revenue Manual §5.21.7.4(1). While MCARs provide a possible "end run" around the Revenue Rule, their utility is limited by the fact that the United States has only entered treaties permitting MCARs with six countries—Canada, Denmark, France, Japan, the Netherlands and Sweden—with the Revenue Rule's long-standing tradition serving as a significant explanation for the infrequency of such provisions. See Joint Committee on Taxation, Testimony of the Staff of the Joint Committee on Taxation Before the Senate Committee on Foreign Relations (JCX-137-15), 2013 WL 1129162 (Oct. 29, 2015).

The MCAR process is also subject to significant restrictions. For example, by treaty, the IRS will not pursue claims against current U.S. citizens on behalf of France, the Netherlands or Sweden; will not pursue collection activity on behalf of Canada or Denmark against individuals who were U.S. citizens during the taxable period at issue; and will only pursue claims filed by Japan with respect to a U.S. citizen who "filed a fraudulent return or refund claim, willfully failed to file a return to evade tax or transferred assets to the U.S. to avoid collection." IRM §5.21.7.4.1 (11)(d). Thus, while the IRS is authorized under the MCAR process to commence an enforcement proceeding as would be appropriate for any U.S. taxpayer, and seek relief including federal tax liens and seizure and sales, id. § 5.21.7.4.4(3)-.7, such efforts are notably rare.

Indeed, in 2017 the Treasury Inspector General for Tax Administration determined that the IRS received a total of 930 requests for collection assistance from its MCAR treaty partners during fiscal years 2011 through 2016, but only collected a paltry $33.8 million during fiscal years 2012 through 2016. TIGTA, *Exchange of Information Capabilities Are Underutilized by the Internal Revenue Service*, at 13 (Sept. 11, 2017). In turn, the reciprocal collection of outstanding U.S. tax liabilities by MCAR treaty partners amounted to a mere $40.3 million for the same period. Id. at 12.

The international community is actively pursuing solutions to the historical absence of multilateral cooperation, including the promulgation of the Convention on Mutual Administrative Assistance in Tax Matters, which, as amended by the 2010 Protocol, has entered into force for 134 jurisdictions. Jurisdictions Participating in the Convention on Mutual Administrative Assistance in Tax Matters (Sept. 20, 2021). While Article 11(1) of the Convention provides that countries will "take the necessary steps to recover tax claims of the first-mentioned state as if they were its own tax claims," the United States has signed but not ratified the current Convention, and, in any event, formally reserved that it "will not provide assistance in the recovery of any tax claim" pursuant to that provision. OECD/Council of Europe, Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol; Text of U.S. Reservation.

Conclusion

Despite increased emphasis on combatting global tax evasion in recent years, the long-standing common law tradition of the Revenue Rule—rooted in deeply-held principles of national sovereignty—presents a substantial obstacle to governments attempting to pursue lost tax revenue across international borders. Although the development of case law and international agreements will certainly continue to shape the mechanisms for international tax collection, the general scope of the Revenue Rule's prohibition has remained constant for over two centuries and shows no meaningful sign of waning.