

**News Analysis: *Pasquantino* Case  
Raises International Tax Planning  
Concerns**

**by Philip West and Keith Sieverding**

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## News Analysis: *Pasquantino* Case Raises International Tax Planning Concerns

by Philip R. West and Keith Sieverding

In *Pasquantino v. United States*, 544 U.S. \_\_\_, 125 S. Ct. 1766 (2005), the U.S. Supreme Court held April 26, that (1) the U.S. federal wire fraud statute, 18 U.S.C. section 1343, could apply to a fraudulent scheme to smuggle liquor into Canada, evading Canadian excise tax laws, and (2) the wire fraud prosecution under review 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. (For prior coverage, see *Tax Notes Int'l*, May 2, 2005, p. 402. For the full text of the U.S. Supreme Court opinion in *Pasquantino*, see 2005 WTD 80-18 or Doc 2005-8734.) Although *Pasquantino* involved conduct hardly considered routine by tax practitioners, the Court’s holding, in particular on the first issue, may throw into question far more routine conduct. Regarding the second issue, the Court found no violation of the revenue rule even though, under its holding, the United States would recover the taxes due and remit them to the Canadian government, with the effect that the prosecution would, in substance, enforce the collection of a foreign tax obligation, a result the revenue rule was intended to prevent.

The Court did not view the 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. The Court conceded that the criminal prosecution under review did “enforce” a foreign tax obligation, albeit in an “indirect” manner, but stated that the common law had yet to clearly establish the difference between

permissible and impermissible indirect enforcement of a foreign tax obligation. The Court distinguished prior cases in which courts have found impermissible indirect enforcement of a foreign tax obligation. In particular, the Court noted that the wire fraud statute that was being enforced is a criminal statute that is intended specifically to deter domestic fraudulent conduct, an object independent of foreign tax enforcement, reasoning that any link between the case and foreign tax collection was incidental and attenuated.

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 where 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.

*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. section 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. As a result, *Pasquantino* may call into question the result in prior court decisions, such as *Attorney General of Canada v. R.J. Reynolds Tobacco Holdings Inc.*, 268 F.3d 103 (2nd Cir. 2001), *cert. denied*, 537 U.S. 1000 (2002), that have applied the revenue rule to dismiss civil anti-racketeering claims brought by a foreign government in a U.S. court for violations of its customs laws. Although the Court avoided opining on this issue in *Pasquantino*, soon after the decision the Court directed the Second Circuit Court of Appeals to revisit this issue considering *Pasquantino* by vacating and remanding the decision in *European Community v. RJR Nabisco*, 150 F. Supp.2d 456 (E.D. N.Y. 2001), *affirmed by* 355 F.3d 123 (2nd Cir. 2004), *vacated by, remanded by, cert. granted*, 544 U.S. \_\_\_ (2005).

The *Pasquantino* decision raises several tax policy concerns. On the one hand, it is obviously desirable that revenue laws be rigorously enforced. Toward that end, increased international cooperation in enforcement is a laudable goal. On the other hand, foreign revenue laws may be confiscatory, lack due process, and so forth, and it is arguably not appropriate for one sovereign to have to make judgments about these matters with respect to another sovereign's laws, or to question the policies behind another sovereign's revenue laws. Also, 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 those conditions are best determined.

Ironically, although *Pasquantino* 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 collection coordination efforts. Those provisions are predicated on the inability of governments to enforce their tax laws abroad in the absence of those 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.

Perhaps most ominously, *Pasquantino* raises questions about the type of conduct that now can be viewed as criminal under U.S. law. Specifically, it raises a concern that practitioners may be at risk by engaging in routine foreign tax planning in the United States, if that conduct has the effect of avoiding foreign taxes and the foreign tax avoidance

is asserted to be a criminal violation by the revenue authorities of the other country. (The asserted criminality may even derive from an ex post facto interpretation by the foreign revenue authorities.) The Court's opinion offers very little basis for comfort on that point, spending a scant two paragraphs analyzing why this avoidance of foreign tax laws constituted a "scheme or artifice to defraud" that resulted in U.S. criminal liability. One reading of *Pasquantino* could easily suggest that the Court has sanctioned criminal prosecution for any conduct asserted to be a criminal violation of a foreign tax law as long as the foreign government could show some concealment. Arguably, *Pasquantino* can be read more narrowly, so that the actions of the taxpayer would have to satisfy a dual criminality standard (that is, the actions would be criminal under foreign law and, if the tax avoided were U.S. tax, would be criminal under U.S. law). But even this reading would represent an expansion of what most practitioners believe current law to be.

Perhaps some comfort could be derived from the fact that the government may be hesitant to prosecute when the violation of foreign tax law is not so obvious, which is usually the case when complex international transactions are involved, but relying on prosecutorial discretion is hardly satisfactory. Finally, one may look for comfort to the fact that the decision to prosecute in *Pasquantino* may have been part of a concerted effort, backed at the highest levels of the U.S. Treasury, to crack down on liquor (and tobacco) trafficking. This too, however, may be cold comfort to those who believe that recent high-level government official comments on tax shelters lack a certain appreciation for the shade-of-gray judgment calls that are a regular part of international tax planning.

These issues are important to taxpayers, in-house tax professionals, and advisers. They create significant uncertainty in areas previously thought settled. They also add additional complexity to an area already beset by the unanswered questions of Circular 230, conflicting court cases and administrative guidance on the appropriate standards to be applied to tax planning, changing domestic and foreign rules regarding tax planning disclosure and penalties, and, last but certainly not least, the U.S. Sarbanes-Oxley Act of 2002. How that uncertainty will ultimately affect taxpayers and tax professionals is currently unclear, but perhaps the Second Circuit will bring some needed elaboration to this corner of the tax world with a well-reasoned opinion in *RJR Nabisco*. ◆

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