

United States Supreme Court Holds that Criminal Wire Fraud Statute Encompasses Schemes to Violate Foreign Law

May 24, 2005

On April 26, 2005, the United States Supreme Court upheld criminal convictions arising from a scheme to avoid taxation by a foreign government. The decision in *Pasquantino v. United States*, 125 S. Ct. 1766 (2005), expands the reach of the U.S. wire fraud statute, 18 U.S.C. § 1343, to encompass the use of interstate wire communications to fraudulently avoid paying foreign tax liabilities. In doing so, the Supreme Court resolved a long-running conflict between lower federal courts over whether the mere use of U.S. wires in connection with a scheme to violate *only* foreign law is sufficient to constitute a felony violation of U.S. law.

The scheme at issue in *Pasquantino* was directed at circumventing Canada's tax on imported alcoholic beverages, but we believe the decision could result in a significant increase in U.S. Department of Justice investigations and prosecutions of multinational corporations and individuals doing business in the United States or merely using the services of U.S. financial institutions. Aggressive tax planning or technical violations of foreign law that carry very little risk of prosecution overseas by foreign governments may now be charged as wire fraud or money laundering in the United States, if U.S. wires (or U.S. mail or express delivery services) are even slightly implicated.

Facts of *Pasquantino*

Carl Pasquantino, David Pasquantino, and Arthur Hilts were convicted of carrying out a scheme to smuggle large quantities of liquor into Canada from the United States. While in New York, the Pasquantinos ordered liquor over the telephone from discount stores in Maryland. They employed Hilts and others to drive the liquor into Canada without paying Canadian excise taxes by hiding the liquor and failing to declare the liquor to Canadian customs officials. The evidence at trial showed that the excise tax due on the alcohol purchased in the U.S. and transported to Canada was approximately double the purchase price.

The defendants appealed and a three-judge panel of the U.S. Court of Appeals for the Fourth Circuit reversed the convictions. The full appellate court later reheard the case *en banc*, vacated the panel's decision, and affirmed the convictions. The Supreme Court, in a 5-4 decision written by Justice Thomas, agreed with the Court of Appeals and reaffirmed the convictions. The Court reached its decision even while acknowledging that an incidental result of the convictions would be an order from the U.S. district court directing restitution to the Canadian government of taxes owed by the defendants.

The Wire Fraud Statute

The U.S. wire fraud statute, 18 U.S.C. § 1343, prohibits the use of interstate wires in “any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses.” The statutory penalties for a violation of section 1343 are up to 30 years in prison and a \$1 million fine.

Under English and American common law, the so-called “revenue rule” generally barred courts from enforcing the tax laws of foreign governments. The lower U.S. courts were divided, however, over the question of whether a plot or scheme to defraud a foreign government of tax revenue violates the U.S. wire fraud statute. Some courts held that the revenue rule prohibited prosecution because the U.S. courts would be required to enforce the revenue laws of a foreign sovereign. E.g., *United States v. Boots*, 80 F.3d 580 (1st Cir. 1996). Other lower courts held that the revenue rule precluded the enforcement of foreign tax judgments by the U.S. government, but did not preclude the use of the wire fraud statute to penalize a scheme to defraud a foreign government of tax revenue that involves the use of domestic wire facilities. E.g., *United States v. Trapilo*, 130 F.3d 547 (2d Cir. 1997).

The Supreme Court’s Decision

The U.S. Supreme Court held in *Pasquantino* that a plot to defraud a foreign government of tax revenue violates the federal wire fraud statute when U.S.-based wire facilities (for example, telephones, facsimiles, electronic mail communications) are employed in the scheme.

A few important points from the decision are:

- Despite the common law revenue rule prohibiting the enforcement of tax liabilities by one country in the courts of another, the Supreme Court held that the broad language of the wire fraud statute permits the U.S. government to punish domestic criminal conduct (involving, for example, the use of domestic telephones, mail, banks and other financial institutions) even when the purpose of the conduct is to defraud a foreign government of tax revenue.
- Such prosecutions are appropriate, the Court decided, even though one component of the resulting judgment is a restitution order directing repayment of foreign tax liabilities. If the defendant is convicted of defrauding a foreign government, the Mandatory Victims Restitution Act of 1996, 18 U.S.C. §§ 3663A-3664, appears to require the restitution of the lost tax revenue to the defrauded foreign government.
- The Court acknowledged that while it may seem unusual for prosecutors to use the resources of the United States government to prosecute a U.S. citizen for smuggling liquor into Canada, the broad language of the wire fraud statute authorizes U.S. prosecutors to do so.
- Nothing in the decision limits the application of the wire fraud statute to U.S. citizens. The statute applies to any individual or corporation, foreign or domestic, who uses U.S. interstate wires to execute a scheme to defraud.

Implications of the Decision

The Supreme Court’s decision in *Pasquantino* would seem to clear the way for further attempts by the U.S. Department of Justice to use the U.S. criminal justice system to punish violations of foreign laws.

The Department of Justice has not hesitated to pursue these cases when able to do so. Recently, the U.S. Attorney's Office in San Francisco, California, obtained convictions of former Ukrainian Prime Minister Pavlo Lazarenko for violations of the U.S. wire fraud and money laundering statutes in connection with various acts of extortion and fraud that took place in Ukraine, including the extortion of a Ukrainian businessman and the defrauding of a Ukrainian state-owned enterprise. The U.S. government established that Lazarenko concealed the source and his receipt of these funds and falsely understated his income and assets to Ukrainian authorities. The government further established that Lazarenko transferred millions of dollars of ill-gotten gains through coded accounts at banks in Switzerland Antigua, and ultimately into bank accounts in the United States.

Under the reasoning adopted by the Supreme Court in *Pasquantino*, prosecutors in the United States may be able to pursue violations of, among other things, foreign income and excise tax laws, corruption and bribery laws, and environmental, antitrust, and securities laws and regulations, so long as the use of wire or mail facilities in the United States can be shown.

* * * * *

Morgan Lewis has one of the largest and most diverse corporate investigations and white-collar criminal defense practices in the United States, including attorneys with experience in complex tax matters. If you have any questions or would like further information about this case or other issues involving United States government investigations of individuals or businesses, please contact any of the following Morgan Lewis attorneys:

New York

Leslie R. Caldwell	212.309.6260	lcaldwell@morganlewis.com
--------------------	--------------	---------------------------

Philadelphia

Nathan J. Andrisani	215.963.5362	nandrisani@morganlewis.com
John ("Jack") C. Dodds	215.963.4942	jdodds@morganlewis.com
Lisa C. Dykstra	215.963.5699	ldykstra@morganlewis.com
Michael J. Holston	215.963.4885	mholston@morganlewis.com

San Francisco

John H. Hemann	415.442.1355	jhemann@morganlewis.com
William H. Kimball	415.442.1277	wkimball@morganlewis.com

Washington, D.C.

Amy J. Conway	202.739.5953	aconway@morganlewis.com
Miriam L. Fisher	202.739.5489	miriam.fisher@morganlewis.com
William L. Gardner	202.739.5180	wgardner@morganlewis.com
James N. Mastracchio	202.739.5488	jmastracchio@morganlewis.com
Mark A. Srere	202.739.5049	msrere@morganlewis.com