New Developments in US Treaty Overrides

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New Developments on US Treaty Overrides

Reuven Avi-Yonah

On April 7, 2022, the US Senate Foreign Relations Committee approved the tax treaty between the US and Chile with two reservations. The first reservation states that:

[N]othing in the treaty shall be construed as preventing the United States from imposing the BEAT tax under section 59A [of the US Internal Revenue Code] on a company that is a resident of the United States or the profits of a company that is a resident of Chile that are attributable to a permanent establishment in the United States.\(^1\)

The second reservation made a similar statement regarding the interaction between section 245A of the Code (providing for a participation exemption for dividends from Controlled Foreign Corporations, or CFCs) and article 23 of the treaty (providing for the indirect credit, which was repealed when section 245A was enacted in 2017).\(^2\)

The reason these reservations (which Chile must accept for the treaty to come into effect) were needed is because of the interaction between treaties and statutes under the US Constitution as interpreted by the Supreme Court. Under that interpretation, treaties and statutes have the same status, so that the later in time rule controls and a later statute can override an earlier treaty and vice versa.\(^3\)

There is an ongoing debate about whether the BEAT overrode the non-discrimination article of US tax treaties (article 24).\(^4\) There is also a lesser debate whether the

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\(^1\) US Senate Foreign Relations Committee, Ex. Rept. 117-1 - TAX CONVENTION WITH CHILE - TAX CONVENTION WITH CHILE, 117th Congress (2021-2022).

\(^2\) Ibid.


participation exemption overrode article 23.\textsuperscript{5} The crux of the debate, as explained in my earlier article in this review, is whether there can be an override of a treaty without any explicit Congressional statement to that effect.\textsuperscript{6}

However, there is agreement that a later treaty can override an earlier statute regardless of whether there was any statement to that effect.\textsuperscript{7} The treaty with Chile is one of seven tax treaties that have been languishing in the US Senate for a long time, from before the Tax Cuts and Jobs Act of 2017 enacted BEAT and the participation exemption.\textsuperscript{8} Four of them were protocols that did not amend articles 23 and 24 and therefore they were eventually ratified in 2020. The other three were full new treaties and therefore if ratified they would override the BEAT and arguably the participation exemption (although the latter argument is weak). Hence the need for the two reservations.

Is this whole complication necessary? There is way out of it, first suggested by Rebecca Kysar, a tax professor who is now at the US Treasury office of tax policy. Prof. Kysar suggested that tax treaties should be non-self-executing, so that they would require legislation to come into effect.\textsuperscript{9} In that case, the situation would revert to one that is familiar to UK readers, namely that all tax treaties require legislation and hence later in time always controls, like it would between any two statutes that conflict with one another.

\textsuperscript{6} See Avi-Yonah, Pacta Sunt Servanda?, supra. See also Rosenbloom, H. David and Shaheen, Fadi, Treaty Override: The False Conflict Between Whitney and Cook (May 1, 2020). 24 Florida Tax Review 375 (2021), Available at SSRN: https://ssrn.com/abstract=3599664 or http://dx.doi.org/10.2139/ssrn.3599664 and Avi-Yonah, The Dubious Constitutional Origins of Treaty Overrides: A Response to Rosenbloom and Shaheen, Florida Tax Rev. (2023, forthcoming). The IRS has taken the position that the BEAT can be collected when earlier treaties are in effect, either because it overrides them or because it is not a covered tax. See Peter Blessing, The Legislative Role of Tax Regulations— A Plea in the Time of Pandemic, in Thinker, Teacher, Traveler: Reimagining International Tax, Essays in Honor of H. David Rosenbloom (Georg Kofler, Ruth Mason Alexander Rust, eds.), 39 (2021) : "Treasury regulations implicitly treat the statute [BEAT] as applicable without treaty limitation and address particular questions of its interaction with treaties," citing Treas. Regs § 1.59A-3(b)(3), (b)(4), (c)(3). Blessing is the current Assistant Commissioner (International) at the IRS.
\textsuperscript{7} Rosenbloom and Shaheen, False Conflict, supra; Avi-Yonah, Dubious, supra.
\textsuperscript{8} All US tax treaties and protocols have been on hold since Sen. Rand Paul, R-Ky., objected in 2011 to approving treaties because of privacy concerns based on the information sharing provisions. As a result of the objections, a lengthier approval process by the Foreign Relations Committee is required. Three treaties (Chile, Hungary, and Poland) and four protocols (Japan, Luxembourg, Spain, and Switzerland) were on hold from 2011 on, awaiting the committee’s approval. It approved the four protocols in June 2019 but did not consider the treaties at that time because changes that need to be made have to reflect U.S. law changes resulting from the TCJA, including BEAT and section 245A, lest the new treaties override these provisions. Hungary is a particularly egregious case because the old Hungary-US treaty lacks a limitations on benefits (LOB) article.
This remedy would require the extra step of passing legislation through both houses for a tax treaty to come into effect. But the House of Representatives is not the problem, because the majority party can usually pass whatever legislation it supports. The problem is in the Senate, because while under arcane Senate rules 60 votes are needed to move legislation, the bar is even higher for treaty ratification (67 votes), so having to pass legislation to make tax treaties effective is in fact easier than getting them through the Senate ratification process. And as Prof Kysar argued, it is also better from a constitutional and democratic perspective for treaties that increase or decrease revenues to be passed through the much more democratically representative House than only be ratified by the very unrepresentative Senate.