The Revenue Rule in Tax Law

By

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A country's revenue laws reflect its political sovereignty and create property rights that affect relationships. Hence, sovereign states will not enforce the revenue laws of foreign countries and domestic courts will not exercise jurisdiction beyond their national boundaries. This rule, known as the "revenue rule", is long standing in the common law. [1]

A judgment based on a tax debt is normally not enforceable in a foreign jurisdiction. Thus, the Canada Revenue Agency ("CRA") cannot enforce collection against a non-resident with no assets in Canada, unless it issues a Requirement to Pay to a Canadian resident that owes or will owe money to the non-resident.[2]

Rationale of the Rule

The rule derives from eighteenth-century English court decisions seeking to protect British trade from the oppressiveness of foreign customs. In *Boucher v. Lawson*, 95 Eng. Rep. 53 (K.B. 1734) (Lord Hardwicke, C.J.), the court acknowledged that its concerns with promoting British trade led it to uphold a transaction that violated Portuguese export laws. Chief Justice Lord Hardwicke stated that to do otherwise "would cut off all benefit of such trade from this kingdom, which would be of very bad consequence to the principal and most beneficial branches of our trade."

The rule is part of Canadian law, United States common law, international law, and the national law of other common law jurisdictions. The revenue rule respects sovereignty, concern for judicial role and competence, and separation of powers. Lord Denning explained the rationale in *Attorney General of New Zealand v. Ortiz*, [1984] A.C. 1 (H.L.) as follows:

> "The class of laws which will be enforced are those laws which are an exercise by the sovereign government of its sovereign authority over property within its territory or over its subjects wherever they may be. But other laws will not be enforced. By international law every sovereign state has no sovereignty beyond its own frontiers. The courts of other countries will not allow it to go beyond the bounds. They will not enforce any of its laws which purport to exercise sovereignty beyond the limits of its authority."

See also: Judge Learned Hand's rationale for the rule:[3]

> "[A] court will not recognize those [liabilities] arising in a foreign state if they run counter to the 'settled public policy' of its own. Thus, a scrutiny of the liability is necessarily

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[1] See, for example, *Holman v. Johnson*, 98 Eng. Rep. 1120, 1121 (K.B. 1775) (Lord Mansfield) ("For no country ever takes notice of the revenue laws of another."); *Planche v. Fletcher*, 99 Eng. Rep. 164, 165 (K.B. 1779) (Lord Mansfield) ("One nation does not take notice of the revenue laws of another.").

[2] *United States v. Harden,* [1963] C.T.C. 450 (SCC); *R.J. Reynolds Tobacco* (2001), 268 F.3d 103 (US Court of Appeals, 2nd Circuit.

[3] *Moore v. Mitchell*, 30 F.2d 600, 604 (2d Cir. 1929) (L. Hand, J., concurring)

always in reserve, and the possibility that it will be found not to accord with the policy of the domestic state. . . . 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."

Lord Keith of Avonholm, having approved of the judgment of Kingsmill Moore J. in the High Court of Eire in *Peter Buchanan Ld. & Macharg v. McVey,* reported as a note in [1955] A.C. 516, suggested two explanations for the rule:

> "One explanation of the rule thus illustrated may be thought to be that enforcement of a claim for taxes is but an extension of the sovereign power which imposed the taxes, and that an assertion of sovereign authority by one State within the territory of another, as distinct from a patrimonial claim by a foreign sovereign, is (treaty or convention apart) contrary to all concepts of independent sovereignties."

A second explanation is that scrutiny of a tax judgement would require analysis of the policy underlying the tax, which would imply review of the policies of a sovereign jurisdiction.

> "This would require the court to rule on the provisions for the public order of another State, which may commit "the domestic State to a position which would seriously embarrass its neighbour. 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."

Application of the Rule

i. The United Kingdom

The House of Lords applied the rule in *Government of India, Ministry of Finance (Revenue Division) v. Taylor*[4]. At page 504, Viscount Simonds adopted the following from *In re Visser, The Queen of Holland v. Drukker*: [5]

> "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."

See also: *Government of India v. Taylor*, [1955] A. C. 491, 508 (H.L.), denying claim of Indian government for unpaid taxes against company in liquidation in Britain because British courts would not enforce Indian revenue laws, stating "we proceed upon the assumption that there is a rule of the common law that our courts will not regard the revenue laws of other countries: it is sometimes, not happily perhaps, called a rule of private international law: is at least a rule which is enforced with the knowledge that in foreign countries the same rule is observed".

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[4] [1955] A.C. 491.
[5] [1928] Ch. 877 at 884.

ii. The United States

The United States limits extraterritorial collection assistance based on preserving its sovereignty, security, and public policy. For example, Article 26, paragraph 4 of its *Model Income Tax Convention*, (September 20, 1996) provides:

> This paragraph shall not impose upon either of the Contracting States the obligation to carry out administrative measures that would be contrary to its sovereignty, security, or public policy.

However, the United States has several tax treaties with foreign countries that provide for information exchange and, sometimes, limited collection assistance. Paragraph 1 of Article XXVI-A of the *U.S.- Canada Tax Convention*, for example, provides for limited assistance between the respective tax authorities of the states in collecting a "revenue claim". The 1995 Protocol requires that a state seeking collection assistance certify that the revenue claim has been "finally determined."

A 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. Thus, the treaty does not abrogate the rule that courts of one nation should not adjudicate the unresolved tax claims of another.

In *United States v. Boots*, 80 F.3d 580 (1st Cir.), cert. denied, 519 U.S. 905, 136 L. Ed. 2d 188, 117 S. Ct. 263 (1996), the First Circuit dismissed an indictment for a cross-border smuggling scheme designed to avoid Canadian taxes. (at page 587: "For our courts effectively to pass on [foreign revenue] laws raises issues of foreign relations which are assigned to and better handled by the legislative and executive branches of government."), and at 587-88 ("Of particular concern is the principle of non-interference by the federal courts in the legislative and executive branches' exercise of their foreign policymaking powers.").[6]

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[6] See, generally: *Aetna Ins. Co. v. Robertson*, 127 Miss. 440, 90 So. 120, 126 (Miss. 1921) (Ethridge, J., dissenting)("It is a familiar principle of law that one state or country will not aid another state or country in giving effect to judgments enforcing its penal laws, or in collecting its revenues."); *Henry v. Sargeant*, 13 N.H. 321 (1843) (collecting cases that support the principle that penal and revenue laws are "strictly local" and are not enforced by foreign states); *State of Colorado v. Harbeck*, 232 N.Y. 71, 85, 133 N.E. 357 (1921) ("The rule [of "private international law"] is universally recognized that the revenue laws of one state have no force in another."); *Williams & Humbert Ltd. v. W&H Trade Marks (Jersey) Ltd.*, 1986 1 All E.R. 129, 133-34 (H.L.) (Although the "revenue laws may in the future be modified by international convention or by the laws of the European Economic Community[,] . . . at present the international rule with regard to the non-enforcement of revenue and penal laws is absolute."); *Peter Buchanan L.D. v. McVey*, [1955] A.C. 516, 524-28 (Ir. H. Ct. 1950) (surveying application of the revenue rule by United Kingdom courts), aff'd, [1955] A.C. 530 (Ir. S.C. 1951);

Similarly, in *Peter Buchanan L.D. v. McVey*, [1955] A.C. 516, 529 (Ir. H. Ct. 1950), aff'd, [1955] A.C. 530 (Ir. S.C. 1951), relied on by the United States Supreme Court in *Sabbatino*, 376 U.S. at 437-38, the Irish High Court noted that courts had traditionally exercised the right to reject foreign law that conflicted with the public policy or morality of the domestic court, and stated:

> "Modern history [is not] without examples of revenue laws used for purposes which would not only affront the strongest feelings of neighbouring communities but would run counter to their political aims and vital interests. . . . So long as these possibilities exist it would be equally unwise for the courts to permit the enforcement of the revenue claims of foreign States or to attempt to discriminate between those claims which they would and those which they would not enforce. Safety lies only in universal rejection."

iii. Canada

Canada applies the revenue rule. In *United States of America* v. *Harnden*, for example, the Supreme Court said:[7]

> "In my opinion, 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 the judgment would be enforcement of the tax claim." (per Cartwright J.)

Canada sought to circumvent the Revenue Rule in *R.J. Reynolds Tobacco Holdings, Inc. et al.* 268 F.3d 103; 2001 U.S. App., by framing its claim in an action for damages based on lost tax revenue, and additional law enforcement costs stemming from a scheme by the defendants to avoid various Canadian cigarette taxes by smuggling cigarettes across the United States-Canadian border for sale on the Canadian black market. Canada framed its claim under the *Racketeer Influenced and Corrupt Organizations Act* ("RICO"), 18 U.S.C. § 1961 et seq., and sought to recover revenue that it lost "from the evasion of tobacco duties and taxes," and from "defendants' conduct that compelled the country to rollback duties and taxes," as well as monies spent "seeking to stop the smuggling and catch the wrongdoers.

RICO creates a civil treble damages remedy for any person injured in its business or property by reason of a violation of the statute. RICO is a broadly worded statute that "has as its purpose the elimination of the infiltration of organized crime and racketeering into legitimate organizations operating in interstate commerce."[8]

The United States District Court for the Southern District of New York held that Canada could not use RICO to recover lost tax revenues and enforced the revenue rule stating:

> "To the extent that the allegations set forth in Canada's complaint are correct, we understand Canada's frustration that it cannot recoup its lost revenue and law enforcement costs against defendants that allegedly committed most of their wrongdoing on our side of the common border with Canada. No court wishes to find itself in the

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[7] See United States of America v. Harden [1963] SCR 366. See also: *Her Majesty the Queen in Right of the Province of British Columbia v. Gilbertson*, 597 F.2d 1161, 1165 (9th Cir. 1979) ("If the court below was compelled to recognize the tax judgment from a foreign nation, it would have the effect of furthering the governmental interests of a foreign country, something which our courts customarily refuse to do."); *Banco Frances e Brasileiro S.A. v. Doe*, 36 N.Y.2d 592, 601-02, 370 N.Y.S.2d 534, 331 N.E.2d 502 (1975) (Wachtler, J., dissenting) ("Under the principle of territorial supremacy, fundamental to the community of nations, courts refuse to enforce any claim which in their view is a manifestation of a foreign State's sovereign authority."); *QRS 1 APS v. Frandsen*, 1999 3 All E.R. 289, 294-97 (C.A.) (denying letters rogatory in connection with a tax claim under the revenue rule because "it may be considered that this line of thinking is obsolete, but it still remains anchored within us that we will not permit the presence in our country of foreign tax men, even if represented by intermediaries; we do not tolerate that any help may be given to them"; *Taylor*, [1955] A.C. at 511 ("[A] claim for taxes is but an extension of the sovereign power which imposed the taxes, and . . . an assertion of sovereign authority by one State within the territory of another . . . is (treaty or convention apart) contrary to all concepts of independent sovereignties.").

[8] S. Rep. No. 91-617, at 76 (1969); see Statement of Findings and Purpose, Organized Crime Control Act of 1970, Pub. L. 91-452, 84 Stat. 922, 922-23 (1970). "RICO provides that 'any person injured in his business or property by reason of' a RICO violation may bring a civil action to recover treble damages."

> position of being unable to right an alleged wrong. See *Loucks v. Standard Oil Co. of New York*, 224 N.Y. 99, 111, 120 N.E. 198 (1918) (Cardozo, J.). Nonetheless, we are without license to abandon unilaterally the centuries-old, albeit sharply-attacked, revenue rule. "The hard fact is that sometimes we must make decisions we do not like" because the laws "compel the result." *Texas v. Johnson*, 491 U.S. 397, 420-21, 105 L. Ed. 2d 342, 109 S. Ct. 2533 (1989) (Kennedy, J., concurring). "When and if the [revenue] rule is changed, it is a more proper function of the policy-making branches of our government to make such a change." *Her Majesty the Queen in Right of the Province of British Columbia v. Gilbertson*, 597 F.2d 1161, 1166 (9th Cir. 1979). Recourse, to the degree it is warranted and available, lies with the executive and legislature."

Exchanges of Information

A State can negotiate bilateral, reciprocal exchange of information agreements that facilitate international tax enforcement. Article 26 of the *OECD Model Convention* (2017) contemplates such exchanges, subject, however, to important safeguards and restrictions, the most significant of which is that the exchange should concern only relevant information.

Article 26 OECD Model Convention (2017)

(1) The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning 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 the Convention. The exchange of information is not restricted by Articles 1 and 2. 2.

"Foreseeable relevance" is a vague test. Relevance is determined at the time that the State makes its request. The OECD Commentary states that the standard of "foreseeable relevance" be interpreted broadly, but not so broadly as to extend to "fishing expeditions" and "irrelevant information". Hence, it is sufficient that there is a "reasonable possibility" that the requested information is foreseeably relevant at that time, regardless of its subsequent immateriality.

The Commentary states:

> A "request may therefore not be declined in cases where a definite assessment of the pertinence of the information to an ongoing investigation can only be made following the receipt of the information. The competent authorities should consult in situations in which the content of the request, the circumstances that led to the request, or the foreseeable relevance of requested information are not clear to the requested State. However, once the requesting State has provided an explanation as to the foreseeable relevance of the requested information, the requested State may not decline a request or withhold requested information because it believes that the information lacks relevance to the underlying investigation or examination."

Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. 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. Notwithstanding the foregoing, information received by a Contracting State may be used for other purposes when such information may be used for such other purposes under the laws of both States and the competent authority of the supplying State authorizes such use.

Paragraph 3 limits the power of Contracting States to exchange information.

(3) In no case shall the provisions of paragraphs 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 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 or of the other Contracting State; 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).

Hence, "a Contracting State is not bound to go beyond its own internal laws and administrative practice in putting information at the disposal of the other Contracting State." The Commentary speaks of cooperation to the "widest extent possible". However, it does not overrule domestic laws, such as the "revenue rule".

The *Multilateral Convention to Implement Tax Treaty Related Measures (MLI)*, a form of international GAAR for tax treaties, incorporates a principal purpose test (PPT) to test the validity of treaty benefits. Article 7 denies tax benefits where it is "reasonable to conclude" test based on the "relevant facts and circumstances" that one of the "principal purposes" of any transaction was to obtain tax benefits unless the benefit was within the object and spirit of the tax agreement.

Article 7 – Prevention of Treaty Abuse

1. Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.

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