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SPECIAL REPORT

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In this report, Doobay and Ruchelman explore the interplay of the revenue rule and the cum-ex cases, and they examine information exchange and collection assistance obligations, using the Canada-U.S. treaty as an example.

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I. Introduction

The common law revenue rule is a judicial doctrine that prevents courts in one country from being used by a foreign government as a tool to collect lost tax revenue of any kind. As explained by one commentator:

> The revenue rule, a common law doctrine with origins in the eighteenth century, is a battleground in the twenty-first century. . . . In its modern form the revenue rule generally allows courts to decline

entertaining suits or enforcing foreign tax judgments or foreign revenue laws.[1]

In a 2005 decision, the Supreme Court described the revenue rule in the following language:

> Since the late 19th and early 20th century, courts have treated the common-law revenue rule as a corollary of the rule that, as Chief Justice Marshall put it, "[t]he Courts of no country execute the penal laws of another." . . . The rule against the enforcement of foreign penal statutes, in turn, tracked the common-law principle that crimes could only be prosecuted in the country in which they were committed. The basis for inferring the revenue rule from the rule against foreign penal enforcement was an analogy between foreign revenue laws and penal laws.[2] [Citations omitted.]

The revenue rule can be overridden by treaty, and when it has been, U.S. and Canadian tax authorities have collected the taxes due in the other country.

This report explores various ways in which the tax authorities and courts may or may not cooperate in reviewing cross-border transactions, with an emphasis on Canada-U.S. transactions. It covers:

- the general development of the revenue rule in the United Kingdom, the United States, Canada, and other common law countries;
- the validity of a conviction for violating U.S. wire fraud criminal statutes resulting from the placement of an interstate telephone call incident to smuggling liquor into Canada;
- the cum-ex litigation involving allegedly fraudulent dividend refund claims in cases brought by the Danish tax authority (SKAT) before courts in the United States and the United Kingdom;
- the applicable provisions of the Canada-U.S. income tax treaty allowing for assistance in collection of taxes and exchanges of information;
- the OECD's Multilateral Convention on Mutual Administrative Assistance in Tax Matters;
- cases in the United States challenging treaty-based summonses issued at the request of a treaty partner;
- cases in Canada challenging the exchange of financial information with the United States;
- Canadian rules for assistance in collecting foreign taxes; and
- U.S. experience in collecting taxes on behalf of Canada.

II. Development of the Common Law Rule

A. English Common Law

A leading treatise on conflicts of law[3] states the revenue rule as follows: "English courts have no jurisdiction to entertain an action: (1) for the enforcement, either directly or indirectly, of a penal, revenue or other public law of a foreign State; or (2) founded upon an act of state."

1. Early cases.

This concept, which later became known as Dicey Rule 3, was initially enunciated in an 18th century case, *Holman*[4]:

> There are a great many cases which every country says shall be determined by the laws of foreign countries where they arise. But I do not see how the principles on which that doctrine obtains are applicable to the present case. For no country ever takes notice of the revenue laws of another.

In a 19th century case, *James*,[5] the court expressed a similar view: "In a British court we cannot take notice of the revenue laws of a foreign State."

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[1] Brena Mallinak, "The Revenue Rule: A Common Law Doctrine for the Twenty-First Century," 16 *Duke J. Comp. & Int'l L.* 79 (2006).

[2] *Pasquantino v. United States*, 544 U.S. 349 (2005).

[3] *Dicey, Morris, and Collins on the Conflict of Laws*, para. SR-019 (2012). This treatise has been described as the gold standard in terms of academic writing on the subject and as the foremost authority on private international law.

[4] *Holman v. Johnson* (1775) 1 Cowp 341, 343; 98 E.R. 1120, 1122.

[5] *James v. Catherwood* (1823) 3 Dow & Ry KB 190, 191.

That view was adopted in two early 20th century cases. The first was *Brostron*,[6] in which the court stated:

> It is perfectly elementary that a foreign government cannot come here — nor will the courts of other countries allow our Government to go there — and sue a person found in that jurisdiction for taxes levied and which he is declared to be liable in the country to which he belongs.

That was followed in *In re Visser*,[7] in which the court stated:

> My own opinion is that there is a well-recognized rule, which has been enforced for at least 200 years or thereabouts, under which these courts will not collect the taxes of foreign States for the benefit of the sovereigns of those foreign States; and this is one of those actions which these courts will not entertain.

2. Mid-20th century cases.

The reasons for not enforcing a foreign state's revenue laws were explained in a 1955 decision by the House of Lords in *Taylor*.[8] The case involved the voluntary liquidation of a company registered in the United Kingdom but trading in India in prior years. In one of those years, the business of the company was sold, and the Indian government asserted that income and capital gains taxes were due and remained unpaid, thereby making the Indian government a creditor of the company. Under applicable English law, the company could not be dissolved while the claim remained open. Citing the revenue rule, the court rejected the claim of the Indian government:

> If one State could collect its taxes through the courts of another, it would have arisen through what is described, vaguely perhaps, as comity or the general practice of nations inter se. . . . Tax gathering is an administrative act, though in settling the quantum as well as in the final act of collection judicial process may be involved. Our courts will apply foreign law if it is the proper law of a contract, the subject of a suit. Tax gathering is not a matter of contract but of authority and administration between the State and those within its jurisdiction. If one considers the initial stages of the process, which may, as the records of your Lordships' House show, be intricate and prolonged, it would be remarkable comity if State B allowed the time of its court to be expended in assisting in this regard the tax gatherers of State A.[9]

The opinion observed that the English company could not have been sued in an English court by the Indian government for the recovery of Indian taxes. Nothing changed simply because the company filed for a voluntary liquidation and the Indian government characterized itself as a creditor rather than a foreign tax authority.

In reaching its decision, the House of Lords relied on the holding of *Peter Buchanan*,[10] a case decided in the Irish High Court. The Court explained that the revenue rule will apply whenever a foreign country's legal claim involves the collection of revenue, albeit indirectly through the filing of a creditor's claim in the course of a voluntary liquidation:

> Cases on penalties would seem to establish that it is not the form of the action or the nature of the plaintiff that must be considered, but the substance of the right sought to be enforced; and that if the enforcement of such right would even indirectly involve the execution of the penal law of another State, then the claim must be refused. I cannot see why the same rule should not prevail where it appears that the enforcement of the right claimed would indirectly involve the execution of the revenue law of another State, and serve a revenue demand.[11]

[6] *King of the Hellenes v. Brostron* (1923) 16 Ll. L.Rep. 190, 193.

[7] *In re Visser, H.M. The Queen of Holland v. Drukker* (1928) Ch. 877, 884; 44 T.L.R. 692.

[8] *Government of India v. Taylor* (1955) AC 491.

[9] *Id.* at 514.

[10] *Peter Buchanan Ltd. v. McVey* (1955) AC 516, 527.

[11] *Id.*

As with *Taylor*, the claim in *Peter Buchanan* was not a claim for taxes due by a tax authority. Rather, the case involved a claim brought in an Irish court by the liquidator of a Scottish company. The asserted basis of the claim was to recover amounts paid inappropriately to a former shareholder who was removing assets that should have been applied to pay creditors. The unpaid creditor was the Scottish government, and the claim had its origin in the company's failure to pay an excess profits tax in Scotland that was enacted retroactively. The defendant stripped out most of the company's assets and moved the proceeds to Ireland, where the former shareholder resided. The court held that the substance of the claim was an attempt to collect Scottish tax due and that relief in Irish courts was barred by the revenue rule.

In *Brokaw*,[12] the taxpayers were U.S. citizens who owed unpaid tax to the IRS. They shipped household possessions from the United States to the United Kingdom using a U.S.-flagged vessel. The IRS served a notice of levy on the shipowner and demanded the surrender of items owned by the taxpayers because an inchoate lien existed on the property, which served as security for the payment of tax due. When the vessel reached England, the IRS sought possession of the goods, as did the taxpayers. In an interpleader action brought by the shipping company, the taxpayers successfully obtained relief because the IRS levy was not the equivalent of possession of the goods. Therefore, the IRS's position was that it wanted the U.K. courts to help in the collection of U.S. taxes due. When the matter was viewed in that light, the IRS's claim fell within English law's prohibition against the enforcement of revenue laws of other countries. The court stated:

> It appears to me that the United States Government are seeking the aid of these Courts. They come as claimants in these interpleader proceedings. By so doing they are seeking the aid of our Courts to collect tax. It is not a direct enforcement (as it would be by action for tax in a Court of law), but it is certainly indirect enforcement by seizure of goods. It comes within the prohibition of our law whereby we do not enforce directly or indirectly the Revenue law of another country. If the position were reversed, I do not think that the United States Courts would enforce our Revenue laws. For no country enforces the Revenue laws of another.[13]

3. Late 20th century cases.

In *Ortiz*,[14] the government of New Zealand tried to seek possession of an important Maori artifact — a great door to a treasure house of a Maori chief — that was exported from New Zealand in breach of applicable law on historic articles. Under New Zealand law, unlawfully exported artifacts were to be forfeited to the state. Hence, the government of New Zealand contended that it was the owner of the artifact in England and sought the return of its property in a U.K. court. The final decision by the House of Lords was that the New Zealand statute did not purport to vest any title to the door located in New Zealand without an actual seizure of the door. Because the New Zealand government did not have title to the property by the mere fact of export, the case was an action brought in an English court by a sovereign state to effect a seizure of property after its illegal removal from New Zealand. In substance, the English court was asked to enforce a "public law" that was unenforceable in the same way that a tax law was unenforceable. The court stated:

> At the outset I must point out that we are here concerned with a suit by a foreign state to enforce its laws. . . . We are concerned with an independent sovereign government which exercises sovereign authority over its own territory, and which, by international law, has no right to exercise sovereign authority beyond its own territorial limits.
>
> This suit by a foreign state to enforce its laws is to be distinguished altogether from a suit between private firms or individuals which raises a question as to whether a contract has been broken by one or the

[12] *Brokaw v. Seatrain UK Ltd.* (1971) 2 QB 476.

[13] *Id.* at para. 10.

[14] *Attorney General of New Zealand v. Ortiz* (1984) AC 1.

> other or whether a wrong has been done by one to the other. In such a suit our courts will often recognise the existence of the laws of a foreign state. We will recognise the foreign law so much that we will refuse to enforce a contract which is in breach of the laws of the foreign state: see the Prohibition case of *Foster v. Driscoll* [1929] 1 K.B. 470, and the jute case of *Regazzoni v. K.C. Sethia (1944) Ltd.* [1956] 2 Q.B. 490 and [1958] A.C. 301.
>
> This present case is different. It is a suit by a foreign state brought in the English courts here to enforce its laws. No one has ever doubted that our courts will not entertain a suit brought by a foreign sovereign, directly or indirectly, to enforce the penal or revenue laws of that foreign state. We do not sit to collect taxes for another country or to inflict punishments for it. Now the question arises whether this rule extends to "other public laws." Dicey & Morris, The Conflict of Laws, 10th ed. (1980), vol. 1, p. 90, rule 3 say it does. I agree with them. The term "other public laws" is very uncertain.

So the question posed is to define when a claim brought by or under the aegis of a government is within the meaning of the term "other public laws." The answer is found in *Mbasogo.*[15] The case involved a claim brought by the president of the state of Equatorial Guinea and the government of the Republic of Equatorial Guinea to recover damages against alleged conspirators who had planned to overthrow the government through a private coup, seize control of the state and its valuable assets, kill or injure the president, and install a successor. The plaintiffs contended that this was a private suit that could be brought in an English court because some activity in support of the conspiracy took place in England. The defendants claimed that the matter could not be tried in an English court because it concerned the exercise of sovereign power by the ruler of the country. The Court of Appeal held that the matter involved a sovereign power and that the English courts therefore had no jurisdiction to hear the matter, as illustrated in the following excerpts from the case:

> The critical question is whether in bringing a claim, a claimant is doing an act which is of a sovereign character or which is done by virtue of sovereign authority; and whether the claim involves the exercise or assertion of a sovereign right. If so, then the court will not determine or enforce the claim. On the other hand, if in bringing the claim the claimant is not doing an act which is of a sovereign character or by virtue of sovereign authority and the claim does not involve the exercise or assertion of a sovereign right and the claim does not seek to vindicate a sovereign act or acts, then the court will both determine and enforce it. . . .
>
> We put the distinction in that broad way because it seems to us to express the rationale behind rule 3(1) in Dicey, Morris and Collins. We have reached the conclusion that rule 3(1) does accurately reflect the law in stating that the English courts have no jurisdiction to entertain an action for the enforcement of "a penal, revenue or other public law of a foreign state." . . . It is true that most of the cases concern actions for the enforcement of penal or revenue laws. But as we have pointed out, these are merely examples of a wider principle. . . .
>
> We turn, therefore, to the critical question that we have identified that . . . by bringing these claims, the claimants are exercising sovereign authority, namely . . . "the preservation of the security of the state and its ruler." All the steps taken, whose cost the claimants seek to recover, were aspects of sovereign authority. . . .
>
> Obviously, the mere fact that the claimants are the President and the Republic of Equatorial Guinea is not sufficient to make these claims non-justiciable. If the alleged coup had been successful and damage had been caused to buildings or other property owned by the claimants, a claim in tort to recover damages would have been justiciable in the courts of this country. In

[15] *Mbasogo v. Logo Ltd.* (2006) EWCA Civ 1370, (2007) QB 846 at (67).

> bringing such a claim, the claimants would not have been exercising or asserting sovereign authority or seeking relief to vindicate an act which may only be done by a sovereign in the capacity of sovereign. They would have been exercising the right of any person to bring private law proceedings to recover damages for loss suffered as a result of a civil wrong. Such a claim would have arisen solely from the fact that the claimants were owners of property that had been damaged by torts committed by the defendants. The claim would be a "patrimonial claim" (to use the language of Lord Keith in the Government of India case).
>
> It is necessary to look at all the circumstances to see whether in substance the losses which are the subject of the claim have been suffered by virtue of an exercise of sovereign authority. If the losses have in truth been suffered as a result of the claimants' ownership of property, then the fact that the claimants are a foreign state and its president would not render their claims non-justiciable.
>
> In our judgment, the claims that are pleaded in the present case are not founded on the claimants' property interests. The alleged losses arose as a result of decisions taken by the claimants to protect the state and citizens of Equatorial Guinea. The defence of a state and its subjects is a paradigm function of government.[16]

The most recent case applying the revenue rule in English courts is *Solo Capital Partners*,[17] which is addressed later in this report.

B. Adoption in Canadian Courts

Canadian common law followed the revenue rule as set out in the English case law. Canadian courts applied the revenue rule in *Harden*,[18] refusing to enforce a U.S. judgment obtained against a Canadian resident who previously was a U.S. resident.

In an attempt to sidestep the revenue rule, the U.S. government obtained a judgment against Esperanza Harden in federal district court in California. The judgment was for outstanding tax plus interest in the amount of $200,037 for 1945 and $439,463 for 1946.

In Canada, the U.S. government conceded the application of the principle that no action will be pursued in Canadian courts by or on behalf of a foreign state to recover taxes payable under foreign revenue laws. However, it contended that the revenue rule does not apply once the foreign state has recovered judgment in its domestic courts and sues to enforce that judgment in Canada. In essence, the U.S. government argued that the once the matter was adjudicated in a U.S. court, the judgment stood on its own merits without the need for any reference to the underlying claim.

The British Columbia Court of Appeal disagreed. It refused to enforce the U.S. judgment because it remained a claim made on behalf of a foreign state to recover tax due under its law. The underlying claim tainted the enforceability of the judgment. The Supreme Court of Canada unanimously affirmed. It cited the previously discussed Irish decision, *Peter Buchanan*, in which Lord Sommervell of Harrow stated that a foreign state could not circumvent the direct or indirect application of the revenue rule. The Supreme Court of Canada in *Harden* concluded:

> A foreign State cannot escape the application of this rule, which is one of public policy, by taking a judgment in its own courts and bringing suit here on that judgment. The claim asserted remains a claim for taxes. It has not, in our courts, merged in the judgment; enforcement of

[16] *Id.*, EWCA Civ 1370 at paras. 50, 51, and 54-57.

[17] *Skatteforvaltningen v. Solo Capital Partners LLP* [2021] EWHC 974 (Comm), *rev'd*, [2022] EWCA Civ 234 (25 February 2022).

[18] *United States v. Harden* (1962) 36 D.L.R. 2d 602 (B.C. C.A.), *aff'd*, [1963] S.C.R. 366.

> the judgment would be enforcement of the tax claim.[19]

C. Adoption in U.S. Courts

1. In general.

Moore[20] addressed the application of the revenue rule in the context of taxes asserted by one U.S. state in a case brought in another state. When the case was decided, the revenue rule had been applied within the United States to attempts to collect a tax imposed by one state in the courts of another state.[21]

The suit was brought in New York federal court by the treasurer of Grant County, Indiana, against the executors of the last will and testament of Richard Breed. The treasurer alleged that Breed resided in Grant County during the 1903-1926 period and that he did not pay a tax as required by Indiana law. However, no allegations were made that Breed ever owned property in Indiana, that he was physically present in Indiana at the time of his death, or that the county treasurer had ever tried to impose the taxes before Breed's death. The will was entered into probate in the Surrogate's Court of New York.

The lower court dismissed the case for lack of jurisdiction, and the Second Circuit affirmed. The court of appeals held that "the tax laws of one state cannot be given extraterritorial effect, so as to make collections through the agency of the courts of another state." It also found that Grant County was limited to tax payments for property within its boundaries.

In a concurring opinion, Judge Learned Hand expressed the view that the action brought by the county treasurer was blocked by the revenue rule:

> Generally it is, of course, true that a liability arising under the law of a foreign state will be recognized by the courts of another, and it is not here relevant whether foreign liability is enforced, or another, precisely similar, raised by the law of the forum. A recognized exception is in the case of criminal and penal liabilities. . . .
>
> While the origin of the exception in the case of penal liabilities does not appear in the books, a sound basis for it exists, in my judgment, which includes liabilities for taxes as well. . . . To pass upon the provisions for the public order of another state is, or at any rate 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 entrusted to other authorities. . . . Revenue laws fall within the same reasoning; they affect a state in matters as vital to its existence as its criminal laws. No court ought to undertake an inquiry which it cannot prosecute without determining whether those laws are consonant with its own notions of what is proper.[22]

2. RICO cases as a purported end run.

a. R.J. Reynolds.

R.J. Reynolds[23] was a civil RICO action brought in the United States by the Canadian government for treble damages based on lost tax revenue and additional law enforcement costs attributable to a smuggling scheme facilitated by the R.J. Reynolds tobacco company to avoid Canadian cigarette taxes. The defendants used the U.S. postal system to place orders and used the U.S. banking system to make payments. Ultimately, a grand jury handed down an indictment for RICO violations, and several guilty pleas were obtained. Suing under RICO, Canada sought to recover (1) revenue that it lost from the evasion of tobacco duties and taxes; (2) lost revenue resulting from a rollback in duties and taxes; and (3) unnecessary expenditures incurred to identify, arrest, and prosecute the wrongdoers.

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[19] *Id.*, S.C.R. at 371 (citing *Peter Buchanan* (1955) AC 516).

[20] *Moore v. Mitchell*, 30 F.2d 600 (2d Cir. 1929).

[21] This changed with the decision in *Milwaukee County v. M.E. White Co.*, 296 U.S. 268 (1935), in which the Supreme Court held that the full faith and credit clause of the U.S. Constitution requires that each state enforce a tax judgment entered in another state if requested to do so. The Court distinguished the obligations of states from those of independent foreign sovereigns, to which the full faith and credit clause is inapplicable.

[22] *Moore*, 30 F.2d at 604.

[23] *Attorney General of Canada v. R.J. Reynolds Tobacco Holdings Inc.*, 268 F.3d 103 (2d Cir. 2001).

RICO broadly created a civil treble damages remedy for any person injured in its business or property by reason of a violation of the statute. Canada's action proceeded on the premise that the taxes it allegedly lost as a result of the defendants' alleged RICO violations fell within the statute's damages provision. The case balanced (1) a foreign government's ability to seek treble damages for its revenue losses though a RICO claim in the United States against (2) the revenue rule's prohibition against such an action being brought by a foreign sovereign in a U.S. court.

The Second Circuit held that the relief sought by Canada was foreclosed by the revenue rule; Canada could not use RICO to seek recovery of damages arising from lost tax revenue and tax enforcement costs. The court reasoned as follows:

- The revenue rule is a long-standing common law doctrine providing that courts of one sovereign will not enforce final tax judgments or unadjudicated tax claims of other sovereigns.
- The revenue rule reflects policies regarding respect for sovereignty, concern for the role and competency of the judiciary in matters relating to foreign affairs, and separation of powers.
- The political branches of the federal government have consistently acted on behalf of the United States in establishing and managing the country's relationships with other countries regarding the domestic collection of foreign taxes and the collection of U.S. taxes abroad. They have clearly expressed their intention to define and limit the extent of any assistance given regarding the extraterritorial enforcement of a foreign sovereign's tax laws. Thus, under income tax treaties that contain assistance in collection provisions, including the Canada-U.S. treaty, assistance is given to collect a treaty partner's taxes on its own residents, but not to collect the treaty partner's taxes on citizens, corporations, or other entities of the country receiving the request for assistance.
- The existing Canada-U.S. income tax treaty provides that the two countries will agree to ensure comparable levels of assistance to each other in extraterritorial tax collection. Canada's courts have repeatedly affirmed the vitality of the revenue rule.
- When the United States prosecutes a criminal action, the U.S. attorney acts in the interests of the United States, and the prosecutor's conduct is subject to the oversight of the executive branch. In contrast, a civil RICO case brought to recover tax revenue by a foreign sovereign to further its own interests may be, but is not necessarily, consistent with the policies and interests of the United States.
- A scheme to defraud a foreign country of its right to impose taxes may be punished under appropriate circumstances by the U.S. government, in U.S. federal courts, using U.S. federal penal laws. This does not mean that U.S. federal courts in a civil case may determine the validity of a foreign tax law or the extent of liability thereunder and award that amount to a foreign sovereign.
- Legal commentators' criticism of the revenue rule is off point. When the two sovereigns have recognized the vitality of the revenue rule and have a well-established treaty process that has strictly limited the extent to which each government can pursue its tax claims using the other's domestic administrative and judicial processes, the foreign affairs and separation of powers rationales for the revenue rule have substantial continuing force.
- When Congress enacted RICO, there was no indication that it intended the act to abrogate the revenue rule regarding claims brought by foreign sovereigns under the statute. To abrogate a common law principle, a statute must speak directly to the question addressed by the common law.
- Canada's claim for damages based on law enforcement costs was in essence an indirect attempt to have a U.S. court enforce Canadian revenue laws — an exercise barred by the revenue rule.

In reaching its decision, the court distinguished claims brought by a foreign government in its role as a sovereign from claims that arose because the foreign government was operating a business. Recovering law enforcement claims and lost revenue are sovereign claims and are barred by the revenue rule, it concluded.

b. RJR Nabisco.

More or less the same issue was litigated in *RJR Nabisco*,[24] in which the plaintiffs argued that the USA PATRIOT Act of 2001, which principally targeted terrorist activity, indicated a congressional intent to override the revenue rule in the circumstances presented. The principal plaintiffs were the European Community and several member states. The defendants were tobacco companies.

The main allegation was that the tobacco companies violated RICO by devising ongoing schemes to smuggle contraband cigarettes into the plaintiffs' territories. The plaintiffs also alleged that as part of these schemes, the companies entered into conspiracies to commit mail fraud, wire fraud, money laundering, and other offenses. Those alleged acts caused the plaintiffs economic harm in the form of lost tax revenue and law enforcement costs. The trial court dismissed the smuggling-related claims as barred by the revenue rule, citing *R.J. Reynolds*.

On appeal, the plaintiffs asserted that the legislative history of the PATRIOT Act reflected congressional intent to allow foreign sovereigns to use RICO to impose liability on domestic tobacco companies that try to evade the revenue laws of other countries. The basis for this contention was Congress's failure to enact a legislative proposal that would have codified the decision in *R.J. Reynolds*. To the plaintiffs, that failure meant that Congress intended to eliminate the revenue rule.

The Second Circuit disagreed, finding no support for that assertion. It noted that an existing common law rule is not considered to be repealed by a newly enacted statute in the absence of a clear manifestation of that intent by Congress, and that nothing in the contemporaneous legislative history suggested that Congress had intended to override the revenue rule. Statements made after the enactment of RICO (that is, in the legislative history of the PATRIOT Act) were given relatively limited consideration. The appeal was denied.[25]

Similar cases unsuccessfully attacking the revenue rule under RICO or the PATRIOT Act include actions brought by the governments of Honduras[26] and Ecuador.[27] The Ecuador case cited *Japan Tobacco*,[28] in which the district court explained that there is an exception to the revenue rule "where the plaintiff can show adequate manifestation of executive or legislative will sufficient to allay the foreign relations and separation of powers concerns underlying the revenue rule."

c. Diageo North America.

Diageo North America[29] explored the application of the revenue rule to private activity carried on by a sovereign. The plaintiffs were various departments of the Republic of Colombia that had a constitutional monopoly in the domestic manufacture and sale of liquor products. Some of the plaintiffs manufactured or distilled liquor in Colombia, while others sold or distributed it there. The defendants were companies that manufactured, distilled, and/or distributed liquor internationally. The plaintiffs alleged that the companies were part of a single RICO enterprise that engaged in a money laundering scheme involving narcotics traffickers who acted as bankers for the sale of liquor in import transactions.

[24] *European Community v. RJR Nabisco Inc.*, 355 F.3d 123 (2d Cir. 2004).

[25] The plaintiffs petitioned the Supreme Court for review. While the petition was pending, the justices handed down *Pasquantino*, 544 U.S. 349 (2005), discussed *infra* at Section III. The Court in *Pasquantino* at footnote 1, citing *R.J. Reynolds*, 268 F.3d 103, stated that it was not expressing a view on whether a foreign government, based on wire fraud or mail fraud predicate offenses, could bring a civil RICO action for a scheme to defraud it of taxes. The Court later granted the *RJR Nabisco* petition, vacated the Second Circuit's judgment, and remanded for reconsideration in light of *Pasquantino*. On remand, the Second Circuit held that *Pasquantino* did not affect its earlier decision. *RJR Nabisco*, 424 F.3d 175 (2d Cir. 2005). However, like the killer robot in the "Terminator" movies, the case dragged on after the complaint was amended. Ultimately, the Supreme Court held that although predicate acts for violation of the RICO statute could take place outside the United States, only U.S. damages are recoverable. *RJR Nabisco,* 579 U.S. 325 (2016).

[26] *Republic of Honduras v. Philip Morris Companies*, 341 F.3d 1253 (11th Cir. 2003).

[27] *Republic of Ecuador v. Philip Morris Companies Inc.*, 188 F. Supp.2d 1359 (S.D. Fla. 2002).

[28] *The European Community v. Japan Tobacco Inc.*, 186 F. Supp.2d 231, 235 (E.D.N.Y. 2002).

[29] *Republic of Colombia v. Diageo North America Inc.*, 531 F. Supp.2d 365 (E.D.N.Y. 2007).

Three independent parties needed to acquire currencies: Liquor smugglers needed to acquire U.S. dollars to purchase liquor from the companies, the Colombian drug traffickers needed pesos to carry on the production of illegal narcotics in Colombia, and the companies needed to be paid in U.S. dollars outside Colombia. An overriding consideration for the liquor smugglers and the companies was the steep fees and taxes imposed by the Colombian government on purchases of foreign currency through legal channels.

The solution to the currency conundrum was simple:

- The liquor smugglers purchased dollars located outside Colombia from the drug traffickers in return for pesos located in Colombia. Generally, the transaction value overstated the value of the peso. The dollars were used to pay the companies at acceptably high prices, measured in dollars. This amounted to wins for the companies and the liquor smugglers.
- The drug traffickers used the pesos received from the smugglers to produce additional narcotics in Colombia. This amounted to a win for the drug traffickers.
- Colombian taxes and fees imposed on the purchase of foreign currencies were completely avoided. This amounted to a major loss for the Colombian government.

In the civil lawsuit brought in the United States, the Columbian government asserted three RICO claims against the companies:

1. The companies charged the Colombian liquor smugglers higher dollar-denominated prices for liquor than they would be able to charge in a legal market because the smugglers obtained the U.S. dollars at an illegal discount and did not have to pay Colombian taxes and fees.
2. The significant currency discount in U.S. dollars acquired by Colombian liquor smugglers enabled them to sell large quantities of illegally imported liquor to Columbian consumers at below-market prices. This allowed the companies to increase their market share and profits.
3. Because liquor demand was relatively elastic, the companies were able to change demographic buying patterns so that consumers purchased more smuggled liquor and less domestic rum because the smuggled liquor was relatively cheaper than locally produced rum.

The plaintiffs sought to recover damages for:

- the total amount of criminal proceeds laundered by the companies;
- the large amounts of money expended in Colombian efforts to stop money laundering and to recoup funds that the plaintiffs lost because of the companies' activities; and
- compensation for the revenue and profits that the plaintiff liquor manufacturers and distributors lost because of the defendants' enterprise.

The court held that the first two RICO claims were barred by the revenue rule but that the third claim was not. It reasoned that a U.S. court should not be asked to address a tax-related claim because tax policy embodies political and social judgments of a sovereign and its people. According to the court, the judiciary should not be drawn into issues and disputes of foreign relations policy that are assigned to and better handled by the political branches of government. It concluded that those concerns do not apply when the claim brought by a foreign sovereign does not relate to damages suffered as a commercial actor:

> A sovereign engages in commercial activity for the same reason a private individual or corporation participates in such activity — to turn a profit. A sovereign's decision to drill for oil, manufacture airplanes, or provide postal services is not infused with the kinds of moral and political judgments necessarily involved in taxing cigarettes or providing a tax credit for higher education spending.
>
> To read the revenue rule to prohibit sovereigns from bringing damages claims irrespective of the nature of the damages claim would have extremely troubling consequences. As Plaintiffs urged at oral argument, if the revenue rule prohibits sovereigns from bringing all claims for damages, then the Venezuelan government could not bring a claim

> arising out of a contract dispute with an American corporation concerning Venezuela's oil business. . . . If the United Kingdom had such a revenue rule, the United States Postal Service could not bring a contract claim in the United Kingdom against a British corporation that it had retained to deliver American mail in the U.K. Such an interpretation of the revenue rule would (1) make it very difficult for sovereigns to participate in commercial activities and (2) provide strong disincentives for foreign sovereigns to do business with United States corporations. Such a reading of the revenue rule would cause these problems while achieving absolutely no public policy purpose: prohibiting sovereigns from bringing claims arising out of purely commercial activities would in no way serve the separation of powers or extraterritoriality concerns that currently motivate federal courts to recognize the revenue rule.[30] [Footnotes omitted.]

The distinction between a damages claim arising from an impairment of a governmental function carried on by a foreign sovereign and a damages claim arising from the impairment of a commercial activity carried on by a foreign sovereign means that a court will have jurisdiction in adjudicating a lost profits claim in the latter case.

The decision leaves several questions unanswered. In a footnote, the court queried whether the operation of a legal monopoly in the production and distribution of liquor became a governmental function because the proceeds were to be used preferably for healthcare services and education.[31] Because the defendants did not raise the matter, the court did not address it further. The court also did not address whether the mere fact that the Colombian government created a monopoly for its exclusive benefit inherently meant that it was not acting as a private business, which typically involves some sort of competition.

[30] *Id.* at 386.

[31] *Id.* at 393 n.6.

The court then turned to whether the revenue rule prevents a court from recognizing a foreign revenue law without enforcing that law:

> There is a continuum along which a claim will require a court to consider or "pass on" a foreign tax law. At the least problematic end of the continuum is the mere recognition of a foreign tax law. At the next point along the continuum, a court must apply such a foreign law. Next, a claim might require a court to rule on the validity of a foreign tax law. Finally, a claim might require a court to explicitly enforce a foreign revenue law. The Second Circuit cases make clear that the revenue rule clearly bars explicit enforcement. However, I find that whether lesser forms of consideration of a foreign revenue law — recognition, application, and determination of validity — are permissible depends on the extent to which the consideration of the foreign revenue law raises separation of powers and sovereignty concerns.[32]

As discussed below in connection with *Pasquantino*, courts may recognize a foreign law when the violation of that law and other U.S. domestic factors result in the commission of a crime under U.S. law.

D. Canadian Cases

The rule of *Taylor*[33] is that the revenue rule is limited to cases of direct and indirect enforcement of the revenue laws of a foreign state. Indirect enforcement occurs when (1) the foreign state (or its nominee) in form seeks a remedy that, in substance, is designed to give the foreign law extraterritorial effect; or (2) a private party raises a defense based on the foreign law to vindicate or assert the right of the foreign state.[34]

Whether the revenue rule would apply indirectly is important in the context of an

[32] *Id.* at 388.

[33] *Taylor* (1955) AC 491. *See* Section II.A.2.

[34] House of Lords Judgment in *In re State of Norway*, 28 I.L.M. 693, 716 (1989), wherein the House of Lords cites *Dicey, Morris, and Collins on the Conflicts of Laws*, *supra* note 3, at 103, stating, "I have been unable to discover any case of indirect enforcement which goes beyond these two propositions."

executor or trustee — a party who in many jurisdictions is held personally liable for the estate taxes of the decedent. The following cases explored that issue.

1. *Re Fudger*.

In *Re Fudger*,[35] the Ontario Supreme High Court disregarded the personal liability of an executor to pay capital taxes to the U.K. revenue authorities that arose upon the death of a dual Canadian-Scottish tax resident.

The decedent died leaving assets in Scotland and Canada. The disposition of the Scottish property was governed by a Scottish will, while the disposition of the Canadian property was governed by a Canadian will. The United Kingdom levied capital tax on the worldwide assets of the decedent, resulting in a tax far exceeding the value of the Scottish estate. Both the Canadian executors and the Scottish executors were personally liable for the assessed U.K. capital transfer tax. The Canadian court interpreted the use of separate wills to mean that only the Scottish assets could be applied to fund payment of the U.K. capital tax. It concluded that any claim made by the U.K. tax authority against the Canadian executor for payment of tax was not "provable or enforceable" in Ontario:

> To construe the Canadian will in such a way as to require the Canadian executor to pay foreign tax simply because a foreign beneficiary under a foreign will might otherwise be exposed to the payment of taxes imposed in the foreign jurisdiction, would be an indirect method of enforcing the revenue laws of the foreign jurisdiction.[36]

2. *Re Reid*.

In *Re Reid*,[37] two conflicting principles of law were brought before the court. One was the revenue rule — that revenue laws of a foreign state are not enforceable in a foreign court. The other was the rule in *Belilios*[38] that the beneficial owner of property is responsible for losses incurred by a trustee in holding the property for the benefit of the beneficiaries, unless the beneficiary can demonstrate a good reason why the trustee must bear the liabilities personally.

Re Reid involved an English corporate executor and trustee of an estate domiciled in England that had assets in both England and British Columbia. The executor-trustee was personally liable for English estate duty levied against the entirety of the decedent's estate.[39] Because the estate's assets in England were insufficient to cover the English estate duty, the executor-trustee paid the estate duty out of its own funds. To do otherwise would have led to the seizure of the assets of the executor-trustee in a forced winding up procedure in England. Later, the executor-trustee sought reimbursement from the estate's Canadian assets.

A remainder beneficiary under the will was based in Canada. That beneficiary brought an action seeking a court order to have the Canadian assets distributed in full, without any provision for the reimbursement of the corporate executor-trustee for payment of the English estate duty shortfall. The request for the court order was denied, and the remainderman appealed. The appeal was dismissed. In reaching its decision, the British Columbia Court of Appeal framed the issue it faced by citing two cases. The first was *Belilios*:

> The [corporate executor-trustee] takes the position that it is entitled to be indemnified in respect of the estate duty that it has paid out of the assets of the estate wherever situate and it relies on the principles stated in *Hardoon v. Belilios* [1901] A.C. 118. There the plaintiff was the registered holder of partly-paid shares that he held in trust for the defendant as beneficial owner; calls were made on the shares; the question raised by the appeal was whether the plaintiff was entitled to be indemnified by the defendant against

[35] *Re Fudger* (1984) 18 E.T.R. 12, 28 (Ont. H.C.).

[36] *Id.* at 21.

[37] *Re Reid* (1970) 17 D.L.R. 3d 199 (*sub nom. Hill v. Yorkshire & Canadian Trust Ltd.* [1971] 2 W.W.R. 121).

[38] *Hardoon v. Belilios* [1901] A.C. 118 (a privy council case) (unless the beneficiary can demonstrate a good reason why the trustee must bear the liabilities personally).

[39] Section 8 of the English Finance Act, 1894.

the calls. Lord Lindley delivered the judgment of the Judicial Committee and he said at p. 123:

> The next step is to consider on what principle an absolute beneficial owner of trust property can throw upon his trustee the burdens incidental to its ownership. The plainest principles of justice require that the cestui que trust who gets all the benefit of the property should bear its burden unless he can shew some good reason why his trustee should bear them himself. The obligation is equitable and not legal, and the legal decisions negativing it, unless there is some contract or custom imposing the obligation, are wholly irrelevant and beside the mark.[40]

The second case cited was *Harden*[41]:

> The [remainderman] advances as a good reason why the respondent itself should bear the estate duties (or, rather, so much of them as cannot be met out of the assets in the United Kingdom) that which is referred to in *United States of America v. Harden* . . . as the well-established rule "that a foreign State is precluded from suing in this country for taxes due under the law of the foreign State," at p. 370 as "the proposition 'that in no circumstances will the courts directly or indirectly enforce the revenue laws of another country,'" and at p. 371 as "the special principle that foreign States cannot directly or indirectly enforce their tax claims here." At p. 371 Cartwright J. (as he then was), who delivered the judgment of the Court, spoke of "this rule, which is one of public policy."[42]

Having recognized the arguments on both sides, the court decided in favor of the corporate executor-trustee, reasoning as follows:

> This is not a case like *United States of America v. Harden, supra*, where the government of the United States, having obtained a judgment there for taxes, sued upon that judgment in a British Columbian court; it was held that the claim upon the judgment remained a claim for taxes, and so the action failed. Nor is this case like *Peter Buchanan Ltd. and Macharg v. McVey*. . . . Kingsmill Moore J. held that the sole object of the liquidation proceedings in Scotland [by the liquidator, Macharg] was to collect a revenue debt and that the sole object of the proceedings in Eire was to collect a Scottish revenue debt, and he rejected the claim. An appeal was dismissed by the Supreme Court of Eire. *Government of India, Ministry of Finance (Revenue Division) v. Taylor* . . . is also distinguishable. There the Government of India sought to prove in the voluntary liquidation of a company registered in the United Kingdom but trading in India for a sum due in respect of Indian income tax; the proof of debt was rejected. Still another case is *Re Visser; Queen of Holland v. Drukker* . . . where the Queen sued in England the administrator of the estate of a Dutch subject, who died domiciled in Holland, to recover Dutch death duties; applying the rule sought to be invoked here, Tomlin J. dismissed the suit. In every one of the cases I have referred to, success would have enriched the treasury of the interested state. In the case at bar, whether or not the respondent trustee is indemnified cannot affect to the slightest degree the amount of estate duty collected in England. Further, in each of those cases the foreign state was, in England or Eire, the plaintiff, the claimant or the instigator of the proceedings. Here the United Kingdom has nothing whatever to do with the respondent's claim to be indemnified.[43] [Citations omitted.]

[40] *Re Reid*, 17 D.L.R. 3d at para. 5.

[41] *Harden* [1963] S.C.R. at 369.

[42] *Re Reid*, 17 D.L.R. 3d at para. 10.

[43] *Id.* at para. 13.

3. *Dubois.*

The Alberta Court of Appeal in *Dubois* declined to follow *Re Reid.*[44] Again, the facts centered on a trustee and an estate. The decedent, a U.S. citizen, died while domiciled in Arizona, with the result that her worldwide estate was subject to U.S. estate tax. The estate consisted of assets in Arizona and a wheat farm in Alberta, the latter of which the decedent had devised to her niece, also a U.S. citizen, by will. The U.S.-situs assets were insufficient to cover the U.S. estate taxes due. The U.S. executor applied to an Arizona court for an order apportioning the total estate taxes due. The court issued an order that 63.15 percent of the U.S. estate tax be paid from the U.S.-situs assets and that the remainder be paid from assets including the Canadian wheat farm.

The niece sought to prevent the executors from liquidating the Canadian farm to cover the estate tax. The Alberta Court of Appeal disagreed with the holding in *Re Reid* and held that the revenue rule was applicable and binding. It was irrelevant that the tax claim was not being enforced by the U.S. government in the Alberta court:

> With the greatest respect, I do not consider that to be a proper basis for distinguishing *Harden*. It implies that the act of a trustee in first paying the foreign levy and then seeking reimbursement would serve to emasculate the *Harden* rule. I do not agree. In any event, in the present case, it is clear that success would have the immediate effect of enriching the U.S. treasury.
>
> . . .
>
> The major difficulty [with the holding in *Re Reid*] is to determine under what circumstances must the *Harden* rule be applied. The authorities seem agreed on the key question that must be asked for that determination, namely, what is the nature or substance of the proceedings placed in issue? In the present case the nature or substance of the proceeding is the indirect enforcement of the tax laws of the United States and as such the rule enunciated in *Harden* should be applied.[45]

The Alberta Court of Appeal and the British Columbia Court of Appeal are at the same level, which means that a decision from one does not override a decision from the other. In Canada, only the vertical convention of *stare decisis* is strictly binding.[46] Consequently, in Canadian provinces other than Alberta and British Columbia, it is unclear whether a beneficiary of an estate can successfully invoke the revenue rule to prevent a trustee from using Canadian-situated assets to pay a death or estate tax levied by a foreign jurisdiction simply by arguing that reimbursing the trustee is an indirect enforcement of the revenue rule.

Re Reid and *Dubois* have not been adjudicated further in Canada regarding the revenue rule. However, as discussed in the following sections, they were considered by the Grand Court of the Cayman Islands in *Compass Trust*,[47] and more recently by the Hong Kong High Court in *Pico Projects.*[48]

4. *Pico Projects.*

Pico Projects concerned the recovery of a tax payment made by a customer in Russia to the tax authorities in Russia. The customer paid the tax with its own funds and brought an action in Russia against the supplier, claiming unjust enrichment.

The plaintiff was the Olympic Organizing Committee for the Sochi Winter Olympics in 2014. The dispute centered on a Russian withholding tax that the committee should have withheld from rental payments to Pico Projects, the supplier of tents and similar structures used at the winter Olympics. Because the committee failed to collect the required withholding tax, it had to pay the tax due from its own funds. Consequently, it obtained a judgment against Pico in a Russian court

[44] *Stringam v. Dubois* (1992) 135 A.R. 64, 33 W.A.C. 64, [1993] 3 W.W.R. 273 (Alta. Ct. App.).

[45] *Id.* at paras. 31 and 34.

[46] The Honourable Justice Malcolm Rowe and Leanna Katz, "A Practical Guide to *Stare Decisis*," 41 *Windsor Rev. Legal Soc. Issues* 6 (2020).

[47] *Wahr-Hansen v. Compass Trust Co. Ltd.* (2007) ITLR 283.

[48] *Non-Commercial Organization "Organizing Committee etc. of 2014 Sochi Winter Autonomous Olympics" v. Pico Projects (International) Ltd.* [2021] 2 HKLRD 246, [2021] HKEC 953.

claiming that the company was enriched unjustly. The committee then sought to enforce that judgment in Hong Kong, where Pico's principal office was located.

The issue presented to the High Court in Hong Kong mirrored the disparate holdings in *Re Reid* and *Dubois*:

- Was the fact that the committee paid the tax sufficient to remove the case from the scope of the revenue rule? If so, this was simply a case of unjust enrichment, as argued by the committee.
- Or was the case brought in Hong Kong an indirect enforcement of Russian tax law? If so, allowing recovery would emasculate the revenue rule, as argued by Pico.

The High Court of Hong Kong ruled that the matter was simply a case brought by a private party for unjust enrichment. Following the reasoning of *Re Reid* and other cases,[49] it held that only when the success of the claim affects the amount of tax collected by the foreign state will the legal proceeding in a court amount to indirect enforcement of foreign tax law. After discussing cases cited by both sides, the court determined that when the matter before a court is between two private parties and the foreign revenue authority no longer has a monetary interest in the outcome, the revenue rule is not applicable. Thus, it concluded in effect that *Re Reid* and *Dubois* were correctly decided:

> Where there is an unsatisfied debt and the factual circumstances justify a conclusion that the tax authorities are enforcing their own tax laws, the nature of the claim, and the identity of the claimant is immaterial. But if there is no unsatisfied debt, I fail to see how it can be said that the claim is an indirect enforcement of the foreign tax law. In its most simplistic form, all foreign tax law has already been enforced if there is no unsatisfied claim.

5. *Compass Trust.*

In *Compass Trust*,[50] the Grand Court of the Cayman Islands refused to apply the revenue rule to prevent a Norwegian representative of the Norwegian probate court from seeking information to uncover assets allegedly belonging to the estate of shipping magnate Anders Jahre, who was domiciled in Norway at the time of his death in 1982.

In a complex fact pattern that spanned over 60 years, Jahre was a person of interest for the Norwegian tax authority regarding unreported investments and income held outside Norway. In the early 1970s he pledged a contribution toward the funding of a town hall in his hometown. A payment in satisfaction of the pledge was made on his behalf from an account in a Swedish bank in the name of Continental Trust Co. Ltd. (CTC), a Panamanian company. This triggered an additional tax examination. Two months after Jahre's death, the Norwegian tax authority retroactively reassessed tax on him in the amount of $125 million (USD) of tax, penalties, and interest for the 12-year period preceding his death. The claim was based on the contention that Jahre was the beneficial owner of 10,000 CTC shares.

Approximately eight years into the probate proceedings, the administrator of the estate was relieved, and the attorney general of Norway advised the probate court that the amount of the unpaid tax deficiency (including tax, penalties, and interest) effectively made the Norwegian tax authority the principal party having an interest in the decedent's estate. Moreover, the Norwegian tax authority wanted an aggressive administrator appointed to be able to liquidate the balance owed by the estate. The Norwegian government recommended Even Wahr-Hansen, an attorney with specialties in taxation and shipping/maritime law and with experience in tracing assets of another Norwegian shipping magnate.

Working with a Norwegian journalist, the administrator was introduced to an individual who had documents that could help prove that CTC belonged to Jahre at the time of his death. The individual demanded a fee of roughly 20

[49] *Williams and Humbert v. W&H Trade Marks (Jersey) Ltd.* [1986] AC 368; *Air India Ltd. v. Caribjet Inc.* [2002] 1 Lloyd's Rep 314.

[50] *Compass Trust* (2007) ITLR 283.

percent of the net recovery. This arrangement was approved by the Norwegian government, which supplied $270,000 — the first installment of the individual's fee. At about the same time, the administrator contemplated bringing a legal action against specific investment bankers. Under Norwegian law, the probate judge was exposed to counterclaims. The Norwegian government agreed to indemnify the probate judge. Other litigation was instituted by the administrator, and the Norwegian government allocated about $16.2 million to the estate to carry on the legal actions. The administrator settled with the investment bankers, who were willing to pay $41.5 million on the condition that no further action would be brought against them by the Norwegian government. The Norwegian government agreed, and the probate court approved the settlement, which effectively eliminated the heirs from any interest in the estate. All recoveries would belong to the creditors, the largest of which was the Norwegian government.

A company owned by the estate initiated bankruptcy proceedings against the estate because the estate was technically bankrupt. This concerned the administrator because if there were no other creditor of the estate other than the Norwegian government, the estate's legal action against CTC would be weakened under the revenue rule because that company existed in the Cayman Islands. With funding of the Norwegian government, the administrator of the estate settled with the company, thereby avoiding bankruptcy.

In this fact pattern, the administrator of the estate brought an action in the Cayman Islands against CTC and others, alleging that Jahre was the beneficial owner of the CTC shares because of a constructive trust at the time of his death, and that those shares belonged to his estate. The defendants raised the "tax gathering" defense, which in substance is the revenue rule. They argued that the action to uncover the ownership of the CTC shares was in substance an action to recover unsatisfied tax liabilities to the Norwegian government. The court disagreed. It found as a factual matter that the Norwegian government was not a party to the action either nominally or in substance, and it allowed the case to proceed.

The court embarked on an exhaustive recitation of applicable case law, including *Re Reid* and *Dubois*. In particular, it cited *Evans*,[51] a matter brought in an Australian court to recover property owned by the official assignee of an estate in bankruptcy in New Zealand:

> About 56 percent of the debts of the estate were due to the New Zealand revenue authorities. One of the grounds advanced in Australia against honouring the letters of request was the rule against indirect enforcement of a foreign revenue claim.
>
> All three judges decided that the request should be honoured and assistance given. Fox, J. referred to the fact that "the farthest the cases have gone" is to deny a claim where the entire amount sought to be recovered by a liquidator or official assignee in a foreign country will go to the Revenue. He held that the rule does not apply where the property claimed will eventually benefit ordinary creditors as well as the foreign revenue authority. His Lordship also said this (39 ALR at 130-131):
>
>> A liquidator, or an official receiver or assignee, does not act to enforce the revenue claim, but to obtain property which is to be dealt with in a due course of administration. In his own country he will doubtless meet revenue claims where these are payable out of the property coming to his hands, but in the foreign country he is simply seeking to get in property under a title recognized in that country. In *Peter Buchanan Ltd v. McVey* it was obvious that the property in Ireland which was wanted by the Scots liquidator would go only to the Scottish revenue authority and the claim was rejected (see [1955] AC at 530). The court looked behind the representative character of

[51] *Ayres v. Evans* (1981) 39 ALR 129.

> the claimant. It is in some respects an anomalous case, although doubtless sensible in its result.[52]

The opposite conclusion was reached in *Frandsen*,[53] an action brought in an English court by the liquidator of five Danish companies. The companies had a common owner who arranged for all assets to be sold and who then used the proceeds to redeem the shares held by the sole shareholder. This asset-stripping scheme gave the companies a remedy against the common shareholder under Danish company law. By the time the action commenced, the common shareholder resided in England. The Danish government funded the litigation. The English court found the revenue rule applicable.

Having discussed the cases, the *Compass Trust* court stated that the following three facts need to exist for a court to apply the revenue rule:

1. *There is an unsatisfied tax claim*. This element was met; it was not in dispute.
2. *The proceeds of the litigation will go to the foreign revenue authority*. This element was met in substance because the heir's position was wiped out and the only claimant other than the Norwegian tax authority was the Norwegian Ministry of Justice. That agency worked in tandem with the Ministry of Finance to pursue the tax claim by advancing funds to pay off a claimant, thereby keeping the estate from being placed in involuntary bankruptcy. In any event, its claim was less than 1 percent of the tax claim.
3. *The claim is in substance an attempt to collect foreign tax*.[54] This element was not met as a matter of fact finding.

The court found the following salient facts:

- The administration of the Jahre estate was not initiated by the Norwegian tax authority. It was only after a severe illness of the first administrator, eight years into the period of administration, that the agency proposed the appointment of the second administrator.
- The mandate to search for assets abroad was given to the second administrator by the probate court in January 1991, with the consent of the principal heir.
- Under Norwegian law, the estate of a decedent is a separate legal entity, with the probate judge as its head.
- The probate court was charged with the responsibility of administering the estate, although a probate judge was empowered to appoint assistants, and did so in appointing the second administrator.
- All significant decisions must ultimately be made by the probate court. The probate court is required to accept a decision of the heir of the estate unless the judge concludes that the decision is contrary to the interests of the creditors.
- Even though the estate was insolvent, the creditors had limited formal influence on its administration. For the most part, the creditors were not entitled to attend meetings of the court. However, the probate judge considered it appropriate to invite the creditors of Jahre's estate to attend probate court meetings and to express their views on important decisions.
- Again, even though the estate was insolvent, the views of the heir had to be considered and acted on unless they were contrary to the interests of the creditors.
- The degree of supervision exercised by the probate court significantly exceeded what would be exercised over a typical court-appointed liquidator, particularly when there is only a single creditor.

The court recognized that the second administrator worked closely with the Norwegian Ministry of Finance and paid much attention to its wishes and views. The Ministry of Finance also provided only limited information to the probate court. Although those assertions were disturbing, the court concluded that the probate court was acting in a fashion commensurate with a probate proceeding rather than a bankruptcy liquidation proceeding. In sum, and as a finding of fact, the court concluded that the claim was not in substance an attempt to collect foreign tax.

[52] *Compass Trust* (2007) ITLR 283 at paras. 57 and 58.

[53] *QRS 1 ApS v. Frandsen* [1999] 1 W.L.R. 2169.

[54] *Compass Trust* (2007) ITLR 283 at para. 11.

III. *Pasquantino*

Pasquantino[55] involved a prosecution under the U.S. federal wire fraud statute for a smuggling scheme to defraud Canada of its rightful customs tax revenue. It did *not* involve a claim by Canada to enforce a customs fraud recovery in the United States. The criminal defendants initially succeeded in arguing that the prosecution was barred by the revenue rule, but they ultimately lost in the Supreme Court.

A. Facts

As discussed in connection with *R.J. Reynolds*, Canada imposes substantial sin taxes on alcohol and cigarettes. As a result, there is a black market for those items. Capitalizing on the situation, David and Carl Pasquantino, both residents of Niagara Falls, New York, began smuggling cheap liquor into Canada.

Their business began in 1996 and continued through May 2000. Their general procedure was to arrange an order by telephone with a discount liquor store in Maryland. They would drive from Niagara Falls to Hagerstown, Maryland, to purchase the liquor. The liquor would be transported to New York and ultimately smuggled into Canada in hidden compartments in cars.

The Pasquantinos were indicted and convicted of wire fraud, in violation of 18 U.S.C. section 1343, which provides:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation affects a financial institution, such person shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

On appeal, the Fourth Circuit reversed the convictions.[56] It found that a scheme to defraud a foreign government of tax revenue was not recognizable under the wire fraud statute because of the application of the revenue rule. The court acknowledged that Canada's right to collect taxes was a property right for wire fraud purposes, but it concluded that the determination of whether Canada was entitled to the tax revenue involved an inquiry into the validity and operation of a foreign revenue law — an inquiry barred by the principles underlying the revenue rule. In substance, the court held that the revenue rule prevented a court in the United States from acknowledging the validity of a foreign revenue statute in a legal proceeding brought by the U.S. government in a U.S. court. In so ruling, the Fourth Circuit joined the First Circuit in holding that a scheme to defraud a foreign country of tax revenue did not violate the wire fraud statute.[57] The Second Circuit previously upheld wire fraud convictions for schemes to defraud a foreign government of tax revenue.[58]

On the U.S. government's motion, the Fourth Circuit in *Pasquantino* granted rehearing en banc, and the full panel vacated the prior appeals decision, thereby affirming the convictions.[59]

B. Supreme Court Ruling

The Supreme Court affirmed the petitioners' convictions for violating the wire fraud statute.

1. Wire fraud statute.

The Supreme Court held that the two elements of wire fraud — (1) a scheme or artifice to defraud, and (2) the object of the fraud being money or property in the victim's hands — were present in the case. The Pasquantinos' plot was a scheme or artifice to defraud the Canadian government of its valuable entitlement to tax revenue. The evidence showed that the

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[55] *Pasquantino*, 544 U.S. 349, *aff'g* 336 F.3d 321 (4th Cir. 2003) (opinion on rehearing en banc).

[56] *Pasquantino*, 305 F.3d 291 (4th Cir. 2002) (three-judge panel decision).

[57] *United States v. Boots*, 80 F.3d 580 (1st Cir. 1996).

[58] *United States v. Trapilo*, 130 F.3d 547 (2d Cir. 1997).

[59] *Pasquantino*, 336 F.3d 321.

Pasquantinos routinely concealed imported liquor from Canadian officials and failed to declare those goods on customs forms.

Further, Canada's right to uncollected excise taxes on the liquor imported into Canada was property in its hands, given the economic equivalence between money in hand and money legally due. The fact that the victim of the fraud happened to be a government, rather than a private party, did not diminish the injury, the Court found.

2. Does the revenue rule prevent prosecution in the United States?

Having found that the predicate acts for wire fraud existed, the Supreme Court next addressed whether Congress intended for the revenue rule to exempt prosecution under the wire fraud statute even if the predicate facts for a violation of the foreign tax law exist. The Court found that no common law revenue rule cases decided as of the enactment of the wire fraud statute in 1952 barred the United States from prosecuting a fraudulent scheme to evade foreign taxes. Odd as it may seem for the federal government to prosecute a U.S. citizen for smuggling cheap liquor into Canada, the broad language of the wire fraud statute authorized that prosecution, and no canon of statutory construction permitted the Supreme Court to read the statute more narrowly, the opinion explained.

The Supreme Court differentiated *Pasquantino* from the actions traditionally barred by the revenue rule — this was not a suit to recover a foreign tax liability, as were the RICO cases discussed earlier (see Section II.C.2); instead, this was a criminal prosecution brought by the United States in its sovereign capacity to punish domestic criminal conduct. A prohibition on the enforcement of foreign penal law does not plainly prevent the U.S. government from enforcing U.S. domestic criminal law, the Court said.

The Pasquantinos argued that the matter inherently involved a collection of tax because a conviction automatically provided restitution rights to the victim — the Canadian government — under the Mandatory Victims Restitution Act of 1996.[60] Under that view, restitution and tax enforcement were one and the same. The Supreme Court adopted a different view, however: It found that the purpose of the Restitution Act is merely to award restitution, not to collect a foreign tax, and that restitution metes out appropriate punishment for the criminal conduct. If awarding restitution to foreign sovereigns were contrary to the revenue rule, the Court observed, the proper resolution would be to construe the Restitution Act in a way that would not allow those awards rather than to implicitly repeal the wire fraud statute when the defrauded party is a foreign sovereign.

The Supreme Court acknowledged that the criminal prosecution enforced Canadian revenue law in an attenuated sense but said that the line the revenue rule draws between impermissible and permissible enforcement of foreign revenue law had always been unclear and that no cases yielded a rule sufficiently well established to narrow the wire fraud statute in the context of the criminal prosecution of the Pasquantinos.

The Court then examined the purposes of the revenue rule and concluded that they did not bar its application in this case, for the following reasons:

- The prosecution posed little risk of causing international friction through judicial evaluation of the policies of foreign sovereigns.
- The prosecution embodied the policy choice of the two political branches of the U.S. government — Congress and the executive branch — to free the interstate wires from fraudulent use, regardless of the object of the fraud. That reading of the wire fraud statute gave effect to the policy choice and posed no risk of illegitimately advancing the policies of Canada.
- The Supreme Court's interpretation of the wire fraud statute did not give it extraterritorial effect — the Pasquantinos' offense was complete the moment they executed the scheme inside the United States. The wire fraud statute punished frauds executed in interstate or foreign commerce, and it was not a statute in which Congress had only domestic concerns in mind.

[60] 18 U.S.C. sections 3663A et seq.

3. Dissenting opinion.

In a dissenting opinion, Justice Ruth Bader Ginsburg pointed out that the decision failed to consider Canada's primary interest in the matter. U.S. citizens who have committed criminal violations of Canadian tax law can be extradited to stand trial in Canada, and Canadian courts were best positioned to decide whether and to what extent the Pasquantinos defrauded the governments of Canada and Ontario out of tax revenue owed under their sovereign excise laws, Ginsburg wrote.

The Pasquantinos' wire fraud convictions could not have been obtained without proof of their intent to violate Canadian revenue laws. The fact that the bulk of their sentences was related not to the U.S. crime of wire fraud but to the Canadian crime of tax evasion showed that this case was primarily about enforcing Canadian law, according to the dissent. The wire fraud statute contains no reference to foreign law as an element of the domestic crime. By construing the wire fraud statute to encompass violations of foreign revenue laws, the Supreme Court majority ignored the absence of anything signaling Congress's intent to give the statute such an extraordinary extraterritorial effect, Ginsburg wrote.

Ginsburg further complained that the majority disregarded the recognized principle that "Congress legislates against the backdrop of the presumption against extraterritoriality." Notably, when Congress explicitly addressed international smuggling under 18 U.S.C. section 546, it provided for criminal enforcement of the customs laws of a foreign country only when that country has a reciprocal law criminalizing smuggling into the United States. At the time of the case, Canada had no such reciprocal law.

The Canada-U.S. income tax treaty addresses requests for assistance in collection of taxes, and it requires certification by the requesting country that the taxes owed have been finally determined. However, the assistance in collection provisions did not apply here because they do not apply to a revenue claim concerning a tax period in which the individual taxpayer is a citizen of the requested state, the dissent noted.

The Pasquantinos' conduct arguably fell within the scope of the wire fraud statute only because of their goal to evade Canadian customs and tax laws. Short of that purpose, no other aspect of their conduct was criminal in the United States. The application of the Restitution Act to wire fraud offenses is corroborative, Ginsburg noted. The fact that the U.S. government effectively invited the district court to overlook the mandatory restitution statute out of concern for the revenue rule was revealing and demonstrated that the government's expansive reading of the wire fraud statute warranted the Supreme Court's disapprobation, according to the dissent. Congress has expressed with notable clarity a policy of mandatory restitution in all wire fraud prosecutions but has been quite ambiguous about the wire fraud statute's coverage of schemes to evade foreign taxes, Ginsburg wrote. Justices Antonin Scalia and David H. Souter joined that portion of the dissent.

Finally, the dissent argued that the rule of lenity would counsel against adopting the Supreme Court's interpretation of the wire fraud statute because the Court has long held that when confronted with two rational readings of a criminal statute, one harsher than the other, the harsher one is to be chosen only when Congress has spoken in clear and definite language. Justices Antonin Scalia and David Souter joined this portion of the dissent.

IV. Cum-Ex Litigation

The cum-ex litigation stems from a plan that took advantage of different rules in different countries for determining the date on which a shareholder's entitlement to dividends paid on specific shares of publicly traded stock moves from the seller to the purchaser.

A. Background

When U.S. persons purchase or sell shares of stock that are publicly traded, the determination of whether the seller or the purchaser is the person taxed in connection with the payment of a dividend is determined under the following regulatory rules[61]:

- If stock is sold and a dividend is both declared and paid after the sale, the

[61]Reg. section 1.61-9(c).

dividend is not gross income to the seller; it is gross income of the purchaser.

- If stock is sold after the declaration of a dividend and after the date on which the seller becomes entitled to the dividend, the dividend ordinarily is income to the seller.
- If stock is sold after the dividend is declared but before it is paid, and the sale takes place when the purchaser becomes entitled to the dividend, the dividend ordinarily is income to the purchaser:
  - The fact that the purchaser may have included the amount of the dividend in the purchase price in anticipation of receiving the dividend does not exempt the purchaser from tax.
  - The purchaser cannot deduct the added amount advanced to the seller in anticipation of the dividend. That added amount is merely part of the purchase price of the stock.
- In some circumstances, the purchaser may be considered the recipient of the dividend even though the purchaser has not received the legal title to the stock itself and does not receive the dividend. This would be the case if, for example, the seller retains the legal title to the stock as trustee solely to secure the payment of the purchase price, and with the understanding that the seller is to apply the dividends received from time to time in reduction of the purchase price.

The foregoing rules indicate that as between the purchaser and the seller, the party properly taxed on the dividend is the person identified as the beneficial owner of the shares on the date the holder of those shares becomes entitled to the dividend. It does not matter when the dividend is paid, nor does it matter when a physical transfer of the shares is effected (the settlement date).

Beneficial ownership is not the same as legal ownership, which typically looks to the person listed as the shareholder of record in the register maintained by the corporation. In the United States, beneficial ownership shifts from the seller to the purchaser on the trade date, not the settlement date.[62] In comparison, claims of entitlement to the physical receipt of a dividend look to the shareholder listed in the shareholder register on the record date of ownership chosen by the board of directors in the declaration of the dividend.

When shares are traded on an exchange, settlement of the trade may not close when expected. If the settlement occurs after the record date, the seller remains the legal owner on the record date, but not the beneficial owner. Hence the seller is not entitled to the dividend for income tax purposes but will receive the dividend in any event. When that occurs, the purchaser will have paid an amount that reflects the value of the anticipated dividend (cum-dividend shares) even though the value of the shares on the actual settlement date is lower, reflecting the absence of a right to the dividend (ex-dividend shares). When that fact pattern exists, the seller issues a payment under a "due bill" procedure, and the purchaser reports the dividend as income. Further, the seller receives a Form 1099-DIV, "Dividends and Distributions," reporting the actual receipt of the dividend and issues a Form 1099-DIV reporting that it received the dividend as a nominee of the purchaser.[63]

B. Cum-Ex Transactions

According to media reports and allegations in multiple lawsuits, an estimated €55 billion in tax revenue was lost in a dividend withholding tax scheme designed to take advantage of the way dividend withholding taxes were collected on publicly traded shares between 2002 and 2012.[64] Targets of the scheme included Germany (an estimated €30 billion in tax revenue), Denmark (€1.7 billion), Belgium (€200 million), France (€17

[62] Rev. Rul. 93-87, 1993-2 C.B. 124.

[63] IRS, "General Instructions for Certain Information Returns," at section A (2021) (forms 1096, 1097, 1098, 1099, 3921, 3922, 5498, and W-2G).

[64] James Siswick and Alexandra Will, "INSIGHT: Cum-Ex — An Introduction to the 55 Billion Euro Heist," Bloomberg Daily Tax Report: International, Sept. 24, 2020.

billion), and Italy (€4.5 billion), and to a lesser extent the Netherlands and Austria.[65]

A report published by the European Securities and Markets Authority dated July 2, 2019,[66] explains the underpinning of the scheme. When issuers of publicly traded shares distribute dividends to shareholders, the tax laws of several EU member states provide for a withholding tax, typically around 25 percent. The tax is withheld by the issuer. At the same time, the tax law provides for a tax certificate to be issued, often by the shareholder's custodial bank. If the shareholder is not a tax resident of the member states in which the dividend-paying corporation is a tax resident, the withholding tax can be refunded in whole or in part to the taxpayer, depending on various factors. In the shareholder's country of residence, the dividend may or may not be taxable, depending on the laws of the country and the shareholder's tax status under the relevant law. When the dividend is not taxable in the shareholder's country of residence, an arbitrage incentive exists for the shareholder to sell the shares to an entity that can benefit from a foreign tax credit on dividend income.

Dividend arbitrage strategies have existed for many years in EU financial markets. They involve the placement of shares in alternative tax jurisdictions around dividend dates, with the aim of minimizing the relevant tax on dividends. The shares are sold before the record date for dividend payments in a cum-dividend transaction and are repurchased after the record date in an ex-dividend transaction. The term "cum" refers to the fact that dividend rights are attached to the shares; the term "ex" refers to the fact that no dividend rights are attached to the shares.

Dividend arbitrage strategies require the establishment of an equity position cum-dividend in a tax-favorable jurisdiction. That equity position is unwound, meaning in an ex-dividend transaction. The borrower-buyer receives the dividend paid out by the issuer of the share and then returns it to the lender-seller, minus the dividend tax and a percentage negotiated between the two counterparties. This is a cum-cum transaction, which has been vilified in Europe, although it has been accepted as a normal treasury function in the United States.

An example of a cum-cum transaction in a wholly U.S. context appears in *Compaq*.[67] Compaq Computer Corp. engaged in a foreign stock transaction involving the purchase and resale of American depository receipts (ADRs), which are certificates that represent an ownership interest in shares of a publicly traded corporation based outside the United States. ADRs are traded on U.S. stock exchanges. The securities chosen for the transaction were ADRs representing shares of Royal Dutch Petroleum Co. Compaq knew little to nothing about Royal Dutch other than generally available market information. Without involving Compaq, the broker chose both the sizes and prices of the trades and the identity of the company that would sell the ADRs to Compaq.

On September 16, 1992, the broker, acting on Compaq's behalf, bought 10 million Royal Dutch ADRs from the designated seller, which was another client of the broker. The broker immediately sold the ADRs back to the seller. The trades were made in 46 separate New York Stock Exchange floor transactions — 23 purchase transactions and 23 corresponding resale transactions — of about 450,000 ADRs each, and were all completed in little over an hour. Any trader on the floor was able to break up any of these transactions by taking part in some or all of the trade, but none did because the trades were completed at market prices. The aggregate purchase price was about $887.6 million cum-dividend. The aggregate resale price was about $868.4 million ex-dividend. Commissions, margin account interest, and fees amounted to about $1.5 million. Under special exchange settlement terms, the purchase trades were formally settled on September 17, 1992, and the resale trades were settled on September 21, 1992.

Compaq was entitled to a gross dividend of about $22.5 million. Approximately $3.4 million in Dutch tax was withheld by Royal Dutch and paid to the Dutch government. The net dividend

[65] Hugh Gunson and Guy Bud, "Danish Tax Authority Loses 'Cum-Ex' Case: Revenue Rule Reigns Supreme," Charles Russell Speechlys Expert Insights (May 12, 2021).

[66] European Securities and Markets Authority, "Preliminary Findings on Multiple Withholding Tax Reclaim Schemes," ESMA70-154-1193 (July 2, 2019). The discussion in the text is based on that report.

[67] *Compaq Computer Corp. v. Commissioner*, 277 F.3d 778 (5th Cir. 2001), *rev'g* T.C. Memo. 1999-220.

— about $19.2 million — was paid directly to Compaq. The net result for Compaq was the recognition of a short-term capital loss that was available to offset capital gains, and an FTC that was available to offset U.S. taxes on foreign-source investment income.

The IRS challenged the transaction on grounds that it lacked economic substance. It treated the Dutch income tax as an expense, not a credit. The Tax Court upheld the IRS's position but was reversed on appeal.[68]

What separates the European cum-ex transactions from the transaction undertaken by Compaq is that a dividend arbitrage benefit was not the goal in many of the European transactions. Rather, the alleged intention was to obtain multiple issuances of withholding tax certificates, leading to multiple tax refunds paid to multiple persons in circumstances in which only one of the certificate holders actually received a dividend distribution and paid the relevant withholding tax. Stated differently, some investors may have rushed to report the purchase of the shares in a short sale, but not the sale of the shares in an offsetting transaction before the record date.

Reports indicate that regulatory bodies failed to establish a system to properly link shareholders, withholding tax payments, and the issuance of withholding certificates. Before 2012, in Germany the corporation issuing the dividend collected the withholding tax, while the bank holding the shares issued the withholding tax certificates. In Denmark the tax office that managed the dividend refund arrangement was understaffed and undermanaged. It operated as a bookkeeping office that tracked certificates and refund payments without matching either of them to specific dividends paid on specific shares. Consequently, multiple issuances of certificates and multiple refunds for a given dividend distribution were possible.

In simplified form, Annex I of the European Securities and Markets Authority report illustrates the steps by which the fraudulent transactions occurred:

- *Introduction*. The players are three investors (A, B, and C) that sell and purchase shares of Corp. X. The players may or may not know each other. The Corp. X shares have a large market cap and are liquid. A owns shares of Corp. X having a value of €15 million.
- *Step 1*. Shortly before the dividend is scheduled to be paid, B short sells Corp. X shares in a sale transaction with C. For C, the shares purchased are cum-dividend. The shares have a value of, say, €15 million. This is the same amount of Corp. X shares held by A. The transaction is a "naked" short sale, meaning that B has not borrowed the shares that are used in the short sale. Given that the transaction with C is executed on an exchange, B must ensure that the shares of Corp. X will be made available to C in time for settlement before the settlement date (T + 2).
- *Step 2*. On the day Corp. X distributes dividends, it withholds tax and directly pays that amount to the relevant tax authorities. If Corp. X is a Danish resident, the withholding tax rate is 27 percent. If Corp. X is a German resident, the withholding tax rate is 25 percent. A receives a tax certificate from its bank.
- *Step 3*. After the distribution of the dividend, B purchases shares of Corp. X from A in an over-the-counter transaction. Because the transaction allows for a reduced time for settlement, these shares are available to deliver to C on the settlement date (T + 2) in the short sale. The shares obtained by B are now ex-dividend and are worth €14.5 million.
- *Step 4*. B delivers shares to C in time for settlement. Given that B should deliver to C cum-dividend shares but can only deliver ex-dividend shares, B pays C €375,000 as compensation. B funds the payment with cash in the amount of €375,000, which is part of the €500,000 difference between (1) the short sale proceeds of €15 million for cum-dividend shares and the €14.5 million purchase price of the ex-dividend shares paid to A and (2) a tax certificate from its custodian bank for €125,000 that C will claim back from the government as the

[68] Although not affecting the decision in the case, the result was legislatively reversed prospectively when section 7701(o)(2)(B) was adopted, codifying the economic substance doctrine.

economic owner of the cum-dividend shares sold short on an exchange.

The intervention of B through a naked short sale created a scenario involving potentially duplicate withholding tax certificates for A and C and a €125,000 gain for B, less various costs and commissions. When B is a tax-exempt private pension in the United States with no employees other than a sole shareholder, the €125,000 is not taxed in the United States until withdrawals are made.

C. Cases Brought by SKAT

The Danish government reportedly authorized a budget war chest of $380 million to engage law firms to pursue recoveries for all financial institutions, advisers, and investors that participated in the cum-ex transactions.[69] As of January 2021, more than 500 lawsuits had been brought in the United Kingdom, the United States, Dubai, Germany, Malaysia, and Canada against financial institutions, financial services companies, private pension funds, law firms, and individual attorneys. In the United States, 61 pension funds reached agreement with SKAT in 2019, repaying $239 million. Two principal cases have been brought, one in the United Kingdom and another in the United States. In each case, the application of the revenue rule has been a preliminary issue, and SKAT has achieved major procedural victories.

1. *In re SKAT*.

In re SKAT[70] involved consolidated preliminary motions to dismiss a series of actions brought by SKAT against myriad defendants that executed cum-ex transactions involving dividend distributions made by Danish corporations. The U.S. District Court for the Southern District of New York denied the consolidated motions to dismiss, allowing the litigation to proceed. The argument in support of the motions was that an action brought by the tax authority of a foreign country is an attempt to collect a tax imposed by that country, and therefore the revenue rule mandates that the action be dismissed as a matter of law. The court disagreed.

In a footnote to its opinion, the court acknowledged that at least one other district court in the Second Circuit has held that the revenue rule is an appropriate basis on which to dismiss a claim under Rule 12(b)(1) of the Federal Rules of Civil Procedure.[71] However, the Second Circuit has not so ruled, even though it has heard several cases involving motions to dismiss based on the revenue rule. In those cases, the Second Circuit did not clarify the subsection of Rule 12(b) under which a motion to dismiss based on the revenue rule must be brought.[72] Under the circumstances, the district court in *In re SKAT* was not convinced that the revenue rule was a sufficient basis for granting a motion to dismiss at an early stage in the litigation. In its view, the revenue rule is a "time-honored common law prudential rule" that appears to share the same "constitutional underpinnings" as the act of state doctrine, which is a "substantive rather than jurisdictional defense."

The gist of the opinion appears in its third paragraph:

> Defendants, relying on the revenue rule, seek dismissal of these actions at the outset. If plaintiff can prove that the defendants never in fact owned the relevant Danish stocks — and the Court is obliged to accept their allegations as true for present purposes — the revenue rule would not apply because the substance of the claims would be for garden variety commercial fraud. Accordingly, the motion to dismiss is denied. Whether[,] in light of discovery and a fuller presentation, the revenue rule will be of greater aid to the defendants must await developments.

As of March 1, 2022, the litigation is ongoing.

[69] Syed Rahman, "Cum-Ex — The Storm Clouds Gather," *Lawyer Monthly*, Jan. 20, 2021. As of March 31, 2022, SKAT estimates that its legal costs are projected to be approximately $640 million, up from $380 million. *See* Jajiyya Budaly, "Denmark's Legal Costs Balloon In Cum-Ex Fraud Litigation," *Law 360*, Apr. 1, 2022. There are rumors that even the increased cost will be far below the final amount when the litigation reaches final decisions with all defendants.

[70] *In re SKAT Tax Refund Scheme Litigation*, 356 F. Supp.3d 300 (S.D.N.Y. 2019).

[71] *Id.* at 309, n.24 (citing *Diageo North America*, 531 F. Supp.2d at 381).

[72] *R.J. Reynolds*, 268 F.3d at 108; *Trapilo*, 130 F.3d at 550-551.

2. *Solo Capital Partners.*

Solo Capital Partners[73] is the U.K. counterpart of *In re SKAT* in the United States. At the trial level, the decision was a major victory for proponents of the revenue rule. At the appeals level, that victory became a defeat.

a. High Court decision.

As with *In re SKAT*, the issue presented was preliminary in nature: whether the claims raised by SKAT should be heard by the court or whether a motion to dismiss should be granted. SKAT made various allegations of fraud, conspiracy, dishonesty, misrepresentation, negligence, unjust enrichment, and proceeds of fraud, choosing one or more of those characterizations for each of the defendants. Each of the allegations regarding English common law[74] was fashioned to avoid Dicey Rule 3, discussed above, which states that "English courts have no jurisdiction to entertain an action: (1) for the enforcement, either directly or indirectly, of a penal, revenue or other public law of a foreign State; or (2) founded upon an act of state."[75]

The High Court in *Solo* applied six principles in its analysis:

1. Dicey Rule 3 is not a rule of jurisdiction, despite the language in which it is articulated in the Dicey treatise. It is a substantive rule of English law leading to the dismissal of claims falling within it, on the ground that the court will not entertain them because they involve an attempt to have the court enforce extraterritorially the exercise of sovereign authority. Consequently, a claim is not admissible if in substance it is a claim directly or indirectly to enforce Denmark's sovereign right to tax dividends declared by Danish companies.
2. The rule demands an analysis of the substance of the claim rather than the form. The court must look past the causes of action pleaded, or even the identity of the claimant, to the substance of the right sought to be vindicated, or the nature of the acts or actions on which the claim is founded. Consequently, a claim may be considered related to Denmark's sovereign right to tax dividends even though, in point of form, it is not a claim for a tax debt or a claim against a party that was or could be a tax debtor.[76]
3. Dicey Rule 3 is a rule of English law applicable to whether English law will govern the merits more generally by reference to English rules on conflict of laws. It is for the court to decide for itself whether, given its substance, a claim falls within Dicey Rule 3. That is not a question for Danish law, for example, even if in this case Danish law is the governing law of a particular claim. Consequently, the substance of the claim is not determined by the private law causes of action pleaded by the plaintiff. Rather, the issue of substance over form arises only because of the way the plaintiff's claim is framed.
4. Whether Dicey Rule 3 applies involves a question of characterization for any given claim — whether it is a claim to directly or indirectly enforce Danish revenue law, whether it falls within English case law, or whether it in some other way amounts in substance to an attempt to exercise sovereign power extraterritorially. The substance of the claim is determined by the central interest of the sovereign in bringing the claim or in whose direct or indirect interests it is brought.
5. There is a distinction to be drawn between an exercise of sovereign power and an action brought by a sovereign state that might equally be brought by an individual to recover losses for damage to property. The latter has been referred to as a patrimonial claim. The mechanism by which harm is said to have been suffered is material to consider, and may be

[73]*Solo Capital Partners* [2021] EWHC 974 (Comm), *rev'd*, [2022] EWCA Civ 234.

[74]Several allegations raised against some of the defendants referred to the Lugano convention on the mutual recognition and enforcement of judgments in civil and commercial matters, and an EU regulation (1215/2012). Those allegations are not relevant to the general application of the revenue rule discussed in this report.

[75]*Dicey, Morris, and Collins on the Conflict of Laws*, *supra* note 3.

[76]This analysis looking to the basis of the claim is what the federal district court refused to do in *In re SKAT*, 356 F. Supp.3d 300.

important, in judging whether the central interest in bringing that claim is a governmental interest rather than a private law interest.

6. There is a distinction between enforcement and mere recognition of foreign penal, revenue, or other public laws or sovereign acts, including recognizing the effects or consequences of the past exercise of sovereign power in the sovereign territory. Dicey Rule 3 is not designed to preclude or prohibit the latter. There is no rule of law that the voluntary act of a defendant, in engaging with the foreign sovereign, takes a case outside Dicey Rule 3, even though the nature of any interaction between the defendant and sovereign will be one factor to be considered.

Based on those six principles, the court concluded:

> Dicey Rule 3 is not avoided because SKAT's claims are for damages, personal restitutionary remedies, or proprietary remedies in respect of traceable proceeds, and the defendants are not the [withholding tax] refund applicants themselves. Dicey Rule 3 would apply to a damages claim against a party involved in the submission by a taxpayer of erroneous tax returns or in a tax evasion scheme for that taxpayer, even if the defendant's conduct involved all the ingredients of a private law cause of action, such as a damages claim for a tort, because in substance the claim would seek to enforce the underlying right to tax the miscreant taxpayer. Likewise if Dicey Rule 3 would apply, in a case of tax refunds wrongly claimed, to the foreign sovereign's claim against the refund applicant erroneously paid, then a claim by the foreign sovereign against those culpably involved in the making of the claim is equally inadmissible in this court. This was also common ground.

The logic trail of the court may be summarized as follows:

- the dividend tax is an income tax;
- the payee is not a tax resident and therefore faces a 27 percent tax on the receipt of the dividend;
- the tax is collected through a withholding mechanism imposed on the Danish company paying the dividend;
- the payment of the withholding tax by the Danish company discharges the recipient from liability to pay the tax;
- the entitlement to receive a refund of the withholding tax under Danish law is an entitlement to a refund of tax even though the payee did not pay any tax;
- the applicant for the refund in effect claims that, as to the dividend, the 27 percent withholding tax paid to SKAT by the company making the distribution discharges the applicant from further tax liability; and
- the acceptance of the refund application is the acceptance by SKAT that the applicant is a taxpayer, and it is an agreement by SKAT to pay a refund of tax.

The foundation for claims by SKAT is the Danish withholding tax act, and that fact distinguishes SKAT's claim from a claim based on a patrimonial activity such as (1) a theft or robbery of cash from a SKAT vault, (2) a loss of SKAT's cash caused by actionable negligence, (3) a cyberattack, (4) the suborning of a SKAT employee to gain access to a SKAT bank account, (5) negligent advice to SKAT on how it might invest its funds, or (6) a dishonest investment trick such as inducing SKAT to put funds into a Ponzi scheme. In all the other actionable circumstances in support of a claim, the fact that SKAT was the Danish sovereign tax authority or the fact that the cash may have been received in payment of taxes would be irrelevant.

A claim to recover a tax refund payment made through error that was induced by the refund applicant's misrepresentation is still a claim seeking directly or indirectly to enforce a foreign revenue law for the benefit of the claimant, even if erroneous. It does not matter that the error is based on dishonesty, results from an innocent mistake or negligence, or arises from underreporting of taxable income or excessive deductible expenses — the matter arises from the performance of a sovereign act. This was the basic weakness in all the claims made by SKAT against the defendants. Those claims fell within Dicey Rule 3 because SKAT, an arm of the sovereign, was trying to recover Danish company dividend tax collected by way of withholding tax except when refund claims were made to it by qualifying applicants. As such, SKAT was indirectly trying to enforce Denmark's underlying sovereign right to tax Danish company dividends. The fact that its claims were brought against persons not entitled to claim the refund did not mean that SKAT was not trying to collect tax on behalf of a foreign sovereign; it simply meant that it was acting to collect tax in a more indirect fashion.

b. Court of Appeal decision.

The Court of Appeal reversed the High Court's decision that the action brought by SKAT was barred because it was an action to recover a foreign tax. Instead, the Court of Appeal concluded that the claim was justiciable. It reasoned that the pleadings involved a claim to recover sums that were wrongfully extracted from SKAT by fraud.[77] Consequently, it was inappropriate to find as a preliminary matter that the substance of the claim was to recover an erroneous refund of tax.

In the Court of Appeal's view, the issue involved theft by fraud and recovery of funds fraudulently absconded with by the defendants:

> In my judgment, this claim against the SKAT defendants is not a claim to unpaid tax or a claim to recover tax at all. It is a claim to recover monies which had been abstracted from SKAT's general funds by fraud. The alleged fraud defendants' submission that the claim to the refund is still a claim to tax is simply wrong as a matter of analysis and the judge fell into error in accepting that submission. Furthermore, because there is no unsatisfied claim to tax, the "essential feature" of the revenue rule as Lord Mackay described it in Williams & Humbert is absent. There is no qualification in his judgment of that essential feature where the claimant is the sovereign foreign state itself, as suggested by Ms Macdonald QC. Rather he expresses the limitation on the revenue rule in quite categorical terms. Accordingly, there being no unsatisfied claim to tax in the present case, the revenue rule does not apply, even though SKAT may be an emanation of the Danish state.
>
> The argument by the alleged fraud defendants that the claim is precluded by the wider sovereign powers rule within Dicey Rule 3 is equally misconceived. In bringing a claim to recover the monies of which it was defrauded, SKAT is not doing an act of a sovereign character or enforcing a sovereign right, nor is it seeking to vindicate a sovereign power. Rather it is making a claim as the victim of fraud for the restitution of monies of which it has been defrauded, in the same way as if it were a private citizen.[78]

The High Court disagreed with one defendant's contention that SKAT serves a governmental function and that it used sovereign administrative powers when it revoked its decisions to pay refunds. The High Court stated:

> Furthermore, as I have already intimated [at para. 46] above, the alleged fraud defendants' reliance on the administrative procedures in which SKAT engaged to revoke its decisions to pay refunds is nothing to the point. There is no question of those administrative decisions somehow being a pre-condition of the present claims being brought and, far from supporting the alleged fraud defendants' case that by these proceedings SKAT is exercising sovereign powers, they support SKAT's case that it is seeking to resile from the powers that it was induced by fraud to exercise.[79]

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[77] [2022] EWCA Civ 234, *rev'g* [2021] EWCH 974 (COMM). Other issues were also decided regarding European law (the Brussels Recast Regulation) and the Lugano Convention, which are not addressed in this report.

[78] *Solo Capital Partners* [2022] EWCA Civ 234 at paras. 128 and 129.

[79] *Id.* at para. 140.

The ultimate conclusion was that the SKAT claims based on alleged fraud were not inadmissible under Dicey Rule 3 and could proceed to trial.

V. Canada-U.S. Treaty

The 1995 protocol to the Canada-U.S. treaty adopted Article XXVIA, an assistance in collection provision. (The text of Article XXVIA appears in Appendix A of this report.)

The adoption of Article XXVIA meant that U.S. citizens would no longer be permitted to move to Canada to avoid their U.S. tax liabilities as in *Harden*. Treasury's technical explanation of the 1995 protocol describes the purpose and workings of the provision as follows:

> Article 15 of the Protocol adds to the Convention a new Article XXVIA (Assistance in Collection). Collection assistance provisions are included in several other U.S. income tax treaties, including the recent treaty with the Netherlands, and in many U.S. estate treaties. U.S. negotiators initially raised with Canada the possibility of including collection assistance provisions in the Protocol, because the Internal Revenue Service has claims pending against persons in Canada that would be subject to collection under these provisions. However, the ultimate decision of the U.S. and Canadian negotiators to add the collection assistance article was attributable to the confluence of several unusual factors.
>
> Of critical importance was the similarity between the laws of the United States and Canada. The Internal Revenue Service, the Justice Department, and other U.S. negotiators were reassured by the close similarity of the legal and procedural protections afforded by the Contracting States to their citizens and residents and by the fact that these protections apply to the tax collection procedures used by each State. In addition, the U.S. negotiators were confident, given their extensive experience in working with their Canadian counterparts, that the agreed procedures could be administered appropriately, effectively, and efficiently. Finally, given the close cooperation already developed between the United States and Canada in the exchange of tax information, the U.S. and Canadian negotiators concluded that the potential benefits to both countries of obtaining such assistance would be immediate and substantial and would far outweigh any cost involved.

However, the two countries were hesitant to extend the application of collection procedures to their respective citizens doing business in the other country. To that end, paragraph 8 of Article XXVIA provides: "No assistance shall be provided under this Article for a revenue claim in respect of a taxpayer to the extent that the taxpayer can demonstrate that . . . the revenue claim relates to a taxable period in which the taxpayer was a citizen of the requested state."

Article XXVII of the treaty addresses exchanges of information between the tax authorities in the United States and Canada. Originally adopted in 1984, the provision was modified by the 2007 protocol to the Canada-U.S. treaty. (The text of Article XXVII appears in Appendix B of this report.)

As now in effect, Article XXVII authorizes the competent authorities to exchange information as may be relevant for carrying out the provisions of the Canada-U.S. treaty or domestic tax law, insofar as the taxation under domestic law is not contrary to the treaty. Treasury's technical explanation of the 2007 protocol clarifies that the phrase "may be relevant" expresses the intention to allow the IRS to obtain items of potential relevance to an ongoing investigation, without reference to its admissibility. The phrase is not intended to support a blanket request in which a contracting country simply asks for information regarding all bank accounts in one country maintained by residents of the requesting country.

The authority to exchange information is not restricted to residents of one or both countries. Information may be exchanged for use in all phases of the taxation process, including assessment, collection, enforcement, or the determination of appeals. Any information received by a country is to be treated as secret in the same manner as information obtained under the tax laws of that country. Disclosure of the information is limited to authorities involved in any of the following governmental activities, including courts and administrative bodies:

- the assessment or collection of tax;
- the administration and enforcement of tax law; or
- the determination of appeals in relation to tax.

Information received in any of these three categories may be disclosed in public court proceedings or in judicial decisions.

If one country requests information, the other country is required to use its information-gathering measures to obtain the requested information. The requested country is not permitted to decline to obtain and supply information simply because it has no domestic tax interest in that information. This provision is in Article XXVII. It is intended to preclude taxpayers from arguing that the requested country is not authorized to obtain information from a bank or fiduciary that is not needed for that country's own tax purposes.

Article XXVII does not obligate the requested state to:

- carry out administrative measures at variance with the laws and administrative practice of either country;
- supply information that is unobtainable under the laws or in the normal course of the administration of either country;
- supply information that would disclose any trade, business, industrial, commercial, or professional secret or trade process; or
- supply information whose disclosure would be contrary to public policy.

Nonetheless, Article XXVII does not prevent a requested country from voluntarily complying with a request on a discretionary basis if its internal laws are not violated.

A requested country may not decline to provide information on grounds that the information is held by a financial institution, nominee, or person acting in an agency or fiduciary capacity. Thus, domestic bank secrecy laws (or similar legislation concerning the disclosure of financial information by financial institutions or intermediaries) are overridden by the country's obligation to provide information under Article XXVII.

Finally, in a general note that accompanied the signing of the 2007 protocol, Canada and the United States expressly agree that the standards and practices described for the exchange of information are to be in no respect less effective than those described in the OECD's Model Agreement on Exchange of Information on Tax Matters.

VI. Multilateral Convention

Unlike the United States, Canada has not publicly released a model treaty. However, guidance can be found in Canada's 2007 proposed federal budget,[80] which stressed the importance of incorporating strong information exchange rules in the country's treaties and tax information agreements. It noted that inadequate information exchange rules in tax treaties had caused serious problems for tax administrators in enforcing the law for the Canada Revenue Agency and tax administrators in other countries. Consequently, the budget included a proposal that all new tax treaties and revisions to existing treaties include the OECD standards regarding exchange of tax information. Canada rarely undertakes an obligation to help treaty partners collect taxes from Canadian tax residents. When it does, the obligation must be imposed bilaterally.

Like the United States, Canada has refused to adopt the assistance in tax recovery provisions of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The convention was designed to cover "all possible forms of administrative co-operation between States in the assessment and collection of taxes . . . through exchange of information . . . to the recovery of taxes."[81]

The convention was developed jointly by the OECD and the Council of Europe. It was open for signature in 1988 and came into force on April 1, 1995. The convention was amended by the 2010 protocol. Although Canada signed the convention

[80] The Budget Plan 2007, tabled in the House of Commons March 19, 2007.

[81] *See* OECD, "Convention on Mutual Administrative Assistance in Tax Matters" (last updated October 2019).

on April 28, 2004, it did not ratify it until November 21, 2013, and the convention entered into force in Canada in 2014. The United States has not ratified the protocol.[82] Article 6 of the convention forms the foundation for what is known as the common reporting standard (CRS). Although only 26 countries signed the 1988 version of the convention, 130 jurisdictions are now signatories.

CRS is an automatic annual financial information exchange for tax authorities. It allows a tax authority to inform another tax authority of the financial accounts held by tax residents of other signatory jurisdictions. The CRA shares information with members of the CRS multilateral agreement with which the CRA has formalized a CRS partnership, including details of bank accounts held by their residents in Canada. In return, the CRA receives information from its CRS partners on financial accounts held outside Canada by Canadian residents. The information exchanged by the CRA comes from filings made to it by Canadian financial institutions. Exchanged information includes the nonresident account holder's name, address, date of birth, account balance or value at year-end, and specified amounts credited or paid into the account during the year. Unlike reporting under the Foreign Account Tax Compliance Act, CRS has no de minimis amount for reporting purposes. The United States is not a signatory to CRS because FATCA has been successful in uncovering accounts held outside the United States by U.S. persons. Nonetheless, the United States has automatic bank deposit exchange of information programs with more than 85 countries.[83]

VII. U.S. Experience[84]

A. Background

The Fourth Amendment to the U.S. Constitution provides:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

In a similar vein, exchange of information provisions in most income tax treaties obligate the requesting party to keep the information secret and to disclose the information only to persons concerned with the tax assessment and collection process. As discussed earlier (see Section V, above), Article XXVII of the Canada-U.S. treaty grants the IRS substantial power to obtain information on behalf of the CRA.

To illustrate, the IRS may use its authority granted under section 7602(a) to summon any person and request any information in the context of an investigation or audit, including information in the possession of a third party. Further, the code provides that the IRS may appeal to federal courts to compel attendance, testimony, or production and enforcement of its summons through appropriate processes.

B. Standards for Issuance of a Summons

In *Powell*,[85] the Supreme Court examined whether the IRS was required to meet any special showing to compel documents or testimony under section 7602. The Court looked to prior case law involving the Department of Labor and the Federal Trade Commission. In *Morton Salt*,[86] a nontax case issued 14 years before *Powell*, Justice Robert H. Jackson explained just how broad that power is:

[82] *See* OECD and Council of Europe, "The Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol" (2011).

[83] *See* Rev. Proc. 2019-23, 2019-38 IRB 725. We acknowledge the contribution of Andreas Apostolides of Ruchelman PLLC regarding this topic, which is detailed in Section VII of this report.

[84] The authors acknowledge the contribution of Andreas A. Apostolides of Ruchelman PLLC regarding Section VII of this report.

[85] *United States v. Powell*, 379 U.S. 48 (1964).

[86] *United States v. Morton Salt*, 338 U.S. 632 (1950).

> We must not disguise the fact that sometimes, especially early in the history of the federal administrative tribunal, the courts were persuaded to engraft judicial limitations upon the administrative process. The courts could not go fishing, and so it followed neither could anyone else. Administrative investigations fell before the colorful and nostalgic slogan "no fishing expeditions." It must not be forgotten that the administrative process and its agencies are relative newcomers to the field of law and that it has taken and will continue to take experience and trial and error to fit this process into our system of judicature. More recent views have been more tolerant of it than those which underlay many older decisions. . . .
>
> The only power that is involved here is the power to get information from those who best can give it and who are most interested in not doing so. Because judicial power is reluctant if not unable to summon evidence until it is shown to be relevant to issues in litigation, it does not follow that an administrative agency charged with seeing the laws are enforced may not have and exercise powers of original inquiry. It has a power of inquisition, if one chooses to call it that, which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not. When investigative and accusatory duties are delegated by statute to an administrative body, it, too, may take steps to inform itself as to whether there is probable violation of law.

In *Powell*, the Supreme Court determined that the IRS needed only to show that four requirements were met before it could issue a valid summons under section 7602:

1. the investigation must be conducted for a legitimate purpose;
2. the inquiry may be relevant to that purpose;
3. the information sought is not within the IRS's possession; and
4. the administrative steps required by the code have all been met.

C. *Stuart* — Tax Treaty Request

The seminal case in this area is *Stuart*,[87] concerning a request by the CRA for bank statements under the Canada-U.S. treaty. The IRS served a summons on a bank for information related to the subject individual's U.S. account. The taxpayer challenged the request in U.S. federal district court, contending that the CRA investigation already proceeded to a stage that was analogous to a U.S. Justice Department criminal investigation. By analogy to the rule of section 7602(c), which prohibits issuances of civil summonses in those situations, the taxpayer moved to quash the summons.[88] The Supreme Court found that section 7602(c) was inapplicable in the cross-border context:

> The concerns that prompted Congress to enact Code section 7602(c) — particularly that of preventing the IRS from encroaching upon the rights of potential criminal defendants — are not present when the IRS issues summonses at the request of most foreign governments conducting investigations into possible violations of their own tax laws. This is especially so where none of the countries, including Canada, with whom the United States has tax treaties providing for exchanges of information employ grand juries and criminal discovery procedures differ considerably among those countries.

In district court, U.S. government attorneys routinely cite the holding in *Stuart* for the proposition that treaty exchange of information

[87] *United States v. Stuart*, 489 U.S. 353 (1989).

[88] Introduced by the 1982 Tax Equity and Fiscal Responsibility Act, this rule has since been relocated to section 7602(d) and provides that "no summons may be issued under this title, and the Secretary may not begin any action under [section] 7604 to enforce any summons, with respect to any person if a Justice Department referral is in effect with respect to such person."

requests are presumptively valid under *Powell*, at least regarding the legitimate purpose prong. Several examples are discussed below.

1. *Mazurek*.

Mazurek[89] involved a taxpayer's motion to quash a summons to provide information requested by the French tax administration. The matter was referred to a magistrate judge who, after hearing from both parties, issued a report and recommendation. In that report, the magistrate judge concluded that discovery and a full evidentiary hearing were unnecessary and that the summons should be enforced based on the evidence in the pleadings. The district court adopted that recommendation, and the decision was affirmed by the Fifth Circuit, which reasoned as follows:

> The information [the taxpayer] sought to procure through discovery and to present during an evidentiary hearing relates to the propriety of the FTA's investigation under French civil tax law. His document requests reflect this same focus. Producing evidence that may demonstrate the bad faith of a French tax agency purely as a matter of French civil tax law is irrelevant to the only good faith issue under *Powell*, i.e., the good faith of the IRS in honoring the French request. And, Mazurek does not seek to discover, or allege that he needs to discover, information that would impugn the good faith of the IRS in issuing the summons or enforcing it in compliance with the FTA's request.

2. *Lidas*.

Lidas[90] involved a request by the French government for information regarding U.S. bank accounts of specific individuals and a corporation. The individuals contended that they were not residents of France, and they challenged enforcement of the summons through a motion to quash. The district court granted the U.S. government summary judgment, and the Ninth Circuit affirmed, stating:

> To obtain enforcement of an administrative summons issued pursuant to 26 U.S.C. section 7602(2) (sic), the IRS need only demonstrate "good faith" in issuing the summons. The IRS's prima facie showing of good faith is based on the four-part test formulated in *United States v. Powell*, 379 U.S. 48 (1964). The IRS must show that: (1) the investigation will be conducted for a legitimate purpose; (2) the inquiry will be relevant to such purpose; (3) the information sought is not already within the Commissioner's possession; and (4) the administrative steps required by the Internal Revenue Code have been followed. See id. at 57-58.
>
> The same test applies where the IRS issues a summons at the request of a tax treaty partner. See *United States v. Stuart*, 489 U.S. 353 (1989). In such case, the IRS need not establish the good faith of the requesting nation. "So long as the IRS itself acts in good faith [under *Powell*] . . . and complies with applicable statutes, it is entitled to enforcement of its summons." Id. at 370. Once the IRS establishes a prima facie case for enforcement of its summons under *Powell*, the burden shifts to the taxpayer, who "may challenge the summons on any appropriate ground," including failure to meet the *Powell* requirements. See *Powell*, 379 U.S. at 58. Nevertheless, the taxpayer bears a "heavy burden" to rebut the presumption of good faith. *United States v. Jose*, 131 F.3d 1325, 1328 (9th Cir. 1997) (en banc).

3. *Villareal*.

Villareal[91] involved a taxpayer who alleged that a treaty request by the Mexican tax authorities (SAT) for records from a third-party bank was made for the improper purpose of harassment. The taxpayer provided an affidavit stating that SAT could not obtain the information under Mexican law. While refusing to grant a stay pending its resolution of the matter, the district court entertained the case on the basis that if the

[89] *Mazurek v. United States*, 271 F.3d 226 (5th Cir 2001).

[90] *Lidas Inc. v. United States*, 238 F.3d 1076 (9th Cir. 2001).

[91] *Villarreal v. United States*, 524 F. App'x 419 (10th Cir. 2013).

taxpayer prevailed, the IRS would ask SAT to return the materials and destroy any copies. Citing *Stuart*, the Tenth Circuit ultimately determined that SAT's good faith was irrelevant to the matter and that only the IRS's good faith in issuing the summons was at issue.

4. *Hanse.*

Hanse[92] involved an individual, Franck Hanse, who was the subject of an investigation by the French tax authorities concerning his potential income tax and wealth tax liabilities for the tax years ending in 2013, 2014, and 2015. The French authorities sought information from a bank regarding two wire transfers to the client trust account of a law firm. The request stated that Hanse was a French citizen domiciled in France, that the request was in conformity with the laws and practices of the French tax administration, and that the French tax authorities had exhausted all means available in France of obtaining the information. The information sought in the request was not in the possession of the IRS, and there was a reasonable basis for the belief that the summonsed records may have contained information relevant to the French tax authorities' investigation. The IRS official designated as the U.S. competent authority under tax treaties and tax information exchange agreements determined that this request from France was proper under the relevant treaty and that it was appropriate to honor the request. A summons was served on the law firm, and Hanse filed a petition to quash the summons. The IRS responded with a motion to dismiss, or alternatively to grant summary judgment.

The district court found that once the IRS made a prima facie case that it acted in good faith under the *Powell* standard, the burden shifted to Hanse to show that the IRS issued the summons in bad faith or in a manner that constituted an abuse of process. The IRS was not required to demonstrate the good faith of the French tax authorities. Hanse argued that he was a resident of Switzerland and that the summons was issued in bad faith. The court rejected that argument, holding that only the good faith of the IRS is at issue when a treaty partner makes a request for the exchange of information.

VIII. Canadian Experience

The automatic exchange of information is permitted by section 2 of the Canada-U.S. Enhanced Tax Information Exchange Agreement Implementation Act (Implementation Act). It states that Article XXVII of the Canada-U.S. treaty authorizes the exchange of information for tax purposes. It is this provision of the Canada-U.S. treaty that authorizes the intergovernmental agreement for purposes of the exchange of information to enforce FATCA.[93]

A. *Hillis*

Article XXVIA of the Canada-U.S. treaty prevents the CRA from collecting penalties imposed on its citizens by reason of FATCA or its global counterpart, CRS. In *Hillis*,[94] two "accidental Americans"[95] moved for summary judgment against the CRA seeking an injunction to prevent the supply of Canadian financial information to the IRS. They argued that the Implementation Act was contrary to the provisions of Article XXVIA. Similar arguments had been raised by others when the IGA was enacted. In broad terms, the individuals argued that the provisions of the Implementation Act:

- unduly harm the privacy rights and interests of all Canadians;
- unduly raise compliance costs to all Canadian financial institutions and Canadian taxpayers;
- impede Canada's efforts to enforce its own tax laws; and
- violate the spirit, and potentially the letter, of several Canadian laws and international treaties.

[92] *Hanse v. United States*, No. 17-cv-4573 (N.D. Ill. 2018).

[93] The Agreement Between the Government of Canada and the Government of the United States of America to Improve International Tax Compliance Through Enhanced Exchange of Information Under the Convention Between Canada and the United States of America With Respect to Taxes on Income and on Capital.

[94] *Hillis v. Canada*, 2015 F.C. 1082 (2015).

[95] The term "accidental American" is popular in Canada for an individual who was born in the United States to Canadian citizens, moved to Canada as a child, and has neither worked nor lived in the United States as an adult. It is the "accident" of birth in the United States that makes the individual a U.S. citizen.

In sum, the individuals argued that by exchanging information under the Implementation Act, the CRA was effectively lending assistance to the IRS in collecting tax from Canadian citizens, which is prohibited by Article XXVIA.

The court disagreed. It noted that the information obtained by Canada under the terms of the Implementation Act is derived from Article XXVII of the Canada-U.S. treaty. As indicated earlier, the treaty's exchange of information provisions do not expressly prohibit disclosure. The court found that the words used in the Implementation Act are explicit and that the intention of the two governments is clear. The intent was that each country would obtain and exchange, annually and automatically, all relevant information regarding reportable accounts, subject to the confidentiality and other provisions of the Canada-U.S. treaty.

The court relied on the CRA's assurances that:

> the IRS cannot use such information to administer non-tax laws (such as the US Bank Secrecy Act) or in its dealings with federal entities (such as the Financial Crimes Enforcement Network of the US Treasury Department) who are involved in money laundering repression. Indeed, the CRA will not assist the US in collecting non-tax related penalties such as penalties for failing to file the [foreign bank account report]. Moreover, while the Canada-US treaty says that Canada may assist the US in collecting certain taxes, it also says that the Canadian authorities will not assist the US authorities in collecting a US tax liability if the person was a Canadian citizen when the liability arose.[96]

The court went on to state that although the Canada-U.S. treaty does not prevent the collection and automatic disclosure of taxpayer information mentioned in article 2 of the IGA regarding U.S. reportable accounts, the IRS cannot use that information to administer nontax laws in the United States or in its operations directed to the suppression of money laundering. Consequently, the CRA will not help the United States collect penalties for failing to file FBAR forms.

The court also rejected the argument that the Implementation Act lends assistance in the collection of tax in a way prohibited by Article XXVIA:

> Article XXVIA applies only to cases in which tax liability has been determined and is enforceable, and does not apply to the assessment of tax payable, the verification of taxpayer compliance, or related exchanges of information. Accordingly, I find that the automatic exchange of information allowed by the IGA does not amount at the present time to providing assistance in collection, and is thus not captured under this Article. The plaintiffs have conflated the assessment of taxes, verification of compliance, and collection of penalties possibly due by US persons for non-reporting. The arguments made in this respect are not relevant and are premature in any event.[97]

The court concluded that the IGA was not contrary to the Canada-U.S. treaty or the Income Tax Act and that it was not up to the court to amend the law:

> True, a great number of Canadian taxpayers holding US reportable accounts are likely to be affected by a reporting system that in many quarters is considered unjust, costly and ineffective, considering that at the end of the day they are not likely to owe taxes to the US. In the absence of legislative provisions requiring all Canadian financial institutions (provincially and federally regulated) to automatically notify their account holders about reporting to the CRA under the IGA and Part XVIII of the ITA, these taxpayers may also be taken by surprise by any consequences that flow from such disclosure. The plaintiffs may find this deplorable, but apart from a constitutional invalidation of the impugned provisions

[96] *Hillis*, 2015 F.C. 1082 at para. 55.

[97] *Id.* at para. 72.

> or a change of heart by Parliament or Congress, or the governments of Canada or the US, there is nothing that this Court can judicially do today to change the situation. The impugned provisions have not been held to be ultra vires or inoperative. Judicial courage requires that judges uphold the Rule of Law.[98]

B. *Deegan*

A similar conclusion was reached in *Deegan*,[99] in which two accidental Americans challenged the constitutionality of provisions of the Implementation Act and sections 263 to 269 of the ITA.

The plaintiffs alleged that those provisions cause Canada to act as an intermediary between Canadian financial institutions and the IRS. Those institutions are required to give the CRA information concerning financial accounts belonging to customers whose account information suggests that they may be U.S. persons. The CRA then provides that information to the IRS. The plaintiffs asserted that the provisions of the Implementation Act violate the Canadian constitution[100] because they amount to an unreasonable seizure of financial information belonging to U.S. persons in Canada. The plaintiffs also alleged that the information exchange under the Implementation Act violates other provisions of the Canadian constitution because it singles out individuals based on citizenship or national or ethnic origin.[101] Finally, the plaintiffs alleged that the violations did not constitute reasonable limitations on the privacy and equality rights of affected individuals.[102]

The Federal Court disagreed with the allegations and held that the disputed provisions of the Implementation Act are not unreasonable and do not violate the Canadian constitution.

It also found that information obtained by the CRA from Canadian financial institutions is not an unreasonable search and seizure. Departing from the approach taken under the revenue rule, the court determined that an expectation of privacy is appropriate principally when a Canadian statute is criminal or quasi-criminal in nature. Reporting of tax information by Canadian financial institutions to the CRA, and ultimately to the IRS, does not fit into that protected framework, the court found. It reasoned that tax is essentially a regulatory statute, and that the information relates to how income tax is calculated and collected. Hence, there is a lesser expectation of privacy.

The court also disagreed with the plaintiffs' assertion that the information is not of a kind regularly obtained under the ITA and therefore should not be delivered to the CRA. Following the holding in *Hillis*, the court concluded that the banking information is foreseeably relevant to U.S. tax compliance and can be obtained by the CRA by request from the IRS under Article XXVII of the Canada-U.S. treaty.

The court also found that to the extent that the disputed provisions draw a distinction based on national origin and citizenship, they are not discriminatory. In reaching its decisions, the court considered the detailed negotiations carried on by the Canadian government, in which it tried to negotiate a carveout for Canada. When the Canadian government realized that a carveout was impossible, it recognized that entering into an IGA was the only way to avoid a potentially devastating effect on the Canadian financial sector.

The plaintiffs alleged that the purpose of the Implementation Act was to help the U.S. government implement FATCA and find U.S. tax evaders and cheats — a purpose that could not be described as pressing and substantial for the Canadian government or Canadian residents. However, when Canada was negotiating its IGA with the U.S. government, the OECD was involved in developing and implementing a common standard for the automatic multilateral exchange of financial account information along the lines of the IGA. Therefore, the Implementation Act could not be said to be out of line with global expectations of financial privacy, the court reasoned.

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[98] *Id.* at para. 76.

[99] *Deegan v. Canada*, 2019 F.C. 960.

[100] Section 8 of the Canadian Charter of Rights and Freedoms (the charter), Part I of the Constitution Act, 1982, being Schedule B to the Canada Act 1982 (U.K.), 1982, c. 11.

[101] Section 15 of the charter.

[102] Section 1 of the charter.

Finally, the court found that the argument that the Implementation Agreement resulted in discrimination based on citizenship and national origin was misplaced. It held that a classification based on national origin is a form of discrimination only when it perpetuates ongoing disadvantages or prejudice. That is not the case when compliance with laws of a country of citizenship are at issue. The court stated:

> The Charter does not require Canada to assist persons resident in this country in avoiding their obligations under duly-enacted laws of another democratic state, nor does it require this country to shelter those living in Canada from the reach of foreign laws. Indeed, as was noted earlier, insulating persons resident in this country from their obligations under duly-enacted laws of another democratic state is not a value that section 15 of the Charter was designed to foster.[103]

Overall, the arguments raised by the plaintiffs paled in comparison to the benefits derived by the banking industry in Canada. The IGA was necessary for Canadian financial institutions to be deemed compliant with the requirements of FATCA, and it simplified the related data-gathering obligations. In sum, the Implementation Act allowed Canadian financial institutions to avoid 30 percent withholding taxes on the receipt of capital payments on loans to U.S. residents, and it simplified the information gathering that would otherwise have been required under FATCA.

IX. Canadian Rules

The revenue rule, which is based in common law, can be overruled by legislation or treaty. For Canadians, the common law revenue rule is overridden by Article XXVII of the Canada-U.S. tax treaty. In broad terms, paragraph 1 of Article XXVII provides that each treaty partner undertakes to lend assistance to the other in the collection of taxes, interest, costs, additions to those taxes, and civil penalties.

[103]*Deegan*, 2019 F.C. 960 at para. 430.

This obligation is subject to two limitations involving persons who are citizens of the country receiving the request for assistance. The first is that the revenue claim relates to a tax period when the taxpayer was a citizen of the requested country. This exception prevents U.S. taxpayers who are not Canadian citizens from fleeing the United States with the expectation of obtaining Canadian citizenship to negate their U.S. tax exposure. The second limit involves a fact pattern in which (1) the taxpayer became a citizen of the requested country before November 9, 1995, and remains a citizen when the requesting country applies for collection of the claim, and (2) the claim relates to a tax period that ended before November 9, 1995. This exception limits the retroactive effect of Article XXVII.

Canada has negotiated tax collection arrangements similar to Article XXVIA with Norway,[104] the Netherlands,[105] New Zealand,[106] Spain,[107] the United Kingdom,[108] and Germany.[109] Those provisions are based on Article XXVII of the OECD model treaty, which does not restrict collections when the recalcitrant taxpayer is a citizen of Canada, presumably because citizenship alone is not a justifiable basis for imposing tax under a treaty based on the OECD model treaty.

A. *Ben Nevis*

Although not a case involving the Canada-U.S. treaty, *Ben Nevis*[110] illustrates the retroactive scope of an assistance in collection provision based on Article XXVII of the OECD model treaty.

The case involved the South Africa-U.K. income tax treaty, which contains such a provision. The Court of Appeal of England and Wales upheld a request from the South Africa Revenue Service for assistance in recovering a tax debt exceeding £220 million, including interest

[104]Article 28 of the Canada-Norway income tax treaty.

[105]Article XXVIA of the Canada-Netherlands income tax treaty.

[106]Article 25 of the Canada-New Zealand income tax treaty.

[107]Article XXVIA of the Canada-Spain income tax treaty.

[108]Article 27(5) of the Canada-U.K. income tax treaty.

[109]Article 27 of the Canada-Germany income tax treaty.

[110]*Ben Nevis (Holdings) Ltd. & Anor v. HM Revenue & Customs* [2013] EWCA Civ. 578.

and penalties from years before the year in which the assistance in collection provision was added to the treaty. The South African tax was assessed for 1998, 1999, and 2000, when the individual was resident in South Africa. He transferred assets to offshore companies, one of which was the plaintiff, a British Virgin Islands company. The company held approximately £7.8 million in a London bank account.

In 2011 the relevant treaty was revised by a protocol adopting an assistance in collection provision. Acting under a treaty request for assistance in collection, HM Revenue & Customs seized the funds, and the seizure was upheld after challenge. The court rejected the plaintiff's claim that the assistance in collection article should be applied only prospectively to tax claims arising in years beginning on or after the date on which the protocol entered into force. The protocol clearly stated that the assistance in collection provision was effective for *requests* received after the date of entry into force. No mention was made regarding the tax year to which the assistance in collection request related. According to the court, there was no reason to look to secondary authorities regarding this point because the effective date was clear. The request was received after the protocol was effective. Therefore, HMRC acted correctly in seizing the funds in satisfaction of tax claims for prior years.

B. CRA Procedures

Each treaty has a minimum balance that is required for a referral. The publicly released documentation by the CRA redacts this information. Debts that can be referred arise under the ITA, the Excise Tax Act, any income or sales taxes collected by Canada on behalf of a province or territory, and all other categories of taxes collected by or on behalf of Canada.

The CRA's administrative position on Canada's process for seeking assistance in collection can be found in the *National Collections Manual* (2015). Any referral that is sent to a treaty partner must detail the citizenship of the taxpayer and provide as much information as possible to help the treaty partner. Before it is sent, however, a referral must clear the CRA's Tax Treaty Collection Program. The program, upon clearing the request, will forward it to the treaty partner and be the entity that liaises with that partner. Information on this program is not readily available. According to David Sherman, a tax lawyer and author, the CRA is reluctant to release any information under an Access to Information Act request, and only through "tortuous litigation" was he able to obtain the following (somewhat dated) general statistics[111]:

- From 1995 to 1999, the CRA made 177 referrals to the IRS, covering $47 million in tax-related debts (the amount collected was not disclosed), and the IRS made 87 referrals to the CRA (the amount at stake and the amount collected were not disclosed).
- From 1999 through 2005, the CRA made 422 referrals to the IRS. The CRA sent 94 referrals in 2003 and 90 referrals in 2004, covering a total of $96 million. The amounts collected were not disclosed. The CRA refused to disclose the number of requests received from the IRS.
- From 2008 to 2012, the CRA's annual referrals to the IRS ranged between 65 and 115, and collections ranged between $13 million and $69 million. Although the IRS accepted all requests, no information on the amounts collected was released, nor was information released about collection requests made by the IRS during that period.

As discussed earlier, Article XXVIA of the Canada-U.S. treaty provides for assistance in the collection of taxes of the treaty partner jurisdiction. As detailed in Section X, below, two U.S. cases illustrate that Canada and the United States have similar approaches to the application of Article XXVIA.

X. Assistance in Collection Experiences

A. *Dewees*

Dewees[112] involved a U.S. citizen residing in Canada who, to his chagrin, decided to come into compliance with his U.S. tax obligations, only to find that he was denied a refund of Canadian tax.

[111] Sherman, "David Sherman's Notes — Canada — United States Income Tax Convention, 1980, Article XXVI-A," TaxnetPro (Oct. 2019).

[112] *Dewees v. United States*, 272 F. Supp.3d 96 (D.D.C. 2017), *aff'd*, 767 F. App'x 4 (D.C. Cir. 2019).

1. Facts.

Donald Dewees moved from the United States to Canada in 1971 and continued to reside in Canada through the years at issue. He owned a consulting business incorporated in Canada and paid his Canadian taxes annually, but he did not file any U.S. federal income tax returns.

Dewees became concerned that the IRS was actively investigating U.S. persons living abroad who did not pay taxes and did not report financial interests in foreign financial accounts (that is, persons who did not file FBARs with FinCEN). The penalties for not filing an FBAR were severe.

Dewees applied to participate in the IRS's 2009 offshore voluntary disclosure program, which offered taxpayers an opportunity to avoid criminal prosecution and to settle a variety of civil and criminal penalties in the form of a single miscellaneous offshore penalty. The OVDP was based on existing voluntary disclosure practices used by the IRS Criminal Investigation division. The miscellaneous offshore penalty for the 2009 program was generally 20 percent of the highest aggregate value of the unreported offshore accounts in the 2003-2008 period. Participants were also required to file amended or late returns and FBARs for those years.[113]

Dewees was preliminarily accepted into the program. Ultimately, the IRS asserted a miscellaneous offshore penalty of $185,862 against him. Viewing the penalty as excessive, he withdrew from the OVDP. This led to an IRS examination in which a $120,000 penalty was assessed ($10,000 for each year Dewees failed to file Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations"). He unsuccessfully sought an abatement of the penalty for reasonable cause, first through the Taxpayer Advocate Service and later through the Appeals Office. Dissatisfied, Dewees refused to pay the penalty.

In 2014, long after Dewees's appeal had been rejected, the IRS introduced another program to encourage taxpayers to voluntarily disclose offshore assets: the streamlined filing compliance procedures. The streamlined procedures differ from the OVDP in several respects. They involve less paperwork and impose lower penalties (no penalties at all, in some cases), and they cover only three years of noncompliance. Moreover, the streamlined procedures do not offer immunity from criminal prosecution. Transferring between the two programs is generally disfavored, but taxpayers who are otherwise eligible for the streamlined procedures and made their OVDP submissions before July 1, 2014, were offered the opportunity to remain in the OVDP while requesting the more favorable terms available under the streamlined procedures.

In 2015 the IRS sought collection assistance under Article XXVIA of the Canada-U.S. treaty. As a result, the CRA notified Dewees that it was withholding his 2014 Canadian tax refund because of his outstanding $120,000 debt to the IRS. Dewees promptly sent the CRA a check in the amount of $134,116, representing the $120,000 penalty plus interest. In September 2015 he filed a claim with the IRS seeking a refund of that amount. The claim was rejected in May 2016. Shortly thereafter, he filed a refund suit in U.S. district court.

2. Contentions in litigation.

Dewees contended that the penalty was unconstitutional under the excessive fines clause of the Eighth Amendment, and under the due process and equal protection clauses of the Fifth Amendment. The district court granted the government's motion to dismiss. In so doing, it made the following findings:

- The excessive fines clause was inapplicable because a tax penalty is considered remedial; the clause applies to penalties intended to punish an individual. Therefore, Dewees failed to state a claim on which relief could be granted.
- The due process clause was not violated by the fact that Dewees could not appeal the penalty to the Tax Court; the availability of a refund action in district court gave him an adequate opportunity to be heard at a

[113]The 2009 OVDP was followed by an initiative in 2011 and a follow-up program in 2012. The penalty rate was increased in general for the 2011 initiative and in a targeted way for persons who used specific "bad" banks in the 2012 program. The 2012 OVDP was terminated for submissions made after September 28, 2018.

meaningful time and in a meaningful manner.[114] Therefore, Dewees failed to state a claim on which relief could be granted.

- Dewees lacked standing to assert his equal protection claim, and the court lacked jurisdiction to hear it. The claim was based on Dewees's contention that he was not allowed to participate in the streamlined procedures while similarly situated taxpayers were, and that he was thus denied the opportunity to have a lower penalty imposed. However, Dewees never applied for the streamlined procedures.

3. Appellate court decision.

On appeal, Dewees challenged the district court's rulings on his due process and equal protection claims.

On the due process claim, Dewees argued that he was denied the opportunity to challenge the penalty before payment. The D.C. Circuit disagreed, pointing out that Dewees had two opportunities to appeal the penalty asserted in the IRS examination and was unsuccessful. The denial of an opportunity of a third prepayment appeal did not amount to a constitutional flaw in the process, the court said.

On the equal protection claim, the court of appeals agreed that, at a surface level, others were afforded more favorable treatment than Dewees received regarding the penalties for failing to file Form 5471. Thus, he had standing to challenge the denial of entry. However, as a matter of substantive constitutional law, differences in government classification are allowed if there is a rational relationship between the disparity of treatment and a legitimate governmental purpose, the court explained. In this case, a rational basis existed for different treatment. The streamlined procedures were designed to encourage taxpayers that were unknown to the IRS as of June 18, 2014, to come forward. Dewees came forward previously. Moreover, he was not treated differently from others with similar facts, the D.C. Circuit concluded.

B. *Retfalvi*

Retfalvi[115] involved a dual Canadian-U.S. citizen's constitutional challenge to Article XXVIA of the Canada-U.S. treaty on grounds that the assistance in collection provision amounts to the adoption of a tax provision that did not originate in the House of Representatives.

1. Facts.

Paul Retfalvi was born in Hungary. He moved to Canada in 1988 under a restricted work permit and became a Canadian citizen in 1993. That same year, Retfalvi came to the United States on a J-1 visa to participate in a medical residency program. After completing his residency in 1997, Retfalvi returned to Canada.

The following year, Retfalvi returned to the United States under an H1-B visa. To ensure that he would have a place to live if his visa was not renewed, Retfalvi purchased a small condominium in Vancouver and signed a pre-construction contract to purchase a larger one.

In 2005 Retfalvi was granted permanent resident status in the United States. Because he was no longer planning to reside in Canada, he sold both condominiums in Canada. Retfalvi reported the sales on a U.S. federal income tax return.

In 2008 the CRA sent Retfalvi a summary of audit adjustments, finding that he had improperly reported the sale of the condominiums, and in 2009 it sent him a notice of assessment. Retfalvi filed an untimely objection in February 2010 and a timely administrative appeal in March 2010. The CRA denied his appeal and gave him 90 days to file a petition for review by the Tax Court of Canada. However, Retfalvi did not challenge the proposed deficiency by the deadline of October 3, 2011. As a result, the Canadian tax liability became final with immediate effect on that date.

On June 23, 2010, Retfalvi became a U.S. citizen. On October 27, 2015, the CRA referred the assessment to the United States for collection under Article XXVIA. On November 16, 2015, the IRS issued a "Final Notice — Notice of Intent to

[114] *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976).

[115] *Retfalvi v. United States*, 335 F. Supp.3d 791 (E.D.N.C. 2018), *aff'd*, 930 F.3d 600 (4th Cir. 2019) (refund suit). *See also Retfalvi v. Commissioner*, 216 F. Supp.3d 648 (E.D.N.C. 2016) (suit to enjoin collection of the tax).

Levy and Your Right to a Hearing" instructing Retfalvi to pay $124,287 in U.S. dollars to satisfy the Canadian revenue claim. In the notice, the IRS advised that it intended to use its collection procedures if Retfalvi did not pay the assessment within the allotted period. The notice indicated that Retfalvi had 30 days to seek a hearing before IRS Appeals regarding the proposed levy. It also stated that the IRS had no authority to adjust the underlying Canadian tax liability.

Retfalvi objected to the notice on January 13, 2016, and requested a hearing. On February 23, 2016, he sought a hearing before IRS Appeals under the collection due process provisions (section 6330). In response, Retfalvi was informed that he was not entitled to a hearing under that CDP provision, but was entitled to a limited hearing under the collection appeals program. Retfalvi then filed for that hearing. On March 24, 2016, the IRS denied his collection appeal request because it lacked the authority to adjust a foreign tax liability.

2. Contentions in litigation.

Retfalvi filed suit for a declaratory judgment and injunctive relief, but the district court dismissed the suit for lack of jurisdiction under the Anti-Injunction Act.[116] He did not appeal, but instead paid the tax assessment and filed a refund claim with the IRS. When the claim was denied, Retfalvi filed a refund suit in district court. He asserted several counts in support of a refund, including the following:

- Article XXVIA violates the U.S. Constitution's origination clause as a revenue-raising measure that did not originate in the House. The origination clause provides that all bills for raising revenue must originate in the House. Retfalvi asserted that Article XXVIA is a bill that raises revenue.
- Article XXVIA does not have the force of law because it is not a self-executing treaty provision. Only Congress has the power to lay and collect taxes. Giving Article XXVIA legal effect absent implementing legislation unconstitutionally encroaches on congressional authority.
- The IRS is not authorized to collect taxes because Article XXVIA has no legal force. The IRS lacked statutory authority to use its domestic enforcement powers to collect a foreign assessment on behalf of Canada.

3. Decision.

The district court rejected Retfalvi's contentions and dismissed the refund case. On appeal, the Fourth Circuit affirmed the decision.

In broad terms, the court reached the following conclusions:

- The Canadian tax collected by the IRS from Retfalvi was not a tax within the meaning of the origination clause. A law does not fall within the origination clause if it raises revenue for a specific purpose instead of the obligations of government generally.
- Although the taxing power is granted to Congress, that grant of power is not exclusive. The mere fact that a congressional power exists does not mean that the power is exclusive so as to preclude the making of a self-executing treaty within the area of that power.[117]
- In broad terms, a self-executing treaty provision is equivalent to an act of the legislature.[118] This rule does not apply to a treaty when (1) its text manifests an intention that implementing language is necessary; (2) the Senate, in giving consent, or Congress, by resolution, requires implementing legislation; or (3) implementing legislation is constitutionally required. Here, Article XXVIA relies on each country's existing tax laws and procedures for assessment and collection and requires no additional legislation to operate effectively.
- Article XXVIA authorizes the IRS to use the procedures created under sections 6201 and 6301 to pursue and collect Canadian revenue claims. It specifies that a revenue claim shall be collected by the requested state as though it were the requested state's own revenue claim that has been finally determined in accordance with the laws

[116] *Retfalvi*, 216 F. Supp.3d 648.

[117] *Edwards v. Carter*, 580 F.2d 1055 (D.C. Cir. 1978).

[118] *Medellín v. Texas*, 552 U.S. 491 (2008).

applicable to the collection of the requested state's own taxes. Consequently, if the United States accepts a request from Canada to collect a revenue claim, the United States must collect the revenue claim as if it were its own.

XI. Conclusion

Although the revenue rule is not dead in common law countries, the world has changed since the rule was first enunciated. Today treaties, multilateral agreements, and domestic criminal law have reduced the effectiveness of the doctrine. Pushed by the OECD base erosion and profit-shifting project and resulting pillars, FATCA, the European Commission, the OECD's Joint International Taskforce on Shared Intelligence and Collaboration, and multilateral instruments, tax authorities around the world speak with each other, provide information to each other, and provide assistance in the collection of taxes. Governments realize that failure to pay tax that has been assessed properly is an activity that should not be supported. Collection cooperation exists when treaties and IGAs are in place. In particular, the United States and Canada have adopted a working relationship that benefits administrators in both countries. Tax cheats can no longer look with confidence to the revenue rule. Nonetheless, the common law doctrine embodied in the revenue rule appears to be in good shape when governments try to seek recoveries in the courts of foreign countries in tax-related matters.

Whether the revenue rule will survive the cum-ex litigation brought by SKAT is not yet clear. It survived a challenge in the High Court of England and Wales in a case addressing preliminary matters, but that decision was reversed in the Court of Appeal. In the United States, the trial court denied a motion to dismiss SKAT's claims. Whether that bodes well for SKAT remains an open question. In each case, the trial court refused to go beyond a literal reading of the claim brought by SKAT. It is almost a certainty that the substance of SKAT's claims will be addressed in evidence to be submitted by the defendants. Also, the Second Circuit has upheld the validity of the revenue rule many times in the RICO cases. Whether it will do so again remains to be seen. Interesting times.

XII. Appendix A

Article XXVIA Assistance in Collection — Canada-U.S. Treaty

1. The Contracting States undertake to lend assistance to each other in the collection of taxes referred to in paragraph 9, together with interest, costs, additions to such taxes and civil penalties, referred to in this Article as a "revenue claim."
2. An application for assistance in the collection of a revenue claim shall include a certification by the competent authority of the applicant State that, under the laws of that State, the revenue claim has been finally determined. For the purposes of this Article, a revenue claim is finally determined when the applicant State has the right under its internal law to collect the revenue claim and all administrative and judicial rights of the taxpayer to restrain collection in the applicant State have lapsed or been exhausted.
3. A revenue claim of the applicant State that has been finally determined may be accepted for collection by the competent authority of the requested State and, subject to the provisions of paragraph 7, if accepted shall be collected by the requested State as though such revenue claim were the requested State's own revenue claim finally determined in accordance with the laws applicable to the collection of the requested State's own taxes.
4. Where an application for collection of a revenue claim in respect of a taxpayer is accepted:
   a. by the United States, the revenue claim shall be treated by the United States as an assessment under United States laws against the taxpayer as of the time the application is received; and
   b. by Canada, the revenue claim shall be treated by Canada as an amount payable under the Income Tax Act, the collection of which is not subject to any restriction.

5. Nothing in this Article shall be construed as creating or providing any rights of administrative or judicial review of the applicant State's finally determined revenue claim by the requested State, based on any such rights that may be available under the laws of either Contracting State. If, at any time pending execution of a request for assistance under this Article, the applicant State loses the right under its internal law to collect the revenue claim, the competent authority of the applicant State shall promptly withdraw the request for assistance in collection.
6. Subject to this paragraph, amounts collected by the requested State pursuant to this Article shall be forwarded to the competent authority of the applicant State. Unless the competent authorities of the Contracting States otherwise agree, the ordinary costs incurred in providing collection assistance shall be borne by the requested State and any extraordinary costs so incurred shall be borne by the applicant State.
7. A revenue claim of an applicant State accepted for collection shall not have in the requested State any priority accorded to the revenue claims of the requested State.
8. No assistance shall be provided under this Article for a revenue claim in respect of a taxpayer to the extent that the taxpayer can demonstrate that:
   a. where the taxpayer is an individual, the revenue claim relates either to a taxable period in which the taxpayer was a citizen of the requested State or, if the taxpayer became a citizen of the requested State at any time before November 9, 1995, and is such a citizen at the time the applicant State applies for collection of the claim, to a taxable period that ended before November 9, 1995; and
   b. where the taxpayer is an entity that is a company, estate, or trust, the revenue claim relates to a taxable period in which the taxpayer derived its status as such an entity from the laws in force in the requested State.
9. Notwithstanding the provisions of Article II (Taxes Covered), the provisions of this Article shall apply to all categories of taxes collected, and to contributions to social security and employment insurance premiums levied, by or on behalf of the Government of a Contracting State.
10. Nothing in this Article shall be construed as:
    a. limiting the assistance provided for in paragraph 4 of Article XXVI (Mutual Agreement Procedure); or
    b. imposing on either Contracting State the obligation to carry out administrative measures of a different nature from those used in the collection of its own taxes or that would be contrary to its public policy (ordre public).
11. The competent authorities of the Contracting States shall agree upon the mode of application of this Article, including agreement to ensure comparable levels of assistance to each of the Contracting States.

XIII. Appendix B

Article XXVII Exchange of Information — Canada-U.S. Treaty

1. The competent authorities of the Contracting States shall exchange such information as may be relevant for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes to which this Convention applies insofar as the taxation thereunder is not contrary to this Convention. The exchange of information is not restricted by Article I (Personal Scope). Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the taxation laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the administration and enforcement in respect of, or the determination of appeals in relation to the taxes to which this Convention applies or, notwithstanding

paragraph 4, in relation to taxes imposed by a political subdivision or local authority of a Contracting State that are substantially similar to the taxes covered by this Convention under Article II (Taxes Covered). Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions. The competent authorities may release to an arbitration board established pursuant to paragraph 6 of Article XXVI (Mutual Agreement Procedure) such information as is necessary for carrying out the arbitration procedure; the members of the arbitration board shall be subject to the limitations on disclosure described in this Article.

2. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information because it has no domestic interest in such information.

3. In no case shall the provisions of paragraph 1 and 2 be construed so as to impose on a Contracting State the obligation:

   a. to carry out administrative measures at variance with the laws and administrative practice of that State or of the other Contracting State;
   b. to supply information which is not obtainable under the laws or in the normal course of the administration of that State or of the other Contracting State; or
   c. to supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public).

4. For the purposes of this Article, this Convention shall apply, notwithstanding the provisions of Article II (Taxes Covered):

   a. to all taxes imposed by a Contracting State; and
   b. to other taxes to which any other provision of this Convention applies, but only to the extent that the information may be relevant for the purposes of the application of that provision.

5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information because the information is held by a bank, other financial institution, nominee, or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

6. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, and writings).

7. The requested State shall allow representatives of the requesting State to enter the requested State to interview individuals and examine books and records with the consent of the persons subject to examination.

XIV. Appendix C

Article XXVII Assistance in the Collection of Taxes — OECD Model Treaty:

1. The Contracting States shall lend assistance to each other in the collection of revenue claims. This assistance is not restricted by Articles 1 and 2. The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this Article.

2. The term "revenue claim" as used in this Article means an amount owed in respect of taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to this Convention or any other instrument to which the Contracting States are parties, as well as interest, administrative penalties and costs of collection or conservancy related to such amount.
3. When a revenue claim of a Contracting State is enforceable under the laws of that State and is owed by a person who, at that time, cannot, under the laws of that State, prevent its collection, that revenue claim shall, at the request of the competent authority of that State, be accepted for purposes of collection by the competent authority of the other Contracting State. That revenue claim shall be collected by that other State in accordance with the provisions of its laws applicable to the enforcement and collection of its own taxes as if the revenue claim were a revenue claim of that other State.
4. When a revenue claim of a Contracting State is a claim in respect of which that State may, under its law, take measures of conservancy with a view to ensure its collection, that revenue claim shall, at the request of the competent authority of that State, be accepted for purposes of taking measures of conservancy by the competent authority of the other Contracting State. That other State shall take measures of conservancy in respect of that revenue claim in accordance with the provisions of its laws as if the revenue claim were a revenue claim of that other State even if, at the time when such measures are applied, the revenue claim is not enforceable in the first mentioned State or is owed by a person who has a right to prevent its collection.
5. Notwithstanding the provisions of paragraphs 3 and 4, a revenue claim accepted by a Contracting State for purposes of paragraph 3 or 4 shall not, in that State, be subject to the time limits or accorded any priority applicable to a revenue claim under the laws of that State by reason of its nature as such. In addition, a revenue claim accepted by a Contracting State for the purposes of paragraph 3 or 4 shall not, in that State, have any priority applicable to that revenue claim under the laws of the other Contracting State.
6. Proceedings with respect to the existence, validity, or the amount of a revenue claim of a Contracting State shall not be brought before the courts or administrative bodies of the other Contracting State.
7. Where, at any time after a request has been made by a Contracting State under paragraph 3 or 4 and before the other Contracting State has collected and remitted the relevant revenue claim to the first-mentioned State, the relevant revenue claim ceases to be:
   a. in the case of a request under paragraph 3, a revenue claim of the first mentioned State that is enforceable under the laws of that State and is owed by a person who, at that time, cannot, under the laws of that State, prevent its collection, or
   b. in the case of a request under paragraph 4, a revenue claim of the first mentioned State in respect of which that State may, under its laws, take measures of conservancy with a view to ensure its collection the competent authority of the first-mentioned State shall promptly notify the competent authority of the other State of that fact and, at the option of the other State, the first-mentioned State shall either suspend or withdraw its request.
8. In no case shall the provisions of this Article be construed so as to impose on a Contracting State the obligation:
   a. to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
   b. to carry out measures which would be contrary to public policy (ordre public);

c. to provide assistance if the other Contracting State has not pursued all reasonable measures of collection or conservancy, as the case may be, available under its laws or administrative practice; and

d. to provide assistance in those cases where the administrative burden for that State is clearly disproportionate to the benefit to be derived by the other Contracting State. ■