

Florida State University College of Law

Scholarship Repository

Scholarly Publications

3-8-2010

Civil RICO and State and Local Taxes

Steve R. Johnson

Florida State University College of Law

Follow this and additional works at: <https://ir.law.fsu.edu/articles>



Part of the [Taxation-State and Local Commons](#), and the [Tax Law Commons](#)

Recommended Citation

Steve R. Johnson, *Civil RICO and State and Local Taxes*, 55 *ST. TAX NOTES* 711 (2010),
Available at: <https://ir.law.fsu.edu/articles/312>

This Article is brought to you for free and open access by Scholarship Repository. It has been accepted for inclusion in Scholarly Publications by an authorized administrator of Scholarship Repository. For more information, please contact efarrell@law.fsu.edu.

RICO and State and Local Taxes

by Steve R. Johnson



Vast is the garden of state and local taxation, and exotic are some of the blossoms to be found there. This installment of Interpretation Matters will consider one of those curious blooms: use of the civil RICO statute directly or collaterally in state-local tax administration. The U.S. Supreme Court has addressed the state-local tax

implications of civil RICO three times in recent years: in the *Anza*¹ case in 2006, *Bridge*² in 2008, and *Hemi*,³ decided on January 25, 2010.

The first section below sketches civil actions under the Racketeer Influenced and Corrupt Organizations Act. The next three sections describe *Anza*, *Bridge*, and *Hemi* respectively. In *Anza* and *Hemi*, the civil RICO claims failed. In *Bridge*, they succeeded. The fifth section assesses whether, in light of the three decisions, any room remains for asserting civil RICO in future controversies arising from state or local taxes. It concludes that some such room likely does exist. A future installment of the column will explore other policy issues raised by these three cases, especially by *Hemi*.

Civil RICO

RICO⁴ is best known in its criminal application, as a powerful tool by which the federal government attacks organized crime. In relevant part, the criminal RICO provision 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,

directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity."⁵

RICO has a civil aspect as well. The statute provides a private right of action, which is available to "any person injured in his business or property by reason of a violation of" the criminal RICO provision.⁶

Anza

Anza did not directly affect the ability of state or local governments to tax. Instead, it addressed a matter collateral to such taxation. The Ideal Steel Supply Corp. brought a RICO claim against a competitor, National Steel Supply. Ideal alleged that National falsely told New York state officials that National did not owe sales tax, and that National defrauded the state by failing to charge and remit sales tax. Ideal claimed that it was injured by that conduct. Had National paid the taxes it properly owed, National would have had to charge customers higher prices and would have had less money to run its business, Ideal claimed. Thus, Ideal would have been able to compete more effectively against National.

The Supreme Court held that Ideal's civil RICO claim did not lie. The Court reasoned that the link between National's alleged fraud and Ideal's injury was too attenuated.⁷ "The direct victim of this conduct was the State of New York, not Ideal," and the cause of the harm allegedly suffered by Ideal was "a set of actions (offering lower prices) entirely distinct from the alleged RICO violation (defrauding the State)."⁸ Accordingly, that violation had not "led directly to [Ideal's] injuries," and Ideal had not met the statute's "requirement of a direct causal connection" between the predicate offense and the putative harm.⁹

Anza was not unanimous. Justice Clarence Thomas took the majority to task for "permit[ing] a

¹*Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451 (2006).

²*Bridge v. Phoenix Bond & Indemnity Co.*, 553 U.S. ___, 128 S. Ct. 2131 (2008).

³*Hemi Group, LLC v. City of New York*, 559 U.S. ___, (2010). (For the decision, see *Doc 2010-1835*, or *2010 STT 17-2*.)

⁴18 U.S.C. section 1962(c).

⁵18 U.S.C. section 1961(1).

⁶18 U.S.C. section 1964(c).

⁷547 U.S. at 459.

⁸*Id.* at 458.

⁹*Id.* at 460-461.

defendant to evade liability for harms that are not only foreseeable, but the *intended* consequences of the defendant's unlawful behavior."¹⁰ Justice Stephen G. Breyer opined that civil RICO should "not cover claims of injury by one competitor where the legitimate procompetitive activity of another competitor immediately causes that injury."¹¹

Bridge

Bridge involved competing bidders at tax-lien auctions in Chicago. Bids took the form of the percentage tax penalty the bidder would require the tax-delinquent property owner to pay, and the lowest possible bid was 0 percent. Since the liens would be profitable at even that lowest possible level, multiple bidders made that same bid. To decide which of those multiple, equal bidders would be awarded the lien, Cook County allocated the liens on a rotating basis.

Some bidders, however, started to "game" the rotational system. Those bidders, in addition to bidding themselves, sent agents to bid on their behalf. To counter that, the county prohibited the use of "shadow bidders."

In *Bridge*, losing bidders claimed that the successful bidder had violated the county's rule by directing its agents to misrepresent to the county that they were independent bidders. Consequently, the shadow bidders were allowed to participate in the auction. Facing additional bidders, the plaintiffs lost some of the liens they would otherwise have won and suffered financial loss as a result.

The *Bridge* Court distinguished *Anza* and unanimously upheld the civil RICO claim. Because of the rotational system and the "zero sum" nature of the auction, a given legitimate bidder necessarily was passed over each time a fraud-induced bid was awarded the tax lien.¹² Moreover, the losing bidders "were the *only* parties injured by the [defendant's] misrepresentations."¹³

The notion of foreseeability also made its way into the *Bridge* decision. The Court said that the harm in *Bridge* was a "foreseeable and natural consequence of [the defendant's] scheme."¹⁴

Hemi

New York City filed a civil RICO action against Hemi, a New Mexico company that sells cigarettes

online to residents of the city. The city imposes tax on cigarettes possessed within the city for sale or use.¹⁵ In-state vendors are responsible for charging, collecting, and remitting the tax when they sell cigarettes; out-of-state vendors are not.¹⁶

Thus, when the sales are made by vendors like Hemi, the city must attempt to recover the tax direct from customers. That difficult task is eased by the federal Jenkins Act, which requires out-of-state cigarette sellers to register and to file reports with state tobacco tax administrators. The reports list the names, addresses, and quantities of cigarettes bought by state residents.¹⁷ New York state and city cooperate in cigarette tax enforcement, and the state forwards Jenkins Act information to the city.

Hemi did not file Jenkins Act information with New York state, so information about Hemi's New York customers did not reach the city. The city alleged that this cost it "tens if not hundreds of millions of dollars a year in cigarette excise tax revenue."¹⁸ The city alleged that Hemi's interstate sale of cigarettes and its failure to file Jenkins Act reports describing those sales constituted the RICO predicate offenses of mail and wire fraud. Hemi did not dispute that characterization of the predicate offenses. It did, however, offer two arguments: first that lost tax revenue is not "business or property" within the meaning of RICO and second that the city could not demonstrate it suffered any injury "by reason of" the failure to file Jenkins Act reports.

The Court held 5 to 3 in favor of Hemi.¹⁹ The plurality decided the case on the "by reason of" issue, so it did not reach the "business or property" issue. The plurality reasoned that a civil RICO plaintiff must show that a RICO predicate offense "not only was a 'but for' cause of [its] injury, but was the proximate cause as well." Such proximate cause

¹⁵N.Y.C. Admin. Code section 11-1302(a)(2008). New York state imposes a similar tax. N.Y. Tax Law Ann. section 47(1) (West Supp. 2009).

¹⁶See *City of New York v. Smokes-Spirits.com, Inc.*, 541 F.3d 425, 432-33 (2d Cir. 2008), *rev'd sub nom. Hemi Group, LLC v. City of New York*, 559 U.S. ____ (2010). Indeed, under the Supreme Court's current view of the commerce clause, the city could not constitutionally compel out-of-state sellers to collect the tax. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 301 (1992); *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753, 758 (1967).

¹⁷15 U.S.C. sections 375-378.

¹⁸*Hemi*, 559 U.S. at ____ (plurality slip op. at 3).

¹⁹Chief Justice John G. Roberts Jr. wrote for the plurality and was joined by Justices Antonin Scalia, Clarence Thomas, and Samuel Alito. Justice Ruth Bader Ginsburg filed a concurring opinion. Justice Stephen Breyer, joined by Justices John Paul Stevens and Anthony Kennedy, dissented. Justice Sonia Sotomayor did not participate in the case because she had been part of the Second Circuit panel that decided the case below.

¹⁰*Id.* at 470 (Thomas, J., concurring in part and dissenting in part) (emphasis in original).

¹¹*Id.* at 479 (Breyer, J., concurring in part and dissenting in part).

¹²553 U.S. at ____ (slip op. at 18).

¹³*Id.* (emphasis in original). The county was not injured because it received the same revenue regardless of which bidder won.

¹⁴*Id.*

is assessed by reference to its common-law foundations and requires “some direct relation between the injury asserted and the injurious conduct alleged.”²⁰ Thus, “[a] link that is ‘too remote,’ ‘purely contingent,’ or ‘indirect[ly]’ is insufficient.”²¹

The plurality found the connection between the RICO violation and the city’s fiscal injury to be far too attenuated, suffering from the same defect as the claim rejected in *Anza*.

Indeed, the disconnect between the asserted injury and the alleged fraud in this case is even sharper than in *Anza*. . . . Here, the City’s theory of liability rests not just on separate actions [by the same defendant], but separate actions carried out by separate parties.

The City’s theory thus requires that we extend RICO liability to situations where the defendant’s fraud on the third party (the State) has made it easier for a fourth party (the taxpayer) to cause harm to the plaintiff (the City). . . . Hemi’s obligation was to file the Jenkins Act reports with the State, not the City, and the City’s harm was directly caused by the customers, not Hemi. We have never before stretched the causal chain of a RICO violation so far, and we decline to do so today.²²

The plurality said that *Bridge* “reaffirmed the requirement that there must be ‘a sufficiently direct relationship between the defendant’s wrongful conduct and the plaintiff’s injury.’”²³ That direct relationship existed in *Bridge* because of the zero-sum nature of the tax lien auction and the absence of independent factors accounting for the plaintiff’s injury. In contrast, in *Hemi*, “there certainly were [independent factors]: The city’s theory of liability rests on the independent actions of third and even fourth parties.”²⁴

In concurrence, Justice Ruth Bader Ginsburg adverted in part to a consideration that had been suggested by Judge Winter of the Second Circuit. Hemi’s alleged fraud was based on violation of the Jenkins Act. Thus, the nature and consequences of that fraud should be ascertained solely by reference to that act. Yet “conspicuously absent from the City’s pleadings is any claim brought pursuant to the Jenkins Act itself, rather than RICO, seeking en-

forcement of the Jenkins Act.”²⁵ To Justice Ginsburg, “the City thus effectively admits that its claim is outside the scope of the very statute on which it builds its RICO suit.”²⁶

Justice Breyer’s dissent moved away from the directness of the relationship between the violation and the injury. Instead, the dissent emphasized the foreseeability and intent aspects of common-law fraud.²⁷

The dissent distinguished *Anza* because “in *Anza* the kind of harm that the plaintiff alleged is not the kind of harm that the tax statutes primarily seek to prevent.”²⁸ In contrast, “New York City’s revenue loss falls squarely within the bounds of the kinds of harms that the Jenkins Act (essentially the predicate statute) seeks to prevent.”²⁹ Unsurprisingly, perhaps, the dissent found *Bridge* to be a more closely analogous decision since, in *Bridge*, “[t]he harm was foreseeable; it was intended; and it was precisely the kind of harm that the county’s bidding rules sought to prevent.”³⁰

Future Controversies

In light of *Anza*, *Bridge*, and *Hemi*, might there be room for advancing civil RICO claims in future state or local tax contexts? I think the answer is in the affirmative, but the extent of that room is not yet clear.

Civil RICO claims are available in state-local tax matters when there are no factors independent of the defendant’s conduct that cause the injury in question.

First, at least one favorable context surely exists. None of the eight justices in *Hemi* questioned that *Bridge* remains good law. The plurality and the dissent put different spins on *Bridge*. At a minimum, civil RICO claims are available in state-local tax

²⁰*Id.* (plurality slip op. at 6), quoting *Holmes v. Securities Investor Protection Corp.*, 503 U.S. 258, 268 (1992).

²¹*Hemi*, 559 U.S. at ___ (plurality slip op. at 6), quoting *Holmes*, *supra*, 503 U.S. at 271, 274.

²²*Hemi*, 559 U.S. at ___ (plurality slip op. at 8) (emphasis in original).

²³*Id.* (plurality slip op. at 11), quoting *Bridge*, 553 U.S. at ___ (slip op. at 18).

²⁴*Hemi*, 559 U.S. at ___ (plurality slip op. at 12).

²⁵*Id.* (Ginsburg, J., concurring at slip op. at 2), quoting *City of New York v. Smokes-Spirits.com, Inc.*, 541 F.3d 425, 460 (2d Cir. 2008) (Winter, J., dissenting in part and concurring in part), *rev’d sub nom. Hemi Group, LLC v. City of New York*, 559 U.S. ___ (2010).

²⁶*Hemi*, 559 U.S. at ___ (Ginsburg, J., slip op. at 2).

²⁷*Hemi* misrepresented the relevant facts in order to bring about New York City’s relevant loss. It knew the loss would occur; it intended the loss to occur; one might even say it desired the loss to occur. It is difficult to find common-law cases denying liability for a wrongdoer’s intended consequences, particularly where those consequences are also foreseeable.” *Id.* (Breyer, J., dissenting at slip op. 5) (emphasis in original).

²⁸*Id.* (Breyer, J., slip op. at 10) (emphasis in original).

²⁹*Id.* (Breyer, J., slip op. at 5).

³⁰*Id.* (Breyer, J., slip op. at 10).

matters when there are no factors independent of the defendant's conduct that cause the injury in question.

Second, a claim like the city's claim in *Hemi* might be viable if brought by a better situated plaintiff. The plurality said that New York state:

certainly is better situated than the City to seek recovery from Hemi. And the State has an incentive to sue — the State imposes its own \$2.75 per pack tax on cigarettes possessed within the State.... We do not opine on whether the State could bring a RICO action for any lost tax revenue.³¹

Third, a plaintiff might have a better chance if it credibly presses a point the city flirted with but did not properly embrace. At the Supreme Court level, the city contended that Hemi made affirmative misrepresentations to residents of the city, and those misrepresentations comprised part of the RICO predicate frauds. However, the city had affirmatively disavowed that theory at trial. For that rea-

son, the plurality "decline[d] to consider Hemi's alleged misstatements as predicate acts at this late stage."³²

No complete picture of civil RICO's viability in future state-local tax matters can be drawn, however, without painting in two more parts of the canvas. First, if a governmental plaintiff survives the "proximate cause" requirement, there still remains the issue of whether uncollected tax revenue constitute "business or property" for RICO purposes. Also, governmental plaintiffs will have to overcome judicial reluctance about turning RICO into a tax collection statute.

Both of those dimensions were present in *Hemi*.³³ They, and ancillary matters, will be explored in the next installment of this column. ☆

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

³¹*Id.* (plurality slip op. at 9).

³²*Id.* (plurality slip op. at 15).

³³See, e.g., *id.* (plurality slip op. at 13 and n.2).