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Is Lost Tax Revenue Property Under RICO?

by Steve R. Johnson



The last installment of this column began an examination of the use of the federal civil RICO Act in state and local tax administration controversies.¹ This installment closes the loop by answering questions posed, but not resolved, last time. This column explores whether uncollected tax revenue — or loss of the opportunity to collect tax

revenue — constitutes “business or property” under the civil RICO statute. This exploration also takes up the related question whether tax authorities will be able to overcome judicial reluctance to turning RICO into a tax collection statute.

Part I of this column reprises how RICO can come into play in state and local tax controversies. Part II describes why the “business or property” issue may determine the outcome in some future cases. Part III evaluates whether the opportunity to collect tax revenue should constitute business or property for RICO purposes. It concludes that although the question is a close one, that opportunity is unlikely to be held to be business or property by the current U.S. Supreme Court.

I. RICO in State-Local Tax Controversies

In its criminal aspect, RICO makes it “unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate commerce, to conduct or participate . . . in the conduct of such enterprise’s affairs through a pattern of racketeering activity.”² In its civil aspect, RICO provides a private right of action

for “any person injured in his business or property by reason of a violation of” the criminal provision.³

The Supreme Court considered the state-local tax consequences of RICO three times in the last four years. In 2006, in *Anza v. Ideal Steel Supply Corp.*, the Court, over two dissenting opinions, rejected a civil RICO claim by one company against a competitor alleging that the defendant’s evasion of state sales tax gave it an unfair and illegal business advantage.⁴ In 2008, in *Bridge v. Phoenix Bond & Indemnity Co.*, the Court unanimously upheld a RICO claim brought by losing bidders in county tax-lien auctions against successful bidders who were violating the county’s auction rules.⁵ In January 2010, in *Hemi Group, LLC v. City of New York*, the Court in a 5-3 vote reversed the Second Circuit and rejected New York City’s RICO claims against an out-of-state vendor whose failure to file legally required reports effectively denied the city the opportunity to collect sales and use taxes from the vendor’s customers in the city.⁶

It is striking that the Supreme Court has heard three RICO cases in four years involving, directly or indirectly, state or local taxation. The diverse contexts of those cases suggest that more such litigation — perhaps much more — is possible in the future, depending on the creativity of plaintiffs’ attorneys.

II. The Business or Property Issue

A civil RICO plaintiff must establish both that the harm it suffered constitutes an injury to its business or property and that the harm was proximately caused “by reason of” the RICO violation.⁷ The *Hemi* Court disposed of the city’s civil RICO claim on the second element. The plurality found the connection

¹Steve R. Johnson, “Civil RICO and State and Local Taxes,” *State Tax Notes*, Mar. 8, 2010, p. 711, Doc 2010-3383, or 2010 STT 44-2.

²18 U.S.C. section 1961(1).

³18 U.S.C. section 1964(c).

⁴*Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451 (2006).

⁵*Bridge v. Phoenix Bond & Indemnity Co.*, 553 U.S. ___, 128 S. Ct. 2131 (2008).

⁶*Hemi Group, LLC v. City of New York*, 559 U.S. ___, 130 S. Ct. 983 (2010).

⁷E.g., *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 268, 268 (1992).

between the alleged RICO violation and the city's fiscal injury to be too attenuated.⁸ As a result, the Court did not consider the first element. Only Justice Stephen G. Breyer's dissent, joined by Justices John Paul Stevens and Anthony M. Kennedy, discussed the business or property issue.

That does not mean, however, that the business or property issue does not merit exploration. First, in other cases, the proximate cause issue may not be dispositive, as it was not in *Bridge*, in which both the elements were considered and the RICO claim was upheld. Second, even in the future *Hemi*-like cases, the proximate cause element might be satisfied, thus requiring consideration of the business or property element.

The shift of one justice's vote would have left the city the victor in *Hemi*. The case was decided on a vote of 5 to 3. A 4-4 vote would have left the decision below unreversed, but the city prevailed in the decision below.⁹ Only eight justices participated in *Hemi* because Justice Sonia Sotomayor recused herself. She had been in the Second Circuit majority that had held for the city. Counting her vote, there are four justices who thought the proximate cause issue was satisfied in *Hemi*. Changing only one justice's mind would have compelled consideration of the business or property issue.

Had the right governmental plaintiff offered the right arguments at the right stage of the proceedings, *Hemi* might have come out differently on the proximate cause issue.

It may be that securing a one-vote switch would be possible if either of two aspects of the case were altered. First, the plurality acknowledged that the case would have been closer had the claim pressed by the city been advanced instead by New York state because the state's connection to the matter was closer than the city's.¹⁰ Second, before the Supreme Court, the city maintained as part of its proximate cause argument that the defendant had made affirmative misrepresentations about taxability to city residents. The *Hemi* plurality refused to entertain the argument because it had not been advanced before the lower courts.¹¹

⁸130 S. Ct. at 989-994.

⁹*City of New York v. Smokes-Spirits.com, Inc.*, 541 F.3d 425 (2d Cir. 2008), *rev'd sub nom. Hemi Group, LLC v. City of New York*, 130 S. Ct. 983 (2010). (For the decision, see *Doc 2010-1835* or *2010 STT 17-2*.)

¹⁰130 S. Ct. at 990.

¹¹*Id.* at 993.

Thus, had the right governmental plaintiff offered the right arguments at the right stage of the proceedings, *Hemi* might have come out differently on the proximate cause issue. Accordingly, it is likely that the business or property issue will have to be addressed, and may be dispositive, in some future cases involving civil RICO claims in state-local tax contexts.

III. Lost Tax Collection Opportunity as Business or Property

The merits of this issue are fascinating. They present a cornucopia of constructional perspectives involving asserted analogies drawn from other legal contexts, canons of interpretation, and policies. To keep the discussion within manageable bounds, however, we will address here principally those four aspects that gained some traction in one or another of the *Hemi* opinions:

- whether the elements of RICO should be understood through the lens of RICO's common-law foundations;
- whether antitrust law provides a viable analogy;
- whether the opportunity to collect taxes is fundamentally different from taxes already collected; and
- whether RICO can appropriately be used to assist the activity of tax collection.

As will be seen, those considerations provide ammunition to both proponents and opponents of applying civil RICO in state and local tax contexts.

A. Common-Law Foundations

In addressing the proximate cause issue, the *Hemi* plurality remarked that the issue "should be evaluated in light of its common-law foundations."¹² In light of the pre-*Hemi* cases, that approach should apply to both of the civil RICO elements, business or property and proximate cause.¹³

In 'dictionary shopping' cases, different results may obtain depending on which of multiple dictionaries, editions, or definitions the judge selects for reference.

This perspective may help future governmental plaintiffs in *Hemi*-like cases. In the 2004 decision in *Pasquantino v. United States*, the Court allowed a criminal RICO claim to proceed when the activity

¹²*Id.* at 989.

¹³*E.g., Bridge, supra* note 5, at 2140; *Beck v. Prupis*, 529 U.S. 494, 504 (2000).

was smuggling that deprived Canada of tax revenue. The Court held that “the right to tax revenue is property in Canada’s hands.”¹⁴ In reaching that result, the Court looked to common-law definitions set out in *Black’s Law Dictionary*, describing property as extending “to every species of valuable right and interest.”¹⁵

To counter that, however, the *Hemi* defendants cited a later edition of *Black’s* that suggested a more restrictive definition of property.¹⁶ Thus, as is common in “dictionary shopping” cases, different results may obtain depending on which of multiple dictionaries, editions, or definitions the judge selects for reference.¹⁷

B. Antitrust Analogy

In discussing the proximate cause issue, the *Hemi* dissent noted that Congress modeled RICO on the federal antitrust laws, thus “we have looked to those laws as an interpretive aid in RICO cases.”¹⁸ Again, this perspective can be broadened to shed light on the business or property issue.

Indeed, that was a central part of the argument on this issue by the *Hemi* defendants. They developed a distinction between sovereign functions versus proprietary functions, maintaining that under federal antitrust law, a state or local government can be a RICO plaintiff if it has been harmed in its proprietary or commercial activities, but not if it has been harmed in its activities as a sovereign. Taxation, of course, is a sovereign function.¹⁹

However, the analogy can be challenged. “Although RICO borrowed the tools of antitrust law . . . the objectives of RICO and the antitrust laws [are not] coterminous.” Specifically, RICO “was [not] limited to the antitrust goal of preventing interference with free trade.”²⁰ Although the phrase “business or property” appears in both RICO and federal antitrust statutes, it may be given different meanings if the statutes have different purposes.²¹

¹⁴*Pasquantino v. United States*, 544 U.S. 349, 356 (2005).

¹⁵*Black’s Law Dictionary*, 1382 (4th ed. 1951).

¹⁶See petitioners’ reply brief at p. 16 (citing the eighth edition of *Black’s Law Dictionary* (1999) as distinguishing the law of property, which deals with proprietary rights in rem, from the law of obligations, which deals with proprietary rights in personam, such as debts).

¹⁷For discussion of dictionary shopping, see Steve R. Johnson, “The Use and Abuse of the Plain Meaning Doctrine,” *State Tax Notes*, Sept. 22, 2008, p. 831, *Doc 2008-19121*, or 2008 *STT* 185-3.

¹⁸130 S. Ct. at 997 (quoting *Holmes*, *supra* note 7, at 267-268).

¹⁹Brief for petitioners at pp. 9-18.

²⁰*Bennett v. Berg*, 685 F.2d 1053, 1059 (8th Cir. 1983).

²¹See Steve R. Johnson, “Supertext and Consistent Meaning,” *State Tax Notes*, May 25, 2009, p. 675, *Doc 2009-9545*, or 2009 *STT* 99-4; see also *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667, 678 (1950).

C. Opportunity to Collect Versus Actual Collection

Money “of course, is a form of property” for RICO purposes.²² There is no doubt that had the defendants’ actions wrongly deprived the city of taxes already assessed and collected, the business or property element would have been satisfied.

But that was not the case. The failure of the *Hemi* defendants to file required reports deprived the city of information by which it might have been able to ascertain which of its residents owed the sales and use taxes so that the city might have assessed and collected taxes from them. Money is property, but is the chance to collect money also property?

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The *Hemi* plurality noticed the city’s attempt to conflate money and the opportunity to collect money.²³ The *Hemi* defendants maintained that the mere opportunity to collect is at most an expectancy not rising to the level of property.²⁴ Also, relying heavily on analogy to assessment for federal tax purposes, they argued that taxes cannot be property earlier than when they are assessed.²⁵

Another federal rule also may be enlisted in the clash. Section 6321 of the Internal Revenue Code establishes the reach of the general federal tax lien in sweeping terms.²⁶ Plaintiffs like the city in *Hemi* could observe that the section 6321 lien attaches to items in various stages of incompleteness, such as executory contracts²⁷ and future or contingent property interests.²⁸ For their part, defendants like those in *Hemi* could rejoin first that the text of section 6321 is broader than that of RICO,²⁹ and second,

²²*Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979). It also is property under New York State law. See N.Y. Gen. Const. Law section 39.

²³130 S. Ct. at 992-993 (“Perhaps the City articulated its argument in terms of the lost revenue itself to meet *Hemi*’s contention that an injury to the mere ‘opportunity to collect’ taxes fell short of RICO’s injury to ‘property’ requirement”).

²⁴Brief for Petitioners at pp. 25-27 (citing cases).

²⁵Petitioners’ Reply Brief at pp. 11-15.

²⁶See, e.g., *Glass City Bank v. United States*, 326 U.S. 265 (1945) (“Stronger language could hardly have been selected to reveal a purpose to assure the collection of taxes”).

²⁷E.g., *Randall v. H. Nakashima & Co., Ltd.*, 542 F.2d 270 (5th Cir. 1976).

²⁸E.g., *United States v. Solheim*, 91-1 U.S. Tax Cas. (CCH) para. 50,108 (D. Neb. 1990), *aff’d on other grounds*, 953 F.2d 379 (8th Cir. 1992); *Bigheart Pipeline Corp. v. United States*, 600 F. Supp. 50, 53 (N.D. Okla. 1984), *aff’d*, 835 F.2d 766 (10th Cir. 1987).

²⁹“Property” is the broader of RICO’s phrase “business or property.” E.g., *Waldron v. British Petroleum Co.*, 231 F. Supp.

(Footnote continued on next page.)

that for all its breadth, section 6321 probably does not go so far as to reach mere expectancies.³⁰

D. RICO as a Tax Collection Tool

The *Hemi* plurality noted that the city's position "poses the troubling specter of turning RICO into a tax collection statute."³¹ That was not the first opinion to do so.³² The *Hemi* dissent replied that "the Department of Justice has taken steps to avoid the 'tax collection agency' problem without reading all tax-related frauds out of similar federal criminal statutes."³³ That reply is less than fully comforting, however, because the Department of Justice guidelines "are, of course, not only changeable, but have no applicability whatever to state or local governments."³⁴

The significance one accords to this concern depends on the role one thinks Congress intended RICO to play. There is no problem with allowing RICO to be used for tax collection if that use is within the statute that Congress enacted.

There is no problem with allowing RICO to be used for tax collection if that use is within the statute that Congress enacted.

At least in its criminal aspects, RICO was inspired by the government's efforts to combat organized crime in the classic gang or mob sense. But the statute Congress wrote is broader than that. The Court has instructed that RICO is broad "enough to

72, 86-87 (S.D.N.Y. 1964). Under section 6321, however, the reach of the general federal tax lien goes beyond property to include "all property and rights to property, whether real or personal" (emphasis added).

³⁰See, e.g., *Drye v. United States*, 528 U.S. 49 (1999); see generally William D. Elliott, *Federal Tax Collection, Liens, and Levies*, para. 9.09 (2d ed. 2003) (discussing section 6321 case law regarding numerous types of property interests).

³¹130 S. Ct. at 993 n.2.

³²See, e.g., *Michigan, Dep't of Treasury, Revenue Div. v. Fawaz*, 1988 WL 44736, at *2 (6th Cir. 1988) (unpublished) (tax revenue should not constitute "property" for RICO purposes lest the courts become "collection agencies for unpaid state taxes"); *West Virginia v. Moore*, 895 F. Supp. 864, 872 (S.D. W.Va. 1985).

³³130 S. Ct. at 1000.

³⁴*Id.* at 993 n. 2 (plurality opinion).

encompass a wide range of criminal activity, taking many different forms and likely to attract a broad array of perpetrators operating in many different ways."³⁵ Indeed, the statute itself directs that it is to be "liberally construed to effectuate its remedial purposes."³⁶

Broad construction, however, does not imply infinite plasticity. One may be forgiven for harboring the feeling that civil RICO has strayed far from its roots when it is applied by taxing authorities for purely tax enforcement ends.

E. Evaluation

What effect will *Hemi* have on attempts by other state or local revenue agencies to use RICO to facilitate tax collection? The Court's decision will require some retooling of agencies' litigation strategies, but I doubt it will cause agencies to give up on the civil RICO tool entirely.

Future courts will be called on to resolve the business or property issue. As shown by the foregoing, both sides have substantial arguments on the issue. Prediction is often risky business, especially because the particular facts of the case that is litigated will considerably affect the outcome. Laying aside caution, my suspicion is that were the issue squarely addressed by the Supreme Court, the justices would be split but that the majority would hold the business or property element as not satisfied in a *Hemi*-like case. Looming large in that result, I think, would be the distinction between taxes collected and the mere opportunity to collect taxes. It will be interesting to watch future developments in this area. ☆

Interpretation Matters is a column by Steve R. Johnson, E.L. Wiegand Professor of Law and associate dean for faculty development and research at the University of Nevada, Las Vegas. He can be reached at steve.johnson@unlv.edu.

³⁵*H.J., Inc. v. Nw. Bell Tel. Co.*, 492 U.S. 299, 248 (1989).

³⁶P.L. No. 91-452, 84 Stat. 922, 947 (1970). For discussion of this canon of statutory interpretation, see Steve R. Johnson, "Interpreting State Tax Exemptions, Deductions, and Credits," *State Tax Notes*, Feb. 23, 2009, p. 607, *Doc 2009-2323*, or *2009 STT 34-7*.