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The BEAT and the Treaties

by H. David Rosenbloom and Fadi Shaheen

H. David Rosenbloom

Fadi Shaheen

H. David Rosenbloom is a member with Caplin & Drysdale Chtd. in Washington and director of the international tax program at New York University School of Law, and Fadi Shaheen is an associate professor of law at Rutgers Law School.

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In this article, the authors discuss the base erosion and antiabuse tax implemented under the U.S. Tax Cuts and Jobs Act, focusing on its relationship with U.S. tax treaties currently in force.

Among the signal achievements of the Tax Cuts and Jobs Act (P.L. 115-97), which passed through Congress on a reconciliation procedure, is new IRC section 59A, the tax on base erosion payments of taxpayers with substantial gross receipts, commonly referred to as the base erosion and antiabuse tax. But the caption of section 59A, like many other aspects of the TCJA, is misleading: The BEAT is not exactly a tax on base erosion payments, nor does it apply to all taxpayers with substantial gross receipts.

This is not, however, the place to explore descriptions of the statute or the many technical problems regarding its interpretation. The focus here is different — namely, on the BEAT's relationship to the 65 or so income tax conventions in force to which the United States is a party. Except for one indirect reference, the TCJA contains not a word about the U.S. tax treaty network.

In approaching the question of how the BEAT operates under the treaties, it seems appropriate to begin with a summary of how the BEAT is supposed to work. Section 59A imposes on each applicable taxpayer a tax equal to the base erosion minimum tax amount for the tax year. That is the excess of 10 percent (5 percent for 2018) of a modified taxable income base over the regular tax liability for the tax year (a pre-credit figure defined in code section 26(b)), reduced by allowable credits (including the foreign tax credit), with one exception and a specific limitation. Modified taxable income is taxable income computed without regard to tax benefits from deductible payments to foreign related persons, depreciation and amortization deductions for property acquired from foreign related persons, reinsurance payments to foreign related persons, net operating loss deductions reflecting those payments, and specific payments to related expatriated entities. The payments are not disregarded if the payee is subject to U.S. tax on them on a gross income basis under section 871 or 881 and the tax is actually withheld from the payments under section 1441 or 1442. If the normal 30 percent U.S. tax is reduced by a tax treaty, the payments are partially disregarded in computing modified taxable income under rules similar to those in section 163(j)(5)(B), as that section stood before enactment of the TCJA.

Any sound analysis of the relationship between the BEAT and the treaties begins with four points. First, section 59A imposes a new and separate tax just like the alternative minimum tax of section 55.[1] Second, the structure of the BEAT is similar to that of the AMT. Third, unlike the AMT, which has always included FTC rules, there is no statutory credit against the BEAT for foreign taxes.[2] Fourth, the modified taxable income to which the BEAT attaches is computed without otherwise deductible payments to foreign related persons, while similar payments to domestic related persons are fully deductible.

The U.S. Model Income Tax Convention, the most recent version of which was published on February 17, 2016, contains two provisions relevant to the BEAT. That model can safely be used for analytical purposes because it is identical or nearly identical in relevant respects to most of the U.S. income tax treaties in force.

The first relevant provision in the U.S. model is the commitment in article 23 (relief from double taxation), paragraph 2, of an FTC for income tax of the treaty partner "in accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof)." It is possible to ponder the precise meaning of the quoted words,[3] but there is no need to do that for the BEAT. It envisions no statutory FTC at all, and that is surely inconsistent with the general principle of article 23, whatever the contours of that principle may be.[4] As the U.S. model technical explanation, issued in connection with the 2006 version of the U.S. model convention, states, the credits "are allowed in accordance with the provisions and subject to the limitations of U.S. law, as that law may be amended over time, so long as the general principle of the Article, that is, the allowance of a credit, is retained."

The second relevant provision in the model is article 24 (nondiscrimination), paragraph 4, which provides (with some exceptions not relevant here[5]) that for determining the taxable profits of an enterprise of a contracting state, interest, royalties, and other disbursements paid by that enterprise to a resident of the other contracting state will "be deductible under the same conditions as if they had been paid to a resident of the first-mentioned Contracting State." The BEAT is computed without deductions for payments to foreign related persons but envisions no disallowance for identical payments to domestic related persons. It would thus appear that section 59A falls squarely within the ambit of article 24(4).

Stated otherwise, in computing regular taxable income taxpayers are allowed deductions under, or subject to, various conditions and limitations. For the corporate income tax, deductions are allowed regardless of whether the payee is a U.S. or a foreign person. For the BEAT, some payments by applicable taxpayers to related foreign persons (including residents of a treaty partner) are not deductible under the same

[1] It is therefore incorrect, except in a colloquial sense, to say that a taxpayer must pay the higher of the BEAT or the regular corporate tax.

[2] That is clear from a combination of code sections 26(b)(2)(B), 27(a), and 901.

[3] *See, e.g.*, Fadi Shaheen, "How Reform-Friendly Are U.S. Tax Treaties?" 41 *Brook. J. Int'l L.* 1243, 1266 (2016) (arguing that "the general principle of allowing a credit in the meaning of Article 23(2) refers to the principle of a dollar-for-dollar reduction in the amount of U.S. tax on U.S.-taxable foreign-source income by the amount of foreign taxes paid, applied on an overall basis, item-by-item basis, or any basis in between").

[4] It is immaterial that the BEAT rate is lower than the regular corporate tax rate because: (i) the BEAT is a separate tax from, and not part of, the regular corporate tax and therefore the lower BEAT rate does not reflect a partial exemption but just two separate taxes with two different rates; (ii) the BEAT base is broader than the regular corporate tax base; and (iii) in any event, the code provides for no BEAT FTC at all. *See also* note 41, *infra*.

[5] The exceptions are relevant only when "the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 8 of Article 11 (Interest), or paragraph 7 of Article 12 (Royalties) apply." Those provisions deal with non-arm's-length payments. Section 59A applies after application of IRC section 482 and the identified treaty provisions, so the exceptions are irrelevant. For a different view, see Bret Wells, "Get With the BEAT," *Tax Notes*, Feb. 19, 2018, p. 1023 (arguing that the BEAT is conceptually consistent with the principles of article 9(1) and that the exceptions of article 24(4) therefore apply even if article 9(1) does not).

conditions as if they had been paid to a U.S. resident.

That the BEAT fails to conform to U.S. tax treaty obligations in two independent respects is not the end of the story. Nonconformity is of significance only if treaty provisions can be invoked against the United States. That might not be the case if the BEAT is not a tax covered by U.S. treaties or if the BEAT overrides the treaties, in whole or in part.[6]

I. Treaty Coverage

If the BEAT is not a covered tax, that would respond to the objection that it allows no FTC, but not to the independent objection based on inconsistency with the nondiscrimination article. Regarding nondiscrimination, article 24(7) states that article 24's provisions "apply to taxes of every kind and description." The BEAT is clearly a tax, so even if it is not generally covered by the treaties, it would still be subject to challenge on nondiscrimination grounds.

Model article 2 (taxes covered), paragraph 3 states that "the existing taxes to which this Convention shall apply are . . . in the case of the United States: the Federal income taxes imposed by the Internal Revenue Code." Paragraph 4 states that the convention also applies to "any identical or substantially similar taxes that are imposed after the date of signature of this Convention in addition to, or in place of, the existing taxes." Does the BEAT fall within those provisions?[7]

The argument that the BEAT is not a covered tax would face a steep uphill climb. Congress and the courts assumed the AMT to be covered by U.S. treaties,[8] and Congress expressly overrode the treaties if a conflict existed.[9] The BEAT is substantially similar to the AMT:[10] It is a separate tax equal to the difference between a tax at a special rate on a modified income base and the taxpayer's regular tax liability. The only significant differences between the AMT and the BEAT are that the BEAT is imposed on a different modified income base, is imposed at a different (lower) rate, and contains no FTC provisions. The last two differences do not relate to the tax base, which is the most important criterion for determining substantial similarity, nor do they relate to other relevant criteria, such as the purpose of the tax or its subject or object.[11] Regarding the first difference, although the BEAT's income base differs from that of the AMT, both bases depart from the base of the regular income tax and serve the same broad purpose of assuring imposition of a minimum tax. Following the Tax Reform Act of 1986, the corporate AMT functioned essentially as a timing provision rather than as a permanent tax; the individual AMT has always been considered covered by U.S. treaties, however, and is certainly a permanent tax.[12]

The BEAT's denial of a deduction for payments to related foreign persons is potentially inconsistent with the net income requirement of the regulations under IRC section 901, which

[6] The saving clause of paragraphs 4 and 5 of article 1 (general scope) is not a factor here. Both articles 23 and 24 are exceptions to that clause, which states that "this Convention shall not affect the taxation by a Contracting State of its residents . . . and its citizens."

[7] Most U.S. treaties do not include the model provisions of article 2(1) and (2), which provide:

> 1. This Convention shall apply to taxes on income imposed on behalf of a Contracting State irrespective of the manner in which they are levied.
> 2. There shall be regarded as taxes on income all taxes imposed on total income, or on elements of income, including taxes on gains from the alienation of property.

[8] S. Rep. No. 100-445 (1988), at 319-321; *Lindsey v. Commissioner*, 98 T.C. 672 (1992), *aff'd*, 15 F.3d 1160 (D.C. Cir. 1994); *Jamieson v. Commissioner*, 70 T.C. Memo. 1372 (1995), *aff'd*, 132 F.3d 1481 (unpub. D.C. Cir. 1997), *cert. denied*, 523 U.S. 1108 (1998); *Pekar v. Commissioner*, 113 T.C. 158 (1999); *Brooke v. Commissioner*, T.C. Memo. 2000-194, *aff'd*, 13 Fed. Appx. 7 (D.C. Cir. 2001); *Kappus v. Commissioner*, T.C. Memo. 2002-36, *aff'd*, 337 F.3d 1053 (D.C. Cir. 2003); *Price v. Commissioner*, T.C. Memo. 2002-215; *Haver v. Commissioner*, T.C. Memo. 2005-137, *aff'd*, 444 F.3d 656 (D.C. Cir. 2006); and *Vax v. Commissioner*, T.C. Memo. 2005-134. These cases are not otherwise relevant to the question discussed below of whether section 59A overrides treaties because these cases either dealt with situations in which Congress expressed its clear intent to override treaties (see note 9, *infra*), or considered the otherwise conflicting statutory limitation on the AMT foreign tax credit to be a preexisting domestic law limitation to which the treaty obligation by its own terms was subject.

[9] Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647), section 1012(a)(2); S. Rep. No. 100-445, *supra* note 8, at 319-321.

[10] Technically, substantial similarity is determined by comparison with existing taxes listed in article 2(3). For purposes of treaties that predate its enactment, the AMT cannot be a listed tax. The substantial similarity between the BEAT and the AMT is relevant to such treaties because if the AMT was considered a covered tax, the BEAT should be covered as well.

[11] Roland Ismer and Christoph Jescheck, "The Substantive Scope of Tax Treaties in a Post-BEPS World: Article 2 OECD MC (Taxes Covered) and the Rise of New Taxes," 45(5) *Intertax* 382, 386-387 (2017).

[12] *See supra* note 8.

define income tax for determining whether a foreign tax is a creditable income tax under the statutory FTC rules.[13] That denial, however, may not be broad enough to disqualify the BEAT as an income tax under the principles of the section 901 regulations, and in any event it is not clear that section 901 principles determine treaty coverage. The BEAT, like the AMT, is housed in subtitle A (income taxes) of the IRC.

For defining the term "regular tax liability" in section 26(b)(2)(B), the BEAT is treated as a tax that is not imposed by chapter 1 of subtitle A of the IRC. That exclusion, however, only extends to chapter 1, not the entirety of subtitle A. The branch profits tax, which clearly is an income tax, is also excluded.

The range of taxes covered by U.S. treaties is usually broad.[14] And the question here is not whether the BEAT falls under article 2(3), which refers to taxes existing when a treaty was signed, but whether the BEAT is substantially similar to such taxes. Given the treatment of the AMT, an argument that the BEAT is not covered would be difficult to sustain. Article 2 is meant to widen as much as possible the application of the treaty and "avoid the necessity of concluding a new convention whenever the Contracting States' domestic laws are modified."[15]

II. Treaty Override

Another approach to defending the BEAT against a treaty-based position would be to maintain that section 59A overrides U.S. treaties in its entirety or overrides specific U.S. treaty commitments. That is certainly a possibility, because treaties and statutes stand on equal constitutional footing and there is no question that a statute can override U.S. treaty commitments. There is, however, a question whether section 59A — or any other aspect of the TCJA, for that matter — actually does that.

The supremacy clause of the U.S. Constitution provides that federal statutes and treaties are the supreme law of the land and have the same constitutional status. With the lack of any further guidance in the Constitution on how to resolve conflicts between a statute and a treaty, the Supreme Court has developed rules of construction to answer the question. One basic rule is that when a treaty and a statute address the same subject, they must be construed "so as to give effect to both, if that can be done without violating the language of either."[16] When an irreconcilable conflict is found, the provision that is later in time generally controls.[17] Despite that, in 1933 the Supreme Court indicated that there is a clear canon of construction against treaty overrides by implication, and that for a later statute to override a treaty, legislative silence is not enough — Congress must express a clear intention to do so.[18]

Cook addressed a conflict between a 1930 identical reenactment of a 1922 anti-bootlegger statutory provision and a 1924 treaty with Great Britain. The Supreme Court said:

> The Treaty was not abrogated by reenacting section 581 in the Tariff Act of 1930 in the identical terms of the act of 1922. A treaty will not be deemed to have been abrogated or modified by a later statute, unless such purpose on the part of Congress has been clearly expressed. . . . Here, the contrary appears. The committee reports and the debates upon the act of 1930, like the re-enacted section itself, make no reference to the Treaty of 1924 . . . .
>
> Searches and seizures in the enforcement of the laws prohibiting alcoholic liquors are governed, since the 1930 act, as they were before, by the provisions of the

[13] Reg. section 1.901-2; specifically, reg. section 1.901-2(b)(4)(i).

[14] *See, e.g.*, John P. Steines Jr., *International Aspects of U.S. Income Taxation* 371 (2015).

[15] OECD Commentary on the Articles of the Model Tax Convention (2017), at 91.

[16] *Kappus*, 337 F.3d at 1056 (citing *Whitney v. Robertson*, 124 U.S. 190, 194 (1888)).

[17] *Whitney*, 124 U.S. at 194.

[18] *Cook v. United States*, 288 U.S. 102 (1933). *See also Trans World Airlines Inc. v. Franklin Mint Corp.*, 466 U.S. 243, 252 (1984), and references therein. In *Owner-Operator Independent Drivers Association v. U.S. Department of Transportation*, 724 F.3d 230, 234 (D.C. Cir. 2013), the Court of Appeals for the D.C. Circuit declined to elevate to a doctrine dictum in one of its earlier decisions (*Fund for Animals Inc. v. Kempthorne*, 472 F.3d 872, 878 (D.C. Cir. 2006)) that the *Cook* canon applies only to ambiguous statutes, and concluded that "absent some clear and overt indication from Congress, we will not construe a statute to abrogate existing international agreements even when the statute's text is not itself ambiguous."

> Treaty. Section 581, with its scope narrowed by the Treaty, remained in force after its reenactment in the act of 1930. The section continued to apply to the boarding, search, and seizure of all vessels of all countries with which we had no relevant treaties. It continued also, in the enforcement of our customs laws not related to the prohibition of alcoholic liquors, to govern the boarding of vessels of those [about 15] countries with which we had entered into treaties like that with Great Britain.

In the legislative history of the Technical Corrections Act of 1988, a senate report analyzed *Cook*:

> The Court reached its conclusion on the stated ground that the treaty limit continued to apply under the 1930 Act, because section 581, "with its scope narrowed by the Treaty, remained in force after its reenactment in the act of 1930 . . . ." Properly construed, therefore, the committee believes that *Cook* stands not for the proposition that Congress must specifically advert to treaties to have later statutes given effect, but that for purposes of interpreting a reenacted statute, it may be appropriate for some purposes to treat the statute as if its effect was continuous and unbroken from the date of its original enactment.[19]

Thus, the Senate report argues there was no treaty override in *Cook* because the 1930 reiteration of the 1922 statutory provision was not a repeal and immediate reenactment but an uninterrupted continuation of the 1922 statute that should be dated back to the original enactment before the treaty. According to the report, there was no treaty override in *Cook* because it was the treaty, not the statute, that was later in time.

That does not appear to be an accurate reading of *Cook*, and it is not the way the Supreme Court later read *Cook*.[20] There is an established body of case law addressing when statutory enactments are viewed not as repealing and immediately reenacting older provisions, but instead as uninterruptedly continuing them.[21]

That, however, was not how *Cook* was decided. *Cook* referred to the 1930 reenactment as later in time, and its core reasoning was that "a treaty will not be deemed to have been abrogated or modified by a later statute, unless such purpose on the part of Congress has been clearly expressed." The Senate report states that "the Court reached its conclusion on the stated ground that the treaty limit continued to apply under the 1930 Act, because section 581, 'with its scope narrowed by the Treaty, remained in force after its reenactment in the act of 1930.'" *Cook*, however, declared that the law before the 1930 reenactment continued to apply because the Court found that the 1930 reenactment did not override the treaty. The Court was saying that the statute was at no time a nullity because it applied fully to vessels of non-treaty countries and partially to vessels of treaty countries if it was not in conflict with the treaty. It is also important to keep in mind that the rationale behind *Cook* was that requiring Congress to express a clear intent to override treaties ensures that Congress has considered and comprehended the actual consequences of its actions,[22] or, as the Supreme Court articulated it in a decision relied on in *Cook*:

> Aside from the duty imposed by the Constitution to respect treaty stipulations when they become the subject of judicial proceedings, the court cannot be unmindful of the fact that the honor of the government and people of the United States is involved in every inquiry whether rights secured by such stipulations shall be recognized and protected. And it would be wanting in proper respect for the intelligence and patriotism of a co-ordinate department of the government were it to doubt, for a moment, that these considerations were

[19] S. Rep. No. 100-445, *supra* note 8, at 325.

[20] *Trans World Airlines*, 466 U.S. at 252, and references therein.

[21] *See, e.g.*, *Posadas v. National City Bank of New York*, 296 U.S. 497 (1936).

[22] *See, e.g.*, *Roeder v. Islamic Republic of Iran*, 333 F.3d 228, 238 (2003); and *Owner-Operator Independent Drivers*, 724 F.3d at 238.

> present in the minds of its members when the legislation in question was enacted.[23]

Section 7852(d), which deals with the relationship between the Internal Revenue Code and U.S. treaty obligations, and which was amended in 1988, has no real bearing on the later-in-time issue. Before amendment, section 7852(d), enacted in 1954, read:

> (d) Treaty Obligations. — No provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title.

As the Senate report explains, that provision was added to the code of 1954 solely "to ensure that the substitution of the 1954 Code for the preexisting 1939 Code did not operate to override then-existing treaty provisions."[24] Following the 1988 amendment, section 7852(d) provides:

> (d) Treaty Obligations. —
>
> (1) In General. — For purposes of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or law.
>
> (2) Savings clause for 1954 treaties. — No provision of this title (as in effect without regard to any amendment thereto enacted after August 16, 1954) shall apply in case where its application would be contrary to any treaty obligation of the United States in effect on August 16, 1954.

The Senate report states that "this provision makes it clear that treaty provisions that were in effect in 1954 and that conflict with the 1954 Code as originally enacted are to prevail over then-existing Code provisions but not over later amendments to the Code." The report goes on to say that the 1988 amendment also "clarifies the interaction between the 1986 Act, this bill, and provisions of U.S. Treaties, identifying and clarifying known interactions where possible, and providing guidance for future interpretation of now-unknown interactions." The amended statute was said to adopt a "later-in-time" rule to resolve conflicts between the IRC and the treaties:

> In adopting this rule, the committee intends to permanently codify (with respect to tax-related provisions) present law to the effect that canons of construction applied by the courts to the interaction of two statutes enacted at different times apply also in construing the interactions of revenue statues and treaties enacted and entered into at different times.[25]

In fact, section 7852(d) says nothing of the kind. Its bland language makes the unobjectionable point that neither a treaty nor a statute is to have preferential status — a point that flows directly from the supremacy clause itself.

In addition to the lack of value in restating the constitutional rule, it is unclear whether Congress has the power to embroider on it.[26] The later-in-time rule is a judicial interpretation of the supremacy clause,[27] which Congress certainly cannot alter. All it can do is play by the constitutional rule: When it enacts a statute that is later in time than a treaty, it can express an intent to override, express an intent not to override, or remain silent. But Congress cannot enhance the status of a statute vis-à-vis a treaty for the same reason that a treaty cannot do so vis-à-vis a statute.[28] All section 7852(d)(1) can do is reiterate that neither the statute nor the treaty enjoys preferential status.

As noted, section 59A is inconsistent with both the nondiscrimination provision of article 24(4) of the U.S. model and the FTC provision of article 23(2). The TCJA is obviously later in time than the entirety of the U.S. treaty network.

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[23] *Chew Heong v. United States*, 112 U.S. 536, 540 (1884).

[24] S. Rep. No. 100-445, *supra* note 8, at 317.

[25] *Id*. at 321.

[26] Nicholas Quinn Rosenkranz, "Federal Rules of Statutory Interpretation," 115 *Harv. L. Rev.* 2085 (2002).

[27] *Whitney*, 124 U.S. at 194.

[28] *Reid v. Covert*, 354 U.S. 1 (1957) ("No agreement with a foreign nation can confer power on Congress, or on any other branch of Government, which is free from the restraints of the Constitution").

There are, however, two problems with a later-in-time analysis where the BEAT is concerned. First, the later-in-time principle was intended to resolve conflicts. Courts, however, are generally not eager to find conflicts between the code and treaties,[29] and it is not clear that section 59A and the treaties are necessarily in conflict. True, they are inconsistent and have different rules, but treaties exist to establish differences from domestic law. Moreover, the rules of statutory construction favor narrow and specific rules over broad and general ones. Treaties that require an FTC or preclude discrimination in the allowance of deductions may be seen as exceptions to general statutory rules that standing alone would not allow credit for foreign taxes or deductions for payments to foreign related persons.

The second and main problem with the later-in-time argument is that even if there is an irreconcilable conflict between the IRC and the treaties, in enacting the BEAT Congress gave no indication of an intent to override the treaties. The reason for that may derive from a hearing on the then-proposed TCJA by Thomas Barthold, chief of staff of the Joint Committee on Taxation, who said in response to a senator's concern about the interaction between the proposed legislation and U.S. treaties:

> And I believe in particular you were talking about the proposed base erosion and antiabuse provision of the chairman's mark. And it is structured as an alternative tax compared to the income tax. So I think our view is that there is not a treaty override inherent in that design.[30]

Asked whether he believed the BEAT would be acknowledged by treaty partners "as a clever way to avoid the treaty," Barthold replied, "I do not think I used quite those words; I think I said it was not a treaty override."

It is difficult to understand what Barthold meant beyond the bottom line that the BEAT was not a treaty override. He might have been concerned that the Senate parliamentarian would not have allowed the inclusion of a treaty-overriding provision in a reconciliation bill without a specific instruction to that effect.[31] Whatever his reasons, the conclusion — that the BEAT was not a treaty override — may be all that matters. If that was Congress' working assumption, it would not have intended for the BEAT to override treaties.[32]

Ultimately, the critical question remains the one identified in *Cook* — whether Congress has expressed a clear intent to override the treaties.[33] As noted, in the TCJA, Congress expressed no explicit intent to override treaties, whether in the statute or in the legislative history. Moreover, considering Barthold's statements, the legislative history affirmatively indicates an intention not to override. The remaining question is whether there is any contrary indication in the statute as enacted.

A. The Nondiscrimination Article

It might be said that application of the nondiscrimination provision would eviscerate the BEAT and that Congress should therefore be seen as implicitly overriding the treaties. In other words, without a treaty override the BEAT would be deprived of its essence and effectively become a nullity because deductible payments to related persons in non-treaty countries would normally be subject to full tax at source under section 871 or 881, which would remove those payments from the BEAT base.

That, however, is unpersuasive. A withholding tax must actually be paid for payments to foreign related persons to be

[29] *Kappus*, 337 F.3d at 1056.

[30] Open Executive Session to Consider an Original Bill Entitled the "Tax Cuts and Jobs Act" (Cont'n Nov. 14, 2017): Hearing on H.R. 1 Before the S. Comm. on Finance, 115th Cong. 163 (2017) (question from Sen. Benjamin L. Cardin, D-Md.).

[31] H. Con. Res. 71, 115th Congress, Title II (20172018); section 313 of the Congressional Budget and Impoundment Control Act of 1974.

[32] It is the effect of Barthold's statements and conclusion on Congress that is important in terms of legislative history, not necessarily the statements as such.

[33] Even if one were to follow *Fund for Animals* and apply *Cook* only to ambiguous statutes, we do not see how section 59A is any less ambiguous than section 581 of the Tariff Act of 1930 discussed in *Cook* in its conflict with the treaties. Section 581 clearly authorized Coast Guard officers to board, search, and seize vessels within four leagues of the U.S. coast, while the 1924 treaty shortened that distance for British vessels to what "can be traversed in one hour by the vessel suspected of endeavoring to commit [an] offense." Again, *Fund for Animals*' reading of the *Cook* canon of construction was rejected by a later decision of the same court in *Owner-Operator Independent Drivers*. *See* note 18, *supra*.

deductible from the BEAT base. Moreover, not all elements classified as nondeductible from that base are subject to withholding in the first place. Depreciation and amortization deductions, reinsurance premiums, and net operating losses are not subject to U.S. tax at source. Also, article 24(4) does not apply in all instances to which the BEAT applies.

That last point responds to the argument that code section 59A(c)(2)(B)(ii) represents an expression of congressional intent to override treaties, because it, with its indirect reference to the treaties, would be meaningless unless the treaties are overridden. Section 59A(c)(2)(B)(i) allows a BEAT deduction for otherwise deductible payments to foreign related persons if the payments are subject to tax at source under section 871 or 881. When payments are made to a related person in a treaty country and the related person is entitled to treaty benefits, the U.S. tax may be reduced accordingly. Section 59A(c)(2)(B)(ii) invokes rules similar to those of pre-TCJA section 163(j)(5)(B) to allow partial BEAT deductibility for those payments in proportion to the amount of the treaty-reduced U.S. tax. The argument is that if the nondiscrimination provision of article 24(4) applied to the BEAT and guaranteed full deductibility of those payments for the BEAT, it would render section 59A(c)(2)(B)(ii) meaningless. Therefore, the argument goes, Congress must have intended the BEAT to override the treaties.

It cannot be assumed, however, that the treaty nondiscrimination provision necessarily applies to every taxpayer subject to the BEAT when a treaty provision reduces the U.S. tax at source on the related foreign payee. There are important instances when the treaty rules reducing U.S. tax operate, while the nondiscrimination provision does not. Article 24(4) applies to an enterprise of a contracting state, defined as an enterprise carried on by a resident of that contracting state.[34] The BEAT, however, does not apply only to U.S. corporations. It also applies to foreign corporations engaged in a U.S. trade or business, such as foreign banks with U.S. branches earning income that is effectively connected with that U.S. trade or business.[35] Those entities could make U.S.-source payments to related foreign persons in treaty countries, who could then claim treaty-based reductions of U.S. tax at source.

Examples of those kinds of U.S.-source deductible payments include interest paid by the U.S. trade or business; rents and royalties for the use or right to use property in the United States paid by, or allocable to, the U.S. trade or business; and guarantee payments connected with effectively connected income.[36] Related foreign payees in treaty countries who claim treaty benefits for those payments could trigger application of section 59A(c)(2)(B)(ii) for the payer who is subject to the BEAT. Not being a U.S. resident, however, the foreign payer may not invoke the nondiscrimination provision of article 24(4) for the BEAT. Nor, it would seem, would that result raise a nondiscrimination concern under article 24(2), which provides:

> The taxation on a permanent establishment that an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other Contracting State than the taxation levied on enterprises of that other Contracting State carrying on the same activities.

The BEAT is less favorably levied on the U.S. PE of the foreign person than on a U.S. resident carrying on the same activities not by reason of U.S. domestic law, but because of the nondiscrimination provision itself, which gives article 24(4) access only to a U.S. resident and not to a foreign resident.

Instances in which the treaty nondiscrimination provision may not be invoked while treaty provisions limiting U.S. taxation at source apply may also be found among U.S. corporate payers subject to the BEAT. The

[34] U.S. model article 3(1)(c).

[35] IRC section 59A(e)(2)(A).

[36] Sections 884(f)(1)(A), 861(a)(4), and 861(a)(9).

nondiscrimination article in some treaties, such as the Australia-U.S. treaty, is deliberately framed as a government-to-government matter that does not confer rights on taxpayers. A U.S. corporate payer that is subject to the BEAT but does not qualify for treaty benefits under the limitation on benefits provision of article 22 would be another example. In both cases, the nondiscrimination provision would not apply, but the foreign related payee might qualify for treaty benefits, and section 59A(c)(2)(B)(ii) would have relevance.

Thus, it is hard to see section 59A as a manifestation of congressional intent to override the nondiscrimination provision of article 24(4). Perhaps it is possible to take that conclusion a step further and maintain that by addressing one treaty concern (section 59A(c)(2)(B)(ii)), while remaining otherwise silent on the question of a treaty override, section 59A suggests an implicit intent not to override treaties.

B. The FTC Article

The lack of FTCs against the BEAT is inconsistent with the U.S. treaty obligation under article 23(2):

> In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income applicable to residents and citizens . . . the income tax paid or accrued to [the treaty partner] by or on behalf of such resident or citizen.

Does the inconsistency reflect an implicit intent to override article 23(2)? We think not. The combination of IRC sections 26(b)(2)(B), 27(a), and 901(a) makes clear that the BEAT is not a "tax imposed by this chapter" and therefore not susceptible to being reduced by a section 901 FTC. Referring to the credit provided in the first sentence of section 901(a), the third sentence of that section provides that "the credit shall not be allowed against any tax treated as a tax not imposed by this chapter under section 26(b)." That, however, means only that the FTC under section 901(a) is disallowed, not that a treaty credit is precluded.[37] Section 901(a) does not have any relevance to a treaty-based FTC. In fact, the AMT is also treated as a tax not "imposed by this chapter,"[38] and therefore a section 901 FTC is not allowed against it. Sections 55(b)(1)(A) and 59(a), however, provide for a separate AMT FTC and do not say that they apply despite section 901(a).

The treaty provision requires the FTC to be "in accordance with the provisions and subject to the limitations" of U.S. law as it may be amended from time to time. That might be interpreted to mean that no credit is allowed without a statutory provision to that effect. The treaty language, however, goes on to say that post-treaty domestic law amendments cannot change the "general principle hereof," which the U.S. model technical explanation interprets to mean the principle of the allowance of a credit. It is surely possible for the United States to provide a treaty FTC against the BEAT that is in accordance with the provisions and subject to the limitations of U.S. domestic law without a specific statutory provision allowing such a credit.

The treaty credit obligation is subject to another condition, which is that the taxes against which a credit must be allowed are U.S. income taxes. The FTC provision applies only to covered taxes, so this condition refers to a covered tax. As discussed earlier, the BEAT appears to satisfy the condition.

C. Implications

In the circumstances of the BEAT, the later-in-time rule is a weak reed on which to rely for treaty dismissal. Courts are generally not eager to find conflicts between the IRC and the treaties or to approve a statutory override of negotiated treaty provisions even when a conflict is found. They would be less inclined to do so in the absence of so much as a hint that Congress intended that result, especially for a statute, such as the TCJA, which was enacted under a special reconciliation procedure that did not contemplate a treaty override.

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[37] Section 901(a) does not say that "a credit shall not be allowed against the BEAT" or that "no credit shall be allowed against the BEAT," and it includes no reference to treaties or a treaty-based FTC.

[38] Section 26(b)(2)(A).

The consequences of applying the nondiscrimination article to the BEAT are straightforward. For calculating the modified BEAT base, deductions would be allowed for otherwise deductible payments to related persons resident in treaty countries. A question could arise whether depreciation or amortization deductions for property acquired from foreign related persons are also covered by the nondiscrimination provision. Those deductions reflect a payment to a foreign person resident in a treaty country. That the deductions are to be taken over time seems inconsequential for nondiscrimination purposes.

The situation is more complex for the FTC. The treaties would require credits for taxes imposed by treaty countries but subject to the limitations of U.S. law. Because the BEAT provisions contain no such limitations, they must be developed. Like the AMT, the BEAT has three relevant features to address: that it is an alternative tax, that it applies to an alternative base, and that it applies at a reduced rate. Those features could be dealt with under the principles of existing AMT FTC rules. The conceivable approaches are intricate, however, and we confine the discussion here to one potential framework.

Section 55(b)(1)(A) provides for an AMT FTC, defined in section 59 as the credit that would be determined under the regular FTC rules if:

- for the FTC limitation, the pre-credit tentative AMT were the tax against which the credit was taken;
- the FTC limitation were applied based on AMT income instead of taxable income; and
- determining whether income is high taxed income and therefore belongs in the general limitation category is made using the AMT rate instead of the regular tax rate.

That structure addresses the three relevant features. Applying the same structure to the BEAT, the BEAT FTC would be the credit that would be determined under the regular FTC rules if:

- for the FTC limitation, the pre-credit tentative BEAT were the tax against which the credit was taken;
- the FTC limitation were applied based on modified taxable income instead of taxable income; and
- determining whether income is high taxed income is made using the BEAT rate instead of the regular tax rate.[39]

The BEAT is an alternative minimum tax, so credits used against regular corporate tax liability can also be used against the BEAT. That is necessary because the FTC is subtracted from regular tax liability in determining the BEAT and the economic effect of some of the regular credits is potentially wasted.

The BEAT broadens the regular tax base by disallowing some deductions. Section 863, Treas. reg. section 1.861-8, and following provisions provide rules for allocating and apportioning deductions among various categories of gross income for determining taxable income in the various categories to which the FTC limitation rules apply. For the BEAT, the allocation and apportionment exercise must be performed again, but without the BEAT-disallowed deductions.

The FTC limitation for the regular corporate tax is the product of the tentative U.S. tax liability and the ratio of taxable foreign-source income to all taxable income, applied separately to each income category.[40] The main purpose of the limitation is to protect the U.S. tax base on U.S.-source income by limiting the credit to the U.S. tax on taxable foreign-source income. The limitation is applied separately to each income category to prevent cross-crediting among the various categories.

The limitation rules must be applied for BEAT purposes using modified taxable income, with the tax against which the credit is claimed being the pre-credit tentative BEAT. That would be consistent with the purpose of the limitation and address the rate differential feature. The lower BEAT rate, as compared with the regular tax rate, results in a lower limitation amount that would

[39] This method operates as an automatic tax benefit adjustment, obviating the need for a rule similar to that of now-repealed section 58(h), which in the context of the former add-on minimum tax provided that "items of tax preference shall be properly adjusted where the tax treatment giving rise to such items will not result in the reduction of the taxpayer's tax" for any tax years. *See* S. Rep. No. 1263 (1978), at 204.

[40] IRC section 904.

allow the credit to apply only against the BEAT on foreign-source modified income.[41]

A simplified example will clarify that suggestion. Assume that a U.S. corporation subject to the BEAT has $100 of U.S.-source gross income, $200 of foreign-source gross income on which it pays $13 of foreign taxes, $50 of deductible expense allocable to U.S.-source income, and $120 of payments to a related foreign person that are deductible under the regular corporate tax but not under the BEAT. The corporation's regular taxable income would be $130 ($100 + $200 - $50 - $120) and its pre-credit U.S. tax liability would be $27.30 ($130 * 21%). If all foreign-source income falls in a single limitation category and the payment to the related foreign person is allocable to foreign-source income, the corporation's FTC limitation would be $16.80 (($27.30 *($80/$130)) and its FTC would be $13. The corporation's final corporate income tax liability is therefore $14.30 ($27.30 - $13).

For BEAT purposes, the corporation's modified taxable income is $250 ($100 + $200 - $50) and its pre-credit tentative BEAT liability is $10.70 (($250 * 10%) - $14.30). The BEAT FTC limitation would be $8.56 (($10.70 * ($200/$250)), and the treaty-based BEAT FTC would also be $8.56 (the lesser of the $8.56 limitation and $13 of foreign taxes). Therefore, the corporation's final BEAT liability would be $2.14, with $4.44 of BEAT credit carried over to other years.

The result is a total U.S. tax payment of $16.44: $14.30 in corporate tax and $2.14 in BEAT. If there had been no foreign tax to credit, the amount would have been $27.30, all in regular corporate tax, and BEAT liability would have been zero (($250 * 10%) - $27.50). Thus, foreign taxes available as credits against the regular corporate tax and the BEAT have reduced U.S. tax by $10.86 ($27.30 - $16.44).

III. Conclusion

Courts generally seek to resolve apparent conflicts between the IRC and treaties and are reluctant to approve a statutory override of negotiated treaty provisions even when a conflict is found. We believe they would be even less inclined to do so in the absence of some indication that Congress intended that result, especially for a statute enacted under a reconciliation procedure that did not contemplate treaty overrides, with legislative history affirmatively indicating an intention not to override, and with nothing to the contrary in the statutory text. We believe that the BEAT's conflicts with the nondiscrimination provision and its reconcilable inconsistency with the FTC provision of U.S. treaties do not constitute treaty overrides. Therefore, for calculating the BEAT, deductions for otherwise deductible payments to related persons resident in treaty countries and FTCs for foreign taxes paid to treaty countries should be allowed. ■

[41]Because the BEAT, like the AMT, is a separate tax, rules similar to the rule of section 904(b)(2)(B) would be irrelevant to the rate differential between the BEAT and the regular corporate tax. That section addresses the issue of the preferential rate, within the regular individual income tax, for long-term capital gain and qualified dividend income. The section generally excludes the rate differential portion of foreign-source capital gain and qualified dividend income from the numerator and the rate differential portion of all capital gain and qualified dividend income from the denominator of the FTC limitation formula, effectively treating the preferential rate accorded to capital gain and qualified dividend income as a partial exemption and the relief from double taxation as a combination of exemption and credit. A similar rule would have been appropriate had the BEAT been applied at different rates to the same taxpayer's different income categories.

The BEAT and Treaty Overrides: A Brief Response to Rosenbloom and Shaheen

by Reuven S. Avi-Yonah and Bret Wells

Reuven S. Avi-Yonah

Bret Wells

Reuven S. Avi-Yonah is the Irwin I. Cohn Professor of Law and director of the international tax LLM program at the University of Michigan. Bret Wells is the George R. Butler Research Professor of Law at the University of Houston Law Center.

In this article, the authors argue that the base erosion and antiabuse tax does not violate U.S. tax treaties and is a treaty override.

In a recent article in *Tax Notes International*,[1] H. David Rosenbloom and Fadi Shaheen argue that the base erosion and antiabuse tax (IRC section 59A, as enacted in 2017) is a potential violation of articles 23 and 24 of U.S. tax treaties. They say the BEAT does not override those treaties, so those agreements can be relied on to overcome the effects of the BEAT. They conclude:

> Courts generally seek to resolve apparent conflicts between the IRC and treaties and are reluctant to approve a statutory override of negotiated treaty provisions even when a conflict is found. We believe they would be even less inclined to do so in the absence of some indication that Congress intended that result, especially for a statute enacted under a reconciliation procedure that did not contemplate treaty overrides, with legislative history affirmatively indicating an intention not to override, and with nothing to the contrary in the statutory text. We believe that the BEAT's conflicts with the nondiscrimination provision and its reconcilable inconsistency with the [foreign tax credit] provision of U.S. treaties do not constitute treaty overrides. Therefore, for calculating the BEAT, deductions for otherwise deductible payments to related persons resident in treaty countries and FTCs for foreign taxes paid to treaty countries should be allowed.

In our opinion, that conclusion is wrong for two reasons: The BEAT is not a treaty violation, and even if were, it is a treaty override.

I. The BEAT Does Not Violate U.S. Tax Treaties

As Rosenbloom and Shaheen argue, the BEAT potentially violates articles 23 (granting an FTC) and 24 (nondiscrimination) of U.S. tax treaties. However, the BEAT violates neither.

Article 23 of the U.S. model treaty requires the United States to grant an FTC for some foreign taxes:

> In accordance with the provisions and *subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle*

[1] H. David Rosenbloom and Fadi Shaheen, "The BEAT and the Treaties," *Tax Notes Int'l*, Oct. 1, 2018, p. 53.

> *hereof)*, the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income applicable to residents and citizens:
>
> the income tax paid or accrued to __________ by or on behalf of such resident or citizen; and
>
> in the case of a United States company owning at least 10 percent of the voting stock of a company that is a resident of __________ and from which the United States company receives dividends, the income tax paid or accrued to __________ by or on behalf of the payor with respect to the profits out of which the dividends are paid. [Emphasis added.]

The BEAT is an FTC limitation because it does not allow those credits against its liability. It also does not change the general principle of the FTC because credits in general are available for foreign taxes imposed on foreign-source income — although even in that context the United States has long restricted cross-crediting of FTCs against low-taxed foreign income. The BEAT instead imposes U.S. tax on what is generally U.S.-source income (the interest and royalties paid to a foreign related party) — or in any event is a special category of income that can create low-taxed income. Since 1921, the U.S. FTC has been limited to foreign-source income or to preventing the creation of homeless income. No FTC general principle is violated when the BEAT is applied to protect the U.S. corporate tax at source.[2]

Further, for many years before the 2017 enactment of section 59A, the United States interpreted a predecessor alternative minimum tax regime under old section 59 that did not allow an FTC to be fully used to reduce the corporate AMT liability.[3] The IRS had a long-standing position[4] that the limitation in old section 59 on the ability to use FTCs under the predecessor AMT regime complied with article 23 because of the italicized language above.

The Tax Court has also held that a further restriction on the availability of FTC relief under a generally applicable AMT regime did not violate U.S. tax treaties. In *Pekar v. Commissioner*, 113 T.C. 158 (1999), the court said the limitations on the availability of U.S. FTC relief under old section 59 did not violate the relief from double taxation in article 23 under the U.K.-U.S. tax treaty. Relying on the italicized language above, the Tax Court said:

> Article 23 of the U.S.-U.K. treaty generally prohibits double taxation and provides to U.S. residents and citizens a credit against their U.S. income tax in an "appropriate amount." An "appropriate amount" is defined as that amount of tax paid to the United Kingdom, not to exceed the limitations provided by U.S. law for that taxable year. One of the limitations for the 1995 taxable year was the foreign tax credit limitation of section 59. Therefore, the U.S.-U.K. treaty provides for the imposition of the tax credit limit, and the treaty and the Code may be harmonized and the limit applied to petitioner.[5] [Cites omitted.]

In addressing that language, however, Rosenbloom and Shaheen were dismissive, saying the BEAT "envisions no statutory FTC at all, and that is surely inconsistent with the general principle of article 23, whatever the contours of that principle may be."

The error in their thinking can be demonstrated by the following hypothetical. Suppose the BEAT applied a rate equal to the

[2] Arguably, however, a general principle was violated when the Tax Cuts and Jobs Act (P.L. 115-97) eliminated IRC section 902, the indirect credit, and substituted a limited participation exemption. That is because the exemption aspect prevents any U.S. indirect FTC relief against any regular corporate income tax, which we think was a treaty override. Similarly, the limitation of the FTC to 80 percent of foreign tax under the global intangible low-taxed income rules may be a treaty override for the same reason. For a contrary argument, see Daniel Shaviro, "The New Non-Territorial U.S. International Tax System," *Tax Notes Int'l*, July 2, 2018, p. 27. However, for reasons discussed in this article, restricting FTC use under an AMT regime that uses a concessionary rate of tax is a permissible limitation allowed under article 23 to let source countries enact minimum tax regimes to limit the erosion of the domestic tax base under the regular income tax regime.

[3] For tax years beginning before December 31, 2004, old section 59(a)(2) allowed the alternative minimum FTC to offset only 90 percent of the tentative minimum tax computed under old section 55(b)(1)(A).

[4] *See* FSA 200110019.

[5] The Tax Court has continued to rely on that reasoning, thus creating long-standing precedent. *See Brooke v. Commissioner*, T.C. Memo. 2000-194, *aff'd*, 13 Fed. Appx. 7 (D.C. Cir. 2001).

regular corporate tax rate of 21 percent but then provided that FTC relief could not offset more than 11 points of the tax computed under section 59A. In that situation, the minimum tax would preserve residual U.S. taxation equal to 10 percent in all events but would allow some FTC relief.

That hypothetical regime is functionally equivalent to what Congress enacted in section 59A — that is, section 59A provides a concessionary rate but restricts further FTC relief (which does provide a benefit under the corporate tax rate) to save U.S. jurisdiction over the tax liability computed under the concessionary rate. The formalistic distinction does not change the substantive reality that more than half of the regular tax liability could be offset by U.S. FTC relief.

The Supreme Court recently applied a functional economic equivalency argument in the FTC context in *PPL v. Commissioner*, 569 U.S. 329 (2013), holding that the substance of the effect of a foreign tax regime was to be considered to determine the regime's import under U.S. tax law. Under the Court's logic in *PPL*, a U.S. tax regime that provides for a reduced tax rate with no FTC relief should be considered functionally similar to an AMT regime that initially provides for a full tax rate and partially disallows credit use. If, as Rosenbloom and Shaheen accept, the second regime is acceptable, the first is as well.

Thus, Rosenbloom and Shaheen's dismissiveness would be relevant only if section 59A applied an AMT at the regular corporate rate of 21 percent and denied U.S. FTC relief in that situation — but again, that is not what section 59A does in fact or substance. A court can easily understand the phrase "subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof" to mean that the use of U.S. FTC relief is subject to the provisions and limitations of U.S. law — of which section 59A is a part — just like the Tax Court did for old section 59 in *Pekar*. The natural reading of article 23 used by the Tax Court harmonizes the application of old section 59 with U.S. tax treaty obligations and keeps the flexibility meant to be retained under article 23 to allow the United States to enact domestic limitations on the availability of U.S. FTC relief without running afoul of that article.

Further, as Rosenbloom and Shaheen explain, it is unclear whether the BEAT is an income tax covered by treaties. The BEAT functions as an AMT, and its base is different from that of the income tax (so that it would not be considered an income tax under IRC section 901, because it is not imposed on net income).[6] That is what Thomas Barthold, chief of staff of the Joint Committee on Taxation, seems to have had in mind when he answered a question from Senate Finance Committee member Benjamin L. Cardin, D-Md., regarding whether the BEAT is a treaty override:

> And I believe in particular you were talking about the proposed base erosion and antiabuse provision of the chairman's mark. And it is structured as an alternative tax compared to the income tax. So I think our view is that there is not a treaty override inherent in that design.[7]

Even if Barthold believed the BEAT were a covered tax, he could well have believed that section 59A is not a treaty override (as we believe) because of the flexibility and authority retained under article 23 to subject FTC relief "to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof)." Given

[6] While the AMT has been considered a covered tax — for example, in *Kappus v. Commissioner*, T.C. Memo. 2002-36, *aff'd*, 337 F.3d 1053 (D.C. Cir. 2003) — courts have not directly addressed whether the BEAT is a covered tax. HM Revenue & Customs believes the diverted profits tax (DPT, which has a function similar to the BEAT's) is not covered (and so cannot be overridden) by tax treaties because it is not substantially similar to corporation tax, and U.K. domestic law does not apply tax treaties to the DPT. Another argument is that as an antiavoidance measure, the DPT is consistent with the spirit and purpose of the United Kingdom's tax treaties. *See, e.g.*, Reuven S. Avi-Yonah, "Three Steps Forward, One Step Back? Reflections on 'Google Taxes,' BEPS, and the DBCT," University of Michigan Law & Econ. Research Paper No. 16-016 (May 24, 2016); Dan Neidle, "The Diverted Profits Tax: Flawed by Design?" 2015 *Brit. Tax Rev.* 147 (2015); Heather Self, "The UK's New Diverted Profit Tax: Compliance With EU Law," 43 *Intertax* 333 (2015); Jonathan Peacock, "U.K.'s Diverted Profits Tax: A Regime Much, Much Broader Than Its True Target?" 17 *Euro. Tax Serv.* 4 (2015); Sol Picciotto, "The U.K.'s Diverted Profits Tax: An Admission of Defeat or a Pre-Emptive Strike?" *Tax Notes Int'l*, Jan. 19, 2015, p. 239; Paul Rutherford, "The U.K.'s Google Tax — First Thoughts," 42 *Tax Plan. Int'l Rev.* 4 (2015); Luca Cerioni, "The New 'Google Tax': The 'Beginning of the End' for Tax Residence as a Connecting Factor for Tax Jurisdiction?" 55 *Eur. Tax'n* 185 (May 2015); and Philip Baker, "Diverted Profits Tax: A Partial Response," 2015 *Brit. Tax Rev.* 167 (2015) (who advised HMRC on the compatibility of the DPT with EU law and tax treaties).

[7] Barthold, speaking November 14, 2017, at the Open Executive Session to Consider the Tax Cuts and Jobs Act: Hearing on H.R. 1 Before the Senate Finance Committee, as quoted by Rosenbloom and Shaheen. As explained below, Barthold's remarks are not a statement of congressional intent. *See* note 15, *infra*, and accompanying text.

the breadth of that language, it is plausible to believe that Barthold did not think a treaty override was necessary for the BEAT to apply. However, Rosenbloom and Shaheen take from that single statement the idea that the BEAT cannot have an application that reduces the allowance of double tax relief, saying that whatever Barthold's reasons:

> the conclusion — that the BEAT was not a treaty override — may be all that matters. If that was Congress' working assumption, it would not have intended for the BEAT to override treaties.

Rosenbloom and Shaheen then simply conclude that the BEAT does not provide an FTC limitation at all without addressing the fact that article 23 does not require that reading and without answering why the BEAT is a covered tax. Thus, we do not believe the BEAT violates article 23, because it may not be a covered tax, and even if it is, it is an FTC limitation consistent with the general principles of allowing a U.S. tax credit against foreign taxes on foreign-source income.

As for article 24, we have explained elsewhere why we do not believe the BEAT violates nondiscrimination[8]; we summarize those arguments here. First, the BEAT applies to payments from U.S. parents to foreign subsidiaries, so it is not limited to payments by foreign multinationals. That is the most important point because it means that both foreign and U.S. multinationals are harmed by the BEAT. Second, the BEAT is not different from the old earnings stripping rule (IRC section 163(j)), which is similar to the thin capitalization rules of other countries, and is an established exception to nondiscrimination that is needed to protect the U.S. tax base. Third, the BEAT is not equivalent to a denial of a deduction because its rate is 10 percent, and the denial of a deduction would have increased tax by 21 percent. Finally, foreign related parties are simply not comparable to U.S. related parties because the first are not subject to U.S. tax jurisdiction while the second are.

[8]Avi-Yonah, "Beat It: Tax Reform and Tax Treaties," University of Michigan Public Law Research Paper No. 587 (Jan. 4, 2018); and Bret Wells, "Get With the BEAT," *Tax Notes*, Feb. 19, 2018, p. 1023.

II. The BEAT as a Treaty Override

Even if the BEAT were found inconsistent with U.S. tax treaties, we think it overrides them.

The supremacy clause in Article VI of the U.S. Constitution was intended to ensure the supremacy of both U.S. laws and treaties over state laws. On its face, it says nothing about the relationship between treaties and federal laws, and it is unclear whether it should ever have been interpreted as the basis for treaty overrides. However, the U.S. Supreme Court has long held otherwise, deciding that under the supremacy clause, treaties and laws are equal and that the principle of *lex posterior* — that a later law abrogates a prior contrary law — prevails.[9] In *Whitney v. Robertson*, 124 U.S. 190, 195 (1888), which discussed the relationship between a treaty that gave most favored nation status and a later statute imposing tariffs, the Court held that in resolving a clear conflict between a treaty and a federal statute, "the duty of the courts is to construe and give effect to the latest expression of the sovereign will." In *Reid v. Covert*, 354 U.S. 1, 18 (1957), the Court made its position even clearer, stating that "an Act of Congress, which must comply with the Constitution, is on a full parity with a treaty, and . . . when a statute which is subsequent in time is inconsistent with a treaty, the statute to the extent of conflict renders the treaty null."

The general U.S. rule is therefore that any statute that is later in time than a treaty and that conflicts with it in some way is a treaty override. That rule could have led to hundreds of tax treaty overrides each year, given the amount of U.S. tax legislation.

But even a 1988 Senate report on the topic does not go so far, explaining that courts generally strive to construe statutes to avoid treaty overrides.[10] "The cardinal rule is that repeals by implication are not favored."[11] When there are two acts on the same subject, effect should be given to both if possible; "the intention of the legislature to

[9]William Blackstone, *Commentaries on the Laws of England* 89 (1765-1769).

[10]S. Rep. No. 100-445 (1988), Tit. I, XII H. 1 (Relationship With Treaties), explaining section 112(aa) of S. 2238 (IRC section 7852). *See also Posadas v. National City Bank*, 296 U.S. 497, 503 (1936).

[11]*Posadas*, 296 U.S. at 503.

repeal must be clear and manifest."[12] The same principle applies in the case of a statute and a later treaty: "A treaty will not be deemed to have been abrogated or modified by a later statute unless such purpose on the part of Congress has been clearly expressed."[13]

However, the Senate report also makes clear that when there is a clear conflict, a treaty override will result:

> Prior judicial efforts to find consistency between earlier and later statutes and treaties illustrate the difficulties of determining when application of the general later-in-time rule should result in giving effect only to the later provision; however, these difficulties cannot be permitted to obscure the fact that if an actual conflict does exist concerning a matter within the scope of both an earlier treaty and a later statute, as properly construed, the later statute prevails.

Moreover, that is the result even when there is no evidence in the law or its legislative history that a treaty override was intended. The Senate report's statement on that sets out the theory underlying the U.S. position and is worth quoting in full:

> Notwithstanding Congress' intent that the [1986 Tax Reform] Act and income tax treaties be construed harmoniously to the extent possible, conflicts other than those addressed in this bill or in the Act ultimately may be found or alleged to exist. Similarly, conflicts between treaties and other acts of Congress affecting revenue are likely to be found or alleged to exist in the future, either with respect to existing or future treaties and statutes. The bill provides that for purpose of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or a law. In adopting this rule, the committee intends to permanently codify (with respect to tax-related provisions) present law to the effect that canons of construction applied by the courts to the interaction of two statutes enacted at different times apply also in construing the interactions of revenue statutes and treaties enacted and entered into at different times. The committee does not intend this codification to alter the initial presumption of harmony between, for example, earlier treaties and later statutes. Thus, for example, the bill continues to allow an earlier ratified treaty provision to continue in effect where there is not an actual conflict between that treaty provision and a subsequent revenue statute (i.e., where it is consistent with the intent of each provision to interpret them in a way that gives effect to both). Nor does the committee intend that this codification blunt in any way the superiority of the latest expression of the sovereign will in cases involving actual conflicts, where that expression appears in a treaty or a statute.
>
> Although the committee believes that the bill's provision regarding the equal status of treaties and statutes merely codifies present law, the committee believes that this provision, and the bill's disclosure provision, are necessary technical corrections to the Act for several reasons. The committee is concerned that the relationship of the tax laws and treaties is misunderstood. The internal tax laws of most countries provide some sort of regime for taxing either the foreign income of domestic persons, the domestic income of foreign persons, or both. Either type of income, then, is potentially subject to two autonomous tax systems each of which is at best designed to mesh with other tax systems only in broad general terms. Double taxation of the same income, or taxation of certain income by neither system, can potentially result. Income tax treaties, in the committee's view, are agreements that provide the

[12] *Id.*

[13] *Cook v. United States*, 288 U.S. 102, 120 (1933). *See also Whitney*, 124 U.S. at 194.

mechanism for coordinating two identified tax systems by reference to their particular provisions and the particular tax policies they reflect, and which have as their primary objectives is a desirable goal that serves to improve the long-term environment for commercial and financial dealings between residents of the treaty partners.

The committee believes that when a treaty partner's internal tax laws and policies change, treaty provisions designed and bargained to coordinate the predecessor laws and policies must be reviewed for purposes of determining how those provisions apply under the changed circumstances. The committee recognizes that there are cases where giving continued effect to a particular treaty provision does not conflict with the policy of a particular statutory change. In certain other cases, however, a mismatch between an existing treaty provision and a newly-enacted law may exist, in which case the continued effect of the treaty provision may frustrate the policy of the new internal law. In some cases the continued effect of the existing treaty provision would be to give an unbargained-for benefit to taxpayers or one of the treaty partners. At that point, the treaty provision in question may no longer eliminate double taxation or prevent fiscal evasion; if not, its intended purpose would no longer be served.

The committee recognizes that some would prefer that existing treaties be conformed to changing U.S. tax policy solely by treaty renegotiation. However, the committee notes that in recent years, U.S. tax laws have been constantly changing. Moreover, once U.S. tax policy has changed, the existence of an unbargained-for benefit created by the change would have the effect of making renegotiation to reflect current U.S. tax policy extremely difficult, because the other country may have little or no incentive to remove an unbargained-for benefit whose cost is borne by the United States.

The committee recognizes that the parties to the treaty can differ as to whether the continued effect of a treaty provision in light of a particular statutory change provides such an unbargained-for benefit or otherwise frustrates the basic objectives of tax treaties. Remedies may be available in the case of what one party views as a breach of international law. However, the committee believes that under the constitutional system of government of the United States, where tax laws must be passed by both Houses of Congress and signed by the President, and where it is the role of the courts to decide the constitutionality of the laws and what the laws mean, it is not the role of taxpayers, the Judicial branch, or the Executive branch to determine that constitutionally valid statutes that actually conflict with earlier treaties ought not to be given effect either because of views of international law or for any other reason.

The committee is concerned that there are some who assert that treaties receive preferential treatment in their interaction with statutes. The committee is further concerned that whatever support is found for this view is based on misinterpretations of authoritative pronouncements on the subject. For example, before original introduction of this technical corrections legislation, the Internal Revenue Service announced that new Code section 367(e)(2), discussed above, which imposes corporate-level tax in certain liquidations, would not apply where it "would violate a treaty non-discrimination provision" (Notice 87-5, 1987-1 C.B. 416). Eventually, the Internal Revenue Service withdrew its notice on a prospective basis, and concluded that no treaty conflict existed (Notice 87-66, 1987-2 C.B. 376). The committee is concerned that the language used in the original notice may have suggested an erroneous inference that, had section 367(e)(2) actually created a conflict in a particular case, it would have been given no effect under the terms of the original Notice.

Normal application of the later-in-time rule would not permit this result.

Other examples exist where the committee is troubled with erroneous inferences that have apparently been drawn from language used by the Executive branch. For example, in Revenue Ruling 80-223, 1980-2 C.B. 217, the Service considered the issue of whether foreign tax credit provisions enacted in the Tax Reduction Act of 1975 (sections 901(f) and 907) prevailed over conflicting provisions in earlier treaties that provide for foreign tax credits determined pursuant to the foreign tax credit provisions of the Code in effect as of dates specified in such treaties. The analysis stated the following:

In *Cook v. United States*, 288 U.S. 102 (1933), subsequent inconsistent legislation was held not to supersede an earlier treaty provision because neither the committee reports nor the debates on the subsequent legislation mentioned the earlier treaty. It is, therefore, necessary to examine the legislative history underlying the enactment of sections 901(f) and 907 of the Code for a clear indication from Congress as to whether it intended these sections to supersede any provision of treaties entered into prior to the enactment of these sections.

The committee believes it would be erroneous to assert that the absence of legislative history mentioning a treaty was sufficient to reach the result in *Cook*. That case dealt with the question of how to construe an anti-bootlegger provision (section 581 of the Tariff Act of 1930) that first became law in an act (the Tariff Act of 1922) passed early on during Prohibition. Section 581 of the 1930 Act was a verbatim reenactment of section 581 of the Tariff Act of 1922. The scope of section 581 of the 1922 Act had been limited by a U.S.-Great Britain treaty made in 1924. The case came before the Supreme Court as Prohibition was in the last stages of being written out of the Constitution. The Court reached its conclusion on the stated ground that the treaty limit continued to apply under the 1930 Act, because section 581, "with its scope narrowed by the Treaty, remained in force after its re-enactment in the Act of 1930." 288 U.S. at 120. Properly construed, therefore, the committee believes that Cook stands not for the proposition that Congress must specifically advert to treaties to have later statutes given effect, but that for purposes of interpreting a reenacted statute, it may be appropriate for some purposes to treat the statute as if its effect was continuous and unbroken from the date of its original enactment.

Similarly the committee believes it would be erroneous to assert that an income tax statute such as the Tax Reduction Act of 1975 prevails over treaties only if treaty interactions are mentioned in the statute or legislative history. On the other hand, the committee believes that any such mention, if made, would be dispositive.

In view of what the committee believes is the correct treatment of treaty-statute interactions, then, the committee finds it disturbing that some assert that a treaty prevails over later enacted conflicting legislation in the absence of an explicit statement of congressional intent to override the treaty; that it is treaties, not legislation, which will prevail in the event of a conflict absent an explicit and specific legislative override. The committee does not believe this view has any foundation in present law. Moreover, the committee believes that it is not possible to insert an explicit statement addressing each specific conflict arising from a particular act in the act or its legislative history; for in the committee's view, it is not possible for Congress to assure itself that all conflicts, actual or potential, between existing treaties and proposed legislation have been identified during the legislative process of enacting a particular amendment to the tax laws. In the absence of a clear statement that legislation prevails over prior treaties, dubious tax avoidance schemes, in the committee's view, have been suggested. See, e.g., *Tax*

> *Notes*, March 9, 1987, at 1004, improperly suggesting that the failure to clarify the relationship between the Subchapter S Revision Act of 1982 and earlier treaties allows foreigners to own and operate U.S. business tax-free.
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> The committee believes that a basic problem that gives rise to the need for a clarification of the equality of statutes and treaties is the complexity arising from the interaction of the Code, treaties, and foreign laws taken as a whole. The committee notes that the United States has over 35 income tax treaties, some of extreme complexity, plus additional treaties bearing on income tax issues. In addition, the application of United States tax law to complex business transactions exacerbates these complexities. The committee does not believe that Congress can either actually or theoretically know in advance all of the implications for each treaty, or the treaty system, of changes in domestic law, and therefore Congress cannot at the time it passes each tax bill address all potential treaty conflict issues raised by that bill. This complexity, and the resulting necessary gaps in Congressional foreknowledge about treaty conflicts, make it difficult for the committee to be assured that its tax legislative policies are given effect unless it is confident that where they conflict with existing treaties, they will nevertheless prevail.
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> The committee further believes that codification of this rule, together with the disclosure requirements in the bill, will lead to the early discovery of now-unknown treaty conflicts and to their appropriate resolution. If any case actually arises in which proper application of the canons of construction ultimately reveals an actual conflict, the committee expects that full legislative consideration of that conflict will take place to determine whether application of the general later-in-time rule is consistent with the spirit of the treaty (namely, to prevent double taxation by an agreed division of taxing jurisdiction, and to prevent fiscal evasion) and the proper expectations of the treaty partners.[14]

Against that strong legislative history, it is hard to argue — as Rosenbloom and Shaheen do in relying on *Cook* — that the absence of a clear statement of congressional intent means the BEAT does not override treaties. If that argument were presented to a court, we do not believe the court would find the BEAT to be a treaty violation for the reasons stated above. But if the court were to consider it a violation, it is hard to envisage the court concluding that the treaties should override the clear intent of the BEAT, which is to protect the U.S. tax base by limiting the affected deductions and to disallow an FTC against the BEAT. Certainly, Barthold's ambiguous statement cannot be relied on for that purpose because he is not a member of Congress.[15]

Moreover, allowing treaties (and especially the nondiscrimination article) to overcome the BEAT would completely defeat the purpose of the legislation. Taxpayers would be able to restructure their affairs so that payments covered by the BEAT would be made to affiliates resident in treaty countries — and soon the BEAT would have no bite at all.

Perhaps most relevant to this discussion is the substantial line of U.S. cases that have addressed the predecessor to section 59A and its interpretation with existing U.S. treaties. In *Kappus v. Commissioner*, 337 F.3d 1053 (D.C. Cir. 2003), the U.S. Court of Appeals for the D.C. Circuit addressed the restriction in old section 59 on the ability to use FTCs under the AMT regime

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[14] The above legislative history for tax legislation is consistent with broader scholarship on how unambiguous later-in-time legislation should be understood as overruling earlier treaty provisions. *See* Andrew H. Bean, "Constraining Charming Betsy: Textual Ambiguity as a Predicate to Applying the Charming Betsy Doctrine," 2015 *B.Y.U. L. Rev.* 1801 (2015).

[15] A stronger indication of congressional intent may be derived from (a) Cardin's question, which suggests that Congress intended the BEAT to apply even if it were a treaty override, and (b) an October 3, 2017, Senate Finance hearing in which one of the authors testified to the urgent need to protect the U.S. tax base even if it meant overriding treaties. The United States has a long history of treaty overrides. *See, e.g.*, IRC sections 897, 884 (branch profit tax, which overrode treaties by applying the qualified resident rule), 894(c), and 163(j) (which, despite its nominal application to tax-exempt related parties, was universally understood to apply only to foreigners and thus arguably to override article 24(4)). *See generally* Avi-Yonah, "Tax Treaty Overrides: A Qualified Defense of U.S. Practice" (Oct. 12, 2005).

in the predecessor to section 59A. The court held that the 90 percent FTC limitation enacted by the Tax Reform Act of 1986 overrode the 1984 Canada-U.S. tax treaty despite the absence of evidence of congressional intent,[16] saying:

> The question of whether the Treaty and statute can be harmonized as the government suggests is an extremely close one. It is not, however, a question that we need resolve. The Kappuses concede that, even if their reading of the Treaty is correct and the Treaty and [section] 59(a)(2) are in irreconcilable conflict, the statute nonetheless would control their tax liability if it were the most recent relevant provision. Accordingly, because we conclude . . . that the statute is in fact the last relevant provision, we need not further pursue the search for harmony. [Cites omitted.]

It is true that the court relied in part on a general clarification in the 1988 Technical and Miscellaneous Revenue Act that Congress intended to override the treaties when enacting TRA 1986. But that clarification was not specific to the 90 percent limit, and in any case was subsequent to the 1986 act and not part of its legislative history. Thus, *Kappus* stands for the proposition that when a conflict between a treaty and a statute clearly exists, the later-in-time rule is dispositive even in the absence of legislative history, and even when the override is a clear violation of the spirit of the treaty (which the BEAT is not).

Rosenbloom and Shaheen fail to address *Lindsey v. Commissioner*, 98 T.C. 672 (1992), *aff'd* 15 F.3d 1160 (D.C. Cir. 1994), although they do cite the case in a string cite. In *Lindsey*, the Tax Court had to determine whether the AMT regime under section 59 that did not allow for full use of U.S. FTC relief violated U.S. treaty obligations to provide double tax relief under the Canada-U.S. treaty. The taxpayer urged the court to harmonize the application of section 59 so that it would not restrict the use of U.S. FTC relief. The Tax Court rejected that argument and applied old section 59 without adjustment, saying the later-in-time rule applied.[17] Given that holding, it is difficult to imagine that the Tax Court would use the logic it rejected in *Lindsey* to find that successor section 59A could not be applied without restriction as an override to any previously enacted treaty obligation.

III. Conclusion

Contrary to Rosenbloom and Shaheen, in calculating the BEAT, deductions for otherwise deductible payments to related persons resident in treaty countries and FTCs for foreign taxes paid to treaty countries should not be allowed. Any argument to the contrary is inconsistent with the clear congressional purpose of the BEAT, which is to protect the U.S. tax base from inflated deductions paid to related foreign parties that are not subject to U.S. tax jurisdiction. ■

[16] In *Owner-Operator Independent Drivers Association Inc. v. U.S. Department of Transportation*, 724 F.3d 230 (D.C. Cir. 2013), the D.C. Circuit refused to allow a general statute requiring truck drivers to have a medical certificate to override an earlier executive agreement with Mexico exempting Mexican drivers from that requirement absent clear evidence of congressional intent. We find that case distinguishable, however, because there was no indication that Congress considered the Mexico executive agreement when it enacted the general statute. Congress clearly was aware of the potential override issue presented by the BEAT, given the question Cardin asked Barthold.

[17] Rosenbloom and Shaheen fail to explain why that precedent does not sufficiently answer their objections regarding the interpretive issues under the successor AMT regime now in section 59A.