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Reprinted from *Tax Notes International*, October 1, 2018, p. 53

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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.

The authors would like to thank Lily Batchelder, Itai Grinberg, David Kamin, Mitchell Kane, Rebecca Kysar, David Noll, James Salles, Leslie Samuels, Daniel Shaviro, John Steines, workshop participants at Rutgers Law School, and members of the Washington International Tax Study Group for their helpful discussions or comments. They would also like to thank Ryan Fackler for excellent research assistance. Any remaining errors are the authors'.

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.

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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 here⁵) 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

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.

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.

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

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.”

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.

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 uninterrupted 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 statutes 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.

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”).

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

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

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-override 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

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*.

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.).

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.

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.