



**TO:** Uniformity Committee

**FROM:** Brian Hamer  
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**SUBJECT:** Authority of states to collect taxes from foreign sellers

**DATE:** October 31, 2018

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As a result of *South Dakota v. Wayfair*, states generally have the authority under the Constitution to impose use tax collection and remittance responsibilities not only on sellers located in the United States but also on sellers in a foreign country, whether or not the seller has a physical presence in the taxing jurisdiction. This authority, however, does not ensure that states will have the ability to enforce those responsibilities, or specifically to collect taxes from intransigent foreign sellers that do not have assets in the United States.

This memorandum describes the legal barriers that states will face. In summary, under longstanding U.S. law, U.S. courts typically do not allow foreign jurisdictions to bring an action to recover taxes or to enforce a tax judgment. As a result, foreign courts likely will elect not to enforce U.S. tax judgments against sellers located in their country. Moreover, like U.S. jurisdictions, many foreign countries have adopted the rule not to enforce foreign tax judgments.

This body of law does not mean, however, that states are without tools to collect unpaid taxes on items sold by those foreign sellers that fail to comply with the law; this memorandum also identifies relevant collection tools that states have at their disposal.

### **The “revenue rule”**

The rule that courts will not enforce revenue claims of another country is known as the “revenue rule.” It is an exception to the general rule that courts will enforce judgments issued by courts of other countries, and has been a part of Anglo-American law since at least *Holman v. Johnson*, 98 Eng. Rep. 1120, 1121 (1775) (“no country ever takes notice of the revenue laws of another”).

The rule's continuing viability in the United States is evidenced in many places. The Uniform Foreign Money-Judgments Act, which was approved by the National Conference of Commissioners on Uniform State Laws in 1963, and has been adopted by 31 states, states that "a foreign judgment . . . is conclusive between the parties to the extent that it grants or denies recovery of a sum of money" and the "foreign judgment is enforceable in the same manner as the judgment of a sister state which is entitled to full faith and credit."<sup>1</sup> However, the Act's definition of "foreign judgment" expressly excludes "a judgment for taxes."<sup>2</sup> The Uniform Foreign-Country Money Judgments Recognition Act [note slightly different title], which was approved in 2005 and updates the 1963 act, has similar language.<sup>3</sup>

The U.S. Supreme Court acknowledged the revenue rule most recently in *Pasquantino v. United States*, 544 U.S. 349 (2005), in which the Court explained that the rule "at its core" prohibits "the collection of tax obligations of foreign nations."<sup>4</sup> In that decision, the Court described the "principal evil" against which the rule was thought to guard: "judicial evaluation of the policy-laden enactments of other sovereigns."<sup>5</sup> See also *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 413-14 (1964), in which the Court referenced the applicability of the rule to penal and revenue laws of foreign countries.

There is one reported U.S. tax case in which taxpayers invoked the revenue rule to avoid enforcement of a foreign tax judgment: *Her Majesty the Queen v. Gilbertson*, 597 F.2d 1161 (9<sup>th</sup> Cir. 1979). In that case, the Canadian province of British Columbia sought enforcement of a Canadian tax judgment. All of the defendants were citizens of the United States and residents of Oregon. Describing the revenue rule as preventing "a foreign jurisdiction from either instituting a suit to recover taxes, or bringing a suit to enforce its own court's judgment for taxes,"<sup>6</sup> and finding that the rule was part of both Oregon and federal law, the Ninth Circuit Court of Appeals refused to enforce the Canadian court judgment:

The revenue rule has been with us for centuries and as such has become firmly embedded in the law. There were sound reasons which supported its original adoption, and there remain sound reasons supporting its continued validity. When and if the rule is changed, it is a more proper function of the policy-making branches of our government to make such a change.<sup>7</sup>

In its written opinion, the Court of Appeals referenced a decision by the Canadian Supreme Court in which that court refused to recognize the tax judgment of a U.S. court.<sup>8</sup> Interestingly, the Canadian court had quoted an opinion by U.S. Judge Learned Hand to reach its

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<sup>1</sup> Section 3.

<sup>2</sup> Section 2.

<sup>3</sup> The Foreign-Country Act has been adopted by 23 states.

<sup>4</sup> *Pasquantino*, at 361. The Court considered the scope of the revenue rule as of 1952, the year in which Congress enacted the wire fraud statute, a statute petitioners argued should be construed in light of the rule.

<sup>5</sup> *Id.*, at 368.

<sup>6</sup> *Gilbertson*, at 1163, n.1.

<sup>7</sup> *Id.*, at 1166.

<sup>8</sup> *United States v. Harden*, 1963 Canada Law Reports 366 (S.Ct. of Canada 1963).

conclusion. The Court of Appeals also considered why there had not been other U.S. cases where a foreign jurisdiction was seeking to enforce a tax judgment, and theorized that the revenue rule had become so well recognized that foreign nations had not attempted to initiate such actions.<sup>9</sup>

More recently, the Second Circuit Court of Appeals applied the revenue rule in a case addressing whether Canada could bring a civil RICO case against companies alleged to have evaded Canadian cigarette taxes: *Attorney General of Canada v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103 (2d Cir. 2001). Unlike *Gilbertson*, this case did not involve a party seeking to enforce a tax judgment. However, the Court did set forth substantial analysis both of the history of the revenue rule and its current status. In summary, the Court concluded that the rule “has entered United States common law, international law and the national law of other common law jurisdictions,”<sup>10</sup> It also noted that the United States over the years has entered into a number of tax treaties “that provide for information exchange and, sometimes, limited collection assistance, but notably fail to make any provision for general enforcement of foreign tax judgments or claims.”<sup>11</sup>

Finally, the Conference Report attached to last December’s Tax Cuts and Jobs Act noted that “[a]lthough U.S. courts extend comity to foreign judgments in some instances, they are not required to recognize or assist in enforcement of foreign judgments for collection of taxes. . . .” The conference report acknowledged that the rule may be abrogated by bilateral treaties.<sup>12</sup> However, as Kathleen K. Wright, Director of state and local taxes at the Golden State University School of Taxation has written, there are no such treaties that are binding on the states, and as the Second Circuit in the *R.J. Reynolds* case noted, the tax treaties which the United States has entered into primarily concern “income and capital taxes.”<sup>13</sup>

Given the state of U.S. law, it seems unlikely that foreign countries will enforce U.S. state tax judgments against remote sellers. Significantly, China is unlikely to do so. See Article 266 of the Civil Procedure Law of the People’s Republic of China which expresses the rule that

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<sup>9</sup> Subsequent to *Gilbertson*, the United States and Canada negotiated a tax convention pursuant to which each country agreed to assist in the enforcement of certain fully adjudicated foreign tax judgments of the other country, although assistance is discretionary. See Convention Between Canada and the United States of America With Respect to Taxes on Income and on Capital. The Convention applies only to taxes imposed by each national government (*i.e.*, not by state or provincial governments) and requires each country (subject to various conditions) to collect taxes on behalf of the other country—if they are finally determined. The Convention is posted at [https://www.fin.gc.ca/treaties-conventions/usa\\_-eng.asp](https://www.fin.gc.ca/treaties-conventions/usa_-eng.asp).

<sup>10</sup> *R.J. Reynolds Tobacco*, at 110.

<sup>11</sup> *Id.*, at 119.

<sup>12</sup> Conference Report, H. Rept. 115-466 to accompany H.R.1, at 432, n.1296.

<sup>13</sup> *R.J. Reynolds Tobacco*, at 119, n.16. As of 2014, the United States had entered into only five tax treaties providing for mutual assistance for collecting taxes. See Samuel D. Brunson, *The U.S. as Tax Haven? Aiding Developing Countries by Revoking the Revenue Rule*, 5 Columbia Journal of Tax Law 170, 197 (2014).

Chinese courts will enforce foreign judgments only pursuant to treaties or to the principle of reciprocity, and then not even in all such situations<sup>14</sup>:

After a people's court of the People's Republic of China reviews an application or pleading for the recognition and enforcement of a legally effective judgment or ruling rendered by a foreign court according to the international treaties concluded or acceded to by the People's Republic of China or based on the principle of reciprocity, if the court considers that such a judgment or ruling does not contradict the basic principles of the laws of the People's Republic of China nor violates the national, social, and public interest of China, the court may render a ruling to recognize its force. Where the enforcement is necessary, the court may issue an order to enforce a foreign judgment according to the relevant provisions of this Law. If a legally effective judgment or ruling rendered by a foreign court contradicts the basic principles of the law of the People's Republic of China or the national, social, and public interest of China, the people's court shall reject the application of recognition and enforcement [emphasis added].

Since there is no relevant tax treaty between the United States and China, and the principle of reciprocity will not cause China to enforce U.S. tax judgments (because U.S. jurisdictions have generally adopted the revenue rule), it seems extremely unlikely that China would enforce a state tax judgment against a remote internet seller located in China.

In fact, a China Law Blog post written in 2016 by the Harris Bricken law firm states that the firm's lawyers had "not been able to find a single instance where a Chinese court enforced a U.S. non-divorce judgment."<sup>15</sup> King & Wood Mallesons, a large law firm with multiple locations in China, reported that on June 30, 2017 the Intermediate People's Court of Wuhan, Hubei Province recognized for the first time a U.S. (non-tax) civil court ruling as legally binding in China. The Chinese court pointed to a ruling by a California court, based on the Uniform Foreign Money Judgments Recognition Act, enforcing a non-tax Chinese court judgment.<sup>16</sup>

A general internet search suggests that a large number of countries around the world have adopted the revenue rule. The Brussels Regime, which encompasses a series of agreements and conventions among member states of the European Union, addresses the recognition and enforcement of judgments. It specifically excludes revenue matters. See Title I, Article 1(1) of the Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("The Convention . . . shall not extend, in particular, to revenue, customs or administrative matters").<sup>17</sup> One India law firm has written that a 1988 report by the International Law Association, entitled the "Transnational Recognition and Enforcement of

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<sup>14</sup> Various internet sources set forth slightly different versions of China's Civil Procedure Law. The versions I found, however, all require either a treaty or reciprocity before a Chinese court will enforce a foreign judgment. The version quoted in the text is set forth at china.org.cn.

<sup>15</sup> <https://www.chinalawblog.com/2016/08/enforcing-us-judgments-in-china-not-yet.html>

<sup>16</sup> <https://www.kwm.com/en/knowledge/insights/china-recognizes-and-execute-foreign-judgement-20170906>

<sup>17</sup> Posted at

<http://ec.europa.eu/world/agreements/downloadFile.do?fullText=yes&treatyTransId=13041>.

Foreign Public Laws,” concluded that “all the civil law countries are of the opinion that foreign tax claims cannot be enforced in their courts.<sup>18</sup> As noted by the Second Circuit Court of Appeals in the *R.J. Reynolds Tobacco* case, the rule has become part of the English common law which is part of the law of many nations.<sup>19</sup>

In conclusion, given the absence of applicable treaty agreements, states will not likely be able to enforce use tax judgments against noncompliant remote sellers located in foreign countries.

### **Collection tools available to states**

Although the revenue rule will prevent states from enforcing use tax judgments against foreign sellers, all is not lost. As a preliminary matter, it is important to keep this matter in perspective. At least for now, purchases from foreign sellers constitute a small portion of total internet retail transactions. Moreover, many sellers, for a variety of reasons, seek to comply with applicable law. Many foreign sellers also may fall below the small seller thresholds being enacted by states. Finally, U.S. businesses that purchase from foreign sellers typically will self-assess use tax to avoid audit liability.

Nevertheless there will be foreign sellers that fail to collect and remit use taxes. With respect to those sellers, there are a number of tools that states can use to achieve compliance and collect unpaid taxes:

- Many foreign sellers sell to U.S. customers through marketplaces. States can impose tax collection and remittance responsibilities on those marketplaces.
- States can obtain purchase data from U.S. Customs and (if the state imposes an individual income tax) deduct unpaid use taxes from state income tax refunds.
- States may be able to avoid application of the revenue rule by pursuing non-tax civil actions against sellers that collect but do not remit use taxes (the tort of conversion).
- States can impose Colorado-style reporting requirements on sellers that do not collect and remit tax and impose penalties on those sellers that do not comply. The revenue rule presumably would not apply to collection of those penalties.
- Purchases are typically effectuated by using a credit card or through a third-part payment network. States can explore levying credit card and similar payment receipts in the possession of entities located in the U.S. that provide payment processing services to foreign sellers.

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<sup>18</sup> Lakshmikumar & Sridharan at <https://www.lakshmisri.com/News-and-Publications/Publications/Articles/Tax/the-revenue-rule-international-taxation>.

<sup>19</sup> See Mallinak, Brenda, “The Revenue Rule: A Common Law Doctrine for the Twenty-First Century,” 16 *Duke Journal of Comparative & International Law* 79 (2006)(describing the evolution and current status of the common law’s revenue rule).

Utilization of some of these tools will be onerous, but then collecting tax debts from out-of-state taxpayers whose assets are located outside of the taxing jurisdiction has never been an easy matter. States will need to monitor this subject closely.

One final word of caution: when devising tools to address non-compliance by foreign sellers, states must be careful not to discriminate against foreign commerce. If states impose requirements that are different from the requirements that are imposed on domestic sellers, they must be prepared to identify a compelling local interest and to show there is no less discriminatory way to achieve that interest.