

## Congressional Unilateral Tax Treaty Overrides: The "Latter in Time Doctrine" is Out of Time!

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## CONGRESSIONAL UNILATERAL TAX TREATY OVERRIDES: THE “LATTER IN TIME DOCTRINE” IS OUT OF TIME!\*

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\* All citations herein are to the 2006 Internal Revenue Code, 26 U.S.C. §§ 1-9833 (2006) (unless otherwise indicated).

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## I. INTRODUCTION

The current form of globalization has resulted in greater global economic integration and liberalization, political openness, and cultural and social acceptance. As the world economy continues to weaken national economic orders, and as nations become more dependent upon international trade, good relations between nations may provide greater global wealth and political stability.<sup>2</sup> Global integration requires a “cooperative multilateralist” approach, encouraging international alliances, partnerships and institutions.<sup>3</sup>

The current global shift, however, finds the United States in a period of protectionism. As a result of 9/11, the United States has begun a strategy of preemption, one triggered at creating measures aimed at preventing substantial casualties to the U.S., whether military or economic.<sup>4</sup> The actions taken in furtherance of this strategy, such as the invasion of Iraq without the consent of the Security Council, altered the perception of the United States around the world.<sup>5</sup> Furthermore, these actions were in direct contradiction of

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2. Richard N. Haas, *The Age of Nonpolarity: What will follow U.S. Dominance*, *Foreign Affairs*, 44 May/June 2008. “Trade can be a powerful tool of integration. It gives states a stake in avoiding conflict because instability interrupts beneficial commercial arrangements that provide greater wealth and strengthen the foundations of domestic political order. Trade also facilitates development, thereby decreasing the chance of state failure and alienation among citizens.” *Id.* at 54.

3. *Id.* “Encouraging a greater degree of global integration will help promote stability. Establishing a core group of governments and others committed to cooperative multilateralism would be a great step forward.” *Id.* at 56.

4. David Hendrickson, *The Curious Case of American Hegemony: Imperial Aspirations and National Decline*, *World Policy Journal*, 1, 2005. The United States “broke from the Cold World doctrines of containment and deterrence, arguing that the threat posed by terrorists and rogue states justified a strategy of preventive war, which it called the strategy of preemption.” *Id.*

5. Robert Kagan, *America’s Crisis of Legitimacy*, *Foreign Affairs*, Mar./Apr. 2004. The global situation is now inverted, “where once the United States risked its own safety to defend the vital interests of a threatened Europe, a threatened United States was now looking out for itself in apparent, and sometimes genuine, disregard for what many Europeans perceived to be their moral, political and security interests.” *Id.* “Europeans objected to the U.S.’s willingness to go to war without the Security Council’s approval – that is, without Europe’s approval – challenged both Europe’s world view and its ability to exercise even a modicum of influence in the new unipolar system.” *Id.* See also Michael Cox, *Empire by Denial: the Strange Case of the United States*, *International Affairs*, Volume 81, 2005. The world has been led into an “age of unparalleled U.S. dominance and global terror, where it looks as if the United States has now arrogated to itself the international role of setting standards, determining threats, using force and meting out justice. Define it as unilateralism, call it necessary response to new threats: it still looks like imperialism and empire.” *Id.*

Secretary of State Condoleezza Rice's pledge to "support and uphold the system of international rules and treaties that allow us to take advantage of our freedom."<sup>6</sup>

International tax treaties are a vital instrument in developing and stimulating economies throughout the world.<sup>7</sup> Countries enter into tax treaties to promote investment, growth, and commerce by avoiding double taxation and preventing tax evasion.<sup>8</sup> Unilateral actions, such as Congress amending the tax code to override an international tax treaty, bear significant negative impacts upon the potential development of economies and the political relationship between the nations.<sup>9</sup> Congress' ability to override

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6. Hendrickson, *supra* note 4. Note that pre-9/11 the government still retained protectionist views. John Bolton stated in 1999, "it is a big mistake for us to grant any validity to international law even when it may seem in our short-term interest to do so – because, over the long term, the goal of those who think that international law really means anything are those who want to constrict the United States." *Id.*

7. See generally, Pending Income Tax Agreements: Hearing before the S. Comm. on Foreign Relations, 109th Cong. 1 (2006). (testimony of Patricia A. Brown, Deputy International Tax Counsel (Treaty Affairs), United States Department of the Treasury). Opening Statement For Hearing on Tax Treaties: Bangladesh, France and Sweden 109th Cong. 1, (2006) (opening statement of Richard G. Lugar, Chairman, S. Comm. on Foreign Relations, (testimony of the Staff, J. Comm. on Taxation), The Ratification of an Income Tax Treaty and Various Protocols Before the Senate Committee on Foreign Relations 109th Cong. 1 2006) (testimony of William A. Reinsch, President, National Foreign Trade Council), Renato Ruggiero, The High Stakes of World Trade, *Wall St. J.*, Apr. 28, 1999, at A18.

8. William H. Newton, III, *International Income Tax and Estate Planning*, 405 (West 2nd ed. 2004). "Double taxation occurs when two jurisdictions, due to overlapping authority, tax the same income or assets. The effect discourages investment and creates artificial barriers to the free flow of commerce. Both international cooperation and goodwill are correspondingly undermined." *Id.* "Tax treaties also limit fiscal evasion by authorizing close administrative coordination and mutual exchange of information between contracting jurisdictions." *Id.* at 405-6 (citations omitted). Another form of tax evasion occurs through treaty shopping. "[T]reaty shopping is the practice of rerouting income through one or more artificial entities in different countries for the main or sole purpose of obtaining treaty benefits that are not directly available to the true earner of income." Simone M. Haug, *The United States Policy of Stringent Anti-Treaty Shopping Provisions: A Comparative Analysis*, 29 *Vand. J. Transnat'l L.* 191, 205 (1996).

9. Richard L. Doernberg, *Overriding Tax Treaties: The U.S. Perspective*, 9 *Emory Int'l L. Rev.* 71, 71 (1997) Such actions have caused treaty partners to come to expect that the United States will breach its treaty obligations because the later-in-time doctrine causes domestic tax law to supersede prior agreements without *due regard* for prior treaty obligations.

these treaties negates the “anti-imperial” design of the Constitution and creates negative consequences for economic development and commerce.<sup>10</sup> In spite of this, treaties are often partially or completely abrogated in a unilateral fashion.

It is vital for the United States to adhere to treaties into which it enters and pay heed to the reliance of other nations on these treaties. The United States “retains more capacity than any other actor to improve the quality of the international system, so the question is whether it will continue to possess such capacity.”<sup>11</sup>

The determination of this question appears to depend on how the nation develops its’ international relations under the new leadership of President Barack Obama.<sup>12</sup> President Obama believes “it is illegal and unwise for the President to disregard international human rights treaties that have been ratified by the United States Senate,” yet, the question remains whether he feels the same about overriding international tax treaties.<sup>13</sup> President Obama stated the United States is in need of repairing relationships with other nations, whereby strengthening its economic alliances and garnering the support for the United States to compete on a global scale.<sup>14</sup>

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10. Bill Emmott, 20:21 Vision: Twentieth Century Lessons for the Twenty-First Century, 2003.

America’s constitutional domestic law has primacy over international treaties...Congress can alter the terms of any international treaty entered into by the administration, and all treaties need to be implemented through domestic laws. Not only is it wrong to imagine that America is a single, unified actor, it is also the case that the constitution was expressly designed by the Founding Fathers to prevent such a single actor from emerging... In international affairs that makes America especially difficult to deal with, since countries are accustomed to dealing with each other as sovereign governments, empowered to negotiate. The American system does its best to prevent the White House from being able to negotiate freely.

Id.

11. Haas, *supra* note 2 at 53.

<sup>12</sup> The question was of great importance in the 2008 Presidential Election and presented to Senator, former Presidential candidate, John McCain. Senator McCain was quoted saying: “if there is a treaty that the Congress has ratified, we have chosen to make it the law of the land, and it must be obeyed under the terms that it was ratified.” Questionnaire on Executive Power, *Boston Globe*, Dec. 20, 2007. Senator McCain further pointed out that “demanding unilateral changes and threatening to abrogate an agreement that has increased trade and prosperity is nothing more than retreating behind protectionist walls.” Mark Murray, *McCain’s Day In Canada*, Jun. 20, 2008. <http://firstread.msnbc.msn.com/archive/2008/06/20/1158780.asp>.

13. *Boston Globe*, *supra* note 12.

14. Barack Obama, *Renewing American Leadership*, Foreign Affairs,

Due to President Obama's overwhelming dedication to international policy,<sup>15</sup> it seems inevitable the question will be answered sooner than expected, especially considering the historic lack of urgency to address this matter.

This article examines the questionable jurisprudence allowing the United States to override treaties unilaterally, freely negotiated between two sovereign nations, through the later-in-time doctrine. Through the perspective of tax conventions, this article provides an overview of the historical development and context of unilateral treaty overrides. The following analysis will demonstrate the flawed reasoning behind the enactment of the later-in-time doctrine; the necessity to distinguish between Indian and sovereign nations; the contravention of the executive branch's treaty powers; the flawed interpretations of the Supremacy Clause; and the growing requirement to fulfill international obligations.

The analysis provides a plausible solution by applying a heightened scrutiny to domestic tax statutes attempting to override prior-in-time treaties. The call for heightened scrutiny is to be applied before potential overrides are granted; it is not meant to displace Congress' power to override international tax treaties by way of the tax code. In the case that an override

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Jul./Aug., 2007. Senator Obama stated "to renew American leadership in the world, I intend to rebuild the alliances, partnerships, and institutions necessary to confront common threats and enhance common security. Needed reform of these alliances and institutions will not come by bullying other countries to ratify changes we hatch in isolation. It will come when we convince other governments and people that they, too, have a stake in effective partnerships... Our essential challenge is to build a relationship that broadens cooperation while strengthening our ability to compete." *Id.*

15. Stop Tax Haven Abuse Act, S. 681, 110th Congress (2007). President Obama was a leading promoter of this bill aimed at the eradication of tax havens, which has substantial impact on the international economy. Not only does the definition of tax havens vary, so does the estimated impact of tax havens on the world's economy. Certain analysts suggest that more than 50% of the world's money goes through tax havens. Nick Kochan, *Cleaning Up by Cleaning Up*, *Euromoney*, April 1991, at 73-77; Marcel Cassard, *The Role of Offshore Centers in International Financial Intermediation* (Int'l Monetary Fund Working Paper WP/94/107, 1994). It is estimated that around 20% of total private wealth and around 22% of banks' external assets are invested offshore. *Id.* See also, Diamond, Walter H. and Dorothy B. Diamond, *Tax Havens of the World*, 1, Newark, NJ: Matthew Bender Books (2002). Additionally, Walter and Dorothy Diamond estimate the current total assets located in tax havens at \$5.1 trillion. *Id.* Regardless of the scholar or the estimated impact, it is indisputable that tax havens have become an emerging consequence of today's ever globalizing economy. President Obama's next steps at restoring the United States' international relations, while trying to regulate them, is going to be of great importance to the United States' economy and overall well-being.

is allowed, the void left from the unfulfilled obligations should spur the United States to make restitution to the parties injured.

## II. INTERNATIONAL TAX POLICY

Because our ever-globalizing economies are becoming dependent on international trade, each country's tax policy is important. Each country's tax specialists and tax advisors need to be totally aware of the other countries' tax policies to negotiate international tax treaties presenting a hospitable environment for foreign investors and also to protect their revenue base.<sup>16</sup> The tax policy is supposed to equalize taxes in cross-border transactions in which many small and medium size companies, as well as large companies, are now engaged.<sup>17</sup>

The relationship between tax treaties and domestic tax legislation is complex in many countries. The basic principle is the treaty should prevail in the event of a conflict between the provisions of domestic law and a treaty.<sup>18</sup> One of the most important issues for many countries in international treaties is the risk to taxpayers of international double taxation.<sup>19</sup> International tax extends beyond the income tax. It may include estate taxes, gift taxes, inheritance taxes, general wealth taxes, sales taxes, customs duties, and a variety of special levies.<sup>20</sup>

The goals of international tax treaties should be to get the country's fair share of revenue from cross-border transactions, promote fairness, enhance the competitiveness of the domestic economy, and to neutralize capital-exports and capital imports.<sup>21</sup> The list of U.S. tax treaties with

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16. Brian J. Arnold & Michael J. McIntyre, *International Tax Primer*, 1 (Kluwer Law Internat'l, 2d ed. 2002).

17. *Id.* at 7. Almost all modern income tax treaties are based on the OECD Model treaty and the UN Model Treaty. *Id.* The OECD Model Treaty has been revised over 8 times, as late as 2002. *Id.* at 107. The UN Model Treaty was first published in 1980, revised in 2001, and is usually used by developing countries. *Id.* at 109.

18. *Id.* at 104.

19. *Id.* at 2. There are three types of double taxation that arise from conflicts over tax jurisdiction: source-source conflicts, residence-residence conflicts and residence-source conflicts, which is the most common because most countries tax on the basis of both the residence status of the taxpayer and the source of income. *Id.* at 27.

20. *Id.* at 4.

21. *Id.* at 5. Three methods are commonly used for providing relief from double taxation: the deduction method, which is generally taxable at a higher effective rate, and the exemption and the credit methods, which usually give equivalent results. *Id.* at 31. On tax policy grounds, the credit method is supposed to be the best method for eliminating international double taxation. *Id.* at 37. But the debate about which method is better is often vigorous and emotional. *Id.* at 44.

developing countries is growing rapidly. Although tax incentives have some supporters in the political arena, they are impossible to justify on the basis of tax policy principles. The costs of tax incentives are typically large, the benefits are uncertain, and very rarely do the benefits justify the likely costs.<sup>22</sup>

The challenge for future governments is to achieve a proper balance of cooperation and competition among taxing regimes. Governments have been reluctant to act on a multilateral basis because they do not want to lose sovereignty over their tax policy. Globalization is a real threat to sovereignty. In the global economy, a unilateral approach to tax policy is obsolete, counterproductive, and ineffective. Some forms of cooperation are now necessary for governments to achieve their traditional tax policy objectives, and some forms of competition are helpful in promoting the best taxing practices.<sup>23</sup>

### III. COMPARISON OF TREATY RATIFICATION AND DOMESTIC TAX LAW ENACTMENT

Overriding a tax treaty is heavily influenced by the processes through which the treaties are ratified and domestic tax laws are enacted. The levels of influence of the two differ, due to the United States Constitution's prescribed roles for the three branches of the government.<sup>24</sup> The Executive

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Treaty relief is very important because it usually is more generous and it usually constrains a country's ability to amend its domestic law to withdraw the double taxation relief afforded to nonresidents. *Id.* at 47.

22. *Id.* at 52.

23. *Id.* at 143-144.

24. The Constitution confers the power to enact domestic tax laws on the House of Representatives, part of the legislative branch of the United States government. U.S. Const. art. I, § 7, cl.1. ("All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills."). The Constitution places the power to enter into treaties on the President and executive branch, subject to two-thirds ratification by the Senate. U.S. Const. art. II, § 2, cl. 2. ("He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur . . ."). When the House of Representatives enacts a domestic law that directly conflicts with a treaty provision, under current U.S. jurisprudence the domestic law overrides the treaty provision and therefore, the House of Representatives is impinging upon the executive's treaty powers. This procedure has been exasperated since the amendment to the language of the 1954 Code. The language as amended allows Congress to give due regard to any treaty obligation and still tax an item that is exempt from taxation under the treaty. Also, in 1988, the House of Representatives amended § 7852(d)(1) providing that "[f]or purposes of determining the relationship between a provision of a treaty and any law of the



branch vests the power to create treaties whereby the process begins with negotiations between representatives of the President and the delegation of the other nation.<sup>25</sup> After an agreement is reached, representatives from both sides sign the proposed treaty and the President forwards it to the Senate for its advice and consent. The Senate Foreign Relations Committee debates the merits of the proposed treaty and votes to accept or reject. During this debate, the Foreign Relations Committee seeks advice from the tax-writing committees in the House of Representatives and the Senate, despite them having no official jurisdiction.<sup>26</sup> After consent is given by the Senate, the treaty is sent back to the Executive branch which decides whether to ratify.<sup>27</sup> The Executive branch maintains the ability to deny the treaty's ratification if conditions relevant to the proposal have changed.<sup>28</sup>

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United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or law." This latter provision reflects the U.S. rule that the "later in time" of either the treaty or the applicable statute controls. Under the U.S. Constitution, U.S. treaties and federal statutes have equal status as the supreme law of the land. U.S. Const. art. VI, cl. 2. Consequently, when a conflict exists between the treaty and the statute, the later in time prevails. See Restatement (Third) of the Foreign Relations Law of the United States § 115 (1986). For well over 100 years the United States has allowed this lack of uniformity and certainty to hinder the United States' international relations. However, this impinging upon the executive's treaty powers, whether intended or not, is inevitable due to the current domestic and international treaty enactment processes. See also IRC § 894(a) which provides "the provisions of this title shall be applied to any taxpayer with *due regard* to any treaty obligation of the United States which applies to such taxpayer." (emphasis added).

25. U.S. Const. art. II, § 2, cl. 2:

He shall have power, by and with the advice and consent of the Senate, to make treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the advice and consent of the Senate, shall appoint ambassadors, other public ministers and consuls, judges of the Supreme Court, and all other officers of the United States, whose appointments are not herein otherwise provided for, and which shall be established by law: but the Congress may by law vest the appointment of such inferior officers, as they think proper, in the President alone, in the courts of law, or in the heads of departments.

26. Overriding Tax Treaties, *supra* note 9, at 77. The tax-writing committee in the House of Representatives is the only component of the House of Representatives which has input into the treaty making process. Such miniscule input helps explain the lack of comity among domestic and international tax legislation.

27. U.S. Const. art. I § 7.

28. Transcript of Senate Foreign Relations Hearing on Tax Treaties, 93 TNT 225-23, Nov. 2, 1993: In 1981, the Senate gave its advice and consent to a treaty and protocol with Israel. The treaty was signed in 1975 and the protocol in

The process for creating domestic tax laws and their influence upon tax treaties differs from the process of ratifying a treaty. While all revenue bills are initiated in the House of Representatives, the Senate may exert its influence by amending tax legislation and voting to approve legislation originating in the House.<sup>29</sup> The Executive branch creates tax bills which originate usually in the Department of Treasury or directly from the President. These bills, whether originating in Congress or the Executive branch, must be screened by the House and Senate before being vetoed or signed into law by the President. If the President vetoes the bill, it may still be passed into law if two-thirds of Congress overrides the veto.<sup>30</sup>

The most significant difference between the enactment of domestic tax laws and the treaty ratification process is the absence of an official role for the House of Representatives. One reason for the House's exclusion is the Senate is expected to have an expertise in foreign politics,<sup>31</sup> while the

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1980. Israel objected, however, to the final terms of the treaty and failed to ratify it. In 1986, Israel changed its views and asked whether the United States would be prepared to exchange instruments of ratification. In the meantime, the United States had adopted an anti-treaty shopping policy that was not reflected in the treaty. Consequently, the Treasury refused to exchange instruments of ratification until a new protocol was negotiated...

29. U.S. Const. art. 1, § 7, cl. 1. ("All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills."); *Overriding Tax Treaties*, supra note 9, at 74-76 (providing a thorough examination of the enactment process for a domestic tax statute which differs greatly from the international treaty enactment process).

30. U.S. Const. art. 1, § 7, cl. 2.

Every Bill which shall have passed the House of Representatives and the Senate, shall, before it become a Law, be presented to the President of the United States; If he approves he shall sign it, but if not he shall return it, with his Objections to that House in which it shall have originated, who shall . . . proceed to reconsider it. If after such Reconsideration two thirds of . . . [Congress] . . . shall agree to pass the Bill, . . . it shall become a Law.

31. *The Federalist* No. 64, at 432 (John Jay) (Jacob E. Cooke ed., 1961).

The framers of the Constitution thought:

[t]he power of making treaties is an important one, especially as it relates to war, peace and commerce; and it should not be delegated but in such a mode, and with such precautions, as will afford the highest security, that it will be exercised by men the best qualified for the purpose, and in the manner most conducive to the public good. Alexander Hamilton did not think that these qualities existed in the House of Representatives. The fluctuating, and taking its future increase into the account, the multitudinous composition

founding forefathers intended for the House of Representatives to be the voice of the people and have power over domestic revenue laws.<sup>32</sup> As the voice of the people, the House of Representatives has the primary role in enacting domestic tax laws and are answerable to their voters in their respective states.<sup>33</sup> The Senate, on the other hand, which is not subject to re-

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of . . . [the House of Representatives] . . . forbid us to expect in it those qualities which are essential to the proper execution of . . . [treaty powers]. Accurate and comprehensive knowledge of foreign politics; a steady and systematic adherence to the same views; a nice and uniform sensibility to national character, decision, secrecy and dispatch; are incompatible with the genius of a body so variable and so numerous.

The Federalist No. 75, at 506-07 (Alexander Hamilton) (Jacob E. Cooke ed., 1961).

However, it was believed that these qualities are found in Senators, as

the age restrictions imposed on their offices should produce candidates of “whom the people have had time to form a judgment, and with respect to whom they will not be liable to be deceived by those brilliant appearances of genius and patriotism, which like transient meteors sometimes mislead as well as dazzle. Thus, ‘the president and senators . . . will always be of the number of those who best understand our national interests . . . and whose reputation for integrity inspires and merits confidence. With such men the power of making treaties may be safely lodged.’

The Federalist No. 64, at 433 (John Jay) (Jacob E. Cooke ed., 1961).

32. U.S. Const. art. 1, § 2, cl. 1 (“The House of Representatives shall be composed of Members chosen every second Year by the People of the several States . . .”). In light of the fact that a Representative is subject to re-election every two years by popular vote, if he or she is not relaying the “people’s voice,” he or she will likely not remain in office for a subsequent term. The House has been called “a popular assembly whose members are ‘constantly coming and going in quick succession’ and, therefore, do not continue in office for ‘sufficient time to become perfectly acquainted with our national concerns, and to form and introduce a system for the management of them.’” The Federalist No. 64, at 432 (John Jay) (Jacob E. Cooke ed., 1961). However, such an assessment of the capabilities of the members of the House of Representatives, made in 1961, should not be set in stone, just as the Internal Revenue Code should not be set in stone. Rather, the Internal Revenue Code should adapt to the growing concerns of the United States to ensure our nation will prosper in our globalizing economy.

33. Another reason the House of Representatives is considered the voice of the people is the number of Representatives a state has is dependent upon the population within each state and each voting district. U.S. Const. art. 1, § 2, cl. 3. In comparison, originally, “[t]he Senate of the United States shall be composed of two Senators from each State, chosen by the Legislature thereof, for six years . . .” U.S. Const. art. 1, § 3, cl. 1. However, since the enactment of the seventeenth amendment, “[t]he Senate of the United States shall be . . . elected by the people thereof, for six years . . .” U.S. Const. amend. 17.

election every two years, is not as directly answerable to the public as is the House. This allows the Senate to act with independent judgment as to what is best for the nation as a whole rather than for his or her particular state.

#### IV. TREATY OVERRIDES DEFINED

A treaty override is the implementation of a domestic law that directly conflicts with a treaty provision.<sup>34</sup> For example, the United States and country B enter into a treaty granting country B a most-favored-nation status for products exported to the United States.<sup>35</sup> The United States subsequently enacts a domestic law taxing imported cotton at \$40 per ton from every country except country C. Country C is taxed at \$25 per ton of cotton it exports to the United States.<sup>36</sup> Under current U.S. jurisprudence, the domestic law enacted after the treaty would supersede the treaty obligation, and obligate country B to pay a tax of \$40 per ton of cotton it exports to the United States while country C pay \$25 per ton; country B is no longer the most-favored-nation. This contradiction arises out of country B no longer having a most-favored-nation status with all exports to the United States, as specifically noted in the treaty. However, despite finding a direct conflict between the treaty and the domestic law, a court would likely find the resulting conflict was intended by Congress and its ensuing consequences are to be accepted.<sup>37</sup>

To delve further into the intricacies of tax treaty overrides, we must analyze the structure of the United States Constitution, separation of powers and the theories of monism and dualism.

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34. *Id.* at 74. Under the current § 7852(d), the Code gives deference to the domestic law regardless of whether the treaty was prior in time. Such practice results in the United States breaching its treaty obligations and placing it in violation of international law. This result may not be anticipated by Congress prior to the change in domestic law.

35. See *Taylor v. Morton*, 23 F. Cas. 784 (Curtis, Circuit Justice, C.C.D. Mass. 1855); see also *infra*, pp. 3-6 (examining the processes by which domestic law is enacted and the treaty ratification process). Reuven S. Avi-Yonah, *International Tax as International Law*, 57 *TAXLR* 483 (2004) (Examining the processes by which international law differs from international tax law).

36. See *Morton*, 23 F. Cas. at 785.

37. See *Id.* at 788; see also *Cook v. United States*, 288 U.S. 102, 120 (1933) (holding 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 clearly been expressed.”); *Trans World Airlines v. Franklin Mint Corp.*, 466 U.S. 243, 252 (1984). It has been conceded by Congress that such conflict cannot always be anticipated. *Id.*

## V. THE IMPACT OF THE SUPREMACY CLAUSE

The Supremacy Clause in the United States Constitution has been interpreted, and further emphasized in *Marbury v. Madison*, to place domestic federal statutes on equal status with treaties.<sup>38</sup> The Supremacy Clause states:

[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.<sup>39</sup>

An ambiguity is found in the complications arising from the Constitution's allocation of power and enforcement. The ambiguity is whether a treaty and a domestic law of the United States carry the same level of authority. Pursuant to Constitution, the President has the power to create treaties<sup>40</sup> subject to the Senate's consent, and Congress has the power to lay

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38. In *Marbury v. Madison* 5 U.S. at 180, the Supreme Court determined, in light of the language of the Supremacy Clause, that the Constitution was the supreme law of the land. Specifically, Justice Marshall stated that

[i]t is also not entirely unworthy of observation, that in declaring what shall be the supreme law of the land, the constitution itself is first mentioned; and not the laws of the United States generally, but those only which shall be made in pursuance of the Constitution, have that rank. Thus the particular phraseology of the constitution of the United States confirms and strengthens the principle, supposed to be essential to all written constitutions, that a law repugnant to the constitution is void; and that courts, as well as other departments, are bound by that instrument.

Id. (Marshall, J.)

Notably absent from this opinion is any mention of "treaty." Yet, *Marbury v. Madison* has subsequently been relied on in holding that while that the Constitution is supreme to statutes, statutes and treaties must be of equal status. However, this overlooks the fact that unlike statutes, treaties are formed as the result of negotiations between two sovereign nations, each ceding some of its sovereignty in return for a benefit, and the fact that the international obligation remains after the domestic override.

See Jordan J. Paust, *International Law as Law of the United States* 277 n.547 (1996).

39. U.S. Const. art. VI, § 2, cl. 2.

40. U.S. Const. art. II, § 2, cl. 2 (giving the Executive Branch treaty powers, subject to Senate consent).

and collect taxes.<sup>41</sup> Yet, when a conflict arises between domestic tax legislation and an international treaty, how should the conflict be resolved? This question has been in debate since 1855; however, with the advent of globalization and the call for stronger economic foreign policy, should the United States continue to follow the later-in-time rule? Current law dictates that, when there is a conflict between a domestic law and a treaty provision, whichever was enacted later-in-time triumphs. Has policy and law become solely an issue of preemptive planning and strategic timing?

To investigate the later-in-time doctrine further, it is important to consider how the Supreme Court originally interpreted the character of an international treaty. In *The Amiable Isabella* case,<sup>42</sup> a 1795 treaty between the United States and Spain led the Court to question the construction of treaties. The 1795 treaty contained a provision allowing either nation to “sail from any port to those of a country which may be at war with either or both nations, and may go to neutral places, or to other enemy ports; and that every article on board, except contraband, to whomsoever belonging, shall be free.”<sup>43</sup> If a ship did not have a passport, it could be captured and claimed as a war prize.<sup>44</sup>

The *Isabella* had a passport, but the captors claimed the document was not issued by a competent authority because the Spanish king was required to authorize such passports; therefore, it was invalid and cause for the *Isabella*’s seizure.<sup>45</sup> The treaty required passports to be issued by the

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41. U.S. Const. art. I, § 8, cl. 1 (giving Congress the power to lay and collect taxes). Specifically, the Constitution gives the House of Representatives the power to create domestic tax laws. U.S. Const. art. I, § 7, cl. 1 (“All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills.”).

42. In re *The Amiable Isabella*, 19 U.S. 1, 4 (1821). A Spanish ship, sailing from Havana, Cuba, under the protection of the British Navy, leaving such protection off the coast of Florida, allegedly setting course for London, was “captured by the privateer ship Roger, and carried into Wilmington, North Carolina, for adjudication.” The captured ship, the *Amiable Isabella*, claimed that it had free passage because the Administrator General of the Royal Revenues for the port of Havana, Cuba granted such authority, in the form of a passport. The passport gave the *Isabella* permission to sail from Cuba to Hamburg, Germany, for the purposes of trading and it gave permission for the return trip.

43. *Id.* at 14. The treaty further provided that ships “shall be furnished with a passport expressing her national character, and with certificates to show, that the cargo is not contraband.” The passport was to have conclusive effect.

44. 19 U.S. at 21 (“[W]ithout which requisites they [the cargo and ship] may be sent to one of the ports of the other contracting party, and adjudged by the competent tribunal . . . [as] legal prizes . . .”).

45. 19 U.S., at 18.

magistrate of the place from which the vessel sails.<sup>46</sup> Therefore, Cuba could not issue the passport because the *Isabella* was a Spanish vessel.<sup>47</sup> However, the Court examined the treaty provision and found it did not proscribe any specific form for the passport.<sup>48</sup> Specifically, the Supreme Court held “the obligations of the treaty could not be changed or varied but by the same formalities with which they were introduced; or at least by some act of as high an import, and of as unequivocal an authority.”<sup>49</sup>

In *The Amiable Isabella* case, Justice Story stated:

[This] Court does not possess any treaty-making power. That power belongs by the constitution to another department of the Government; and to alter, amend, or add to any treaty, by inserting any clause, whether small or great, important or trivial, would be on *our part an usurpation of power, and not an exercise of judicial functions. It would be to make, and not to construe a treaty.*<sup>50</sup> (emphasis added)

Justice Story further held:

[t]he parties who formed this treaty, and they alone, have a right to annex the form of the passport. It is a high act of sovereignty, as high as the formation of any other stipulation of the treaty. It is a matter of negotiation between the Governments. The treaty does not leave it to the *discretion* of either party to annex the form of the passport; it requires it to be the *joint* act of both; and that act is to be expressed by both parties in the only manner known between independent nations – by a solemn compact through agents specially delegated, and by a formal ratification.<sup>51</sup>

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46. *Id.* at 18

47. *Id.*

48. *Id.* at 23.

49. This was decided thirty-four years before the *Taylor v. Morton*, 23 F. Cas. 784, 786-87 (Curtis, Circuit Justice, C.C.D. Mass. 1855). Justice Story wrote the opinion in which the following Justices concurred: Chief Justice Marshall, Justice Livingston, Justice Washington, Justice Todd, and Justice Duvall; Justice Johnson provided the sole dissenting opinion. *The Amiable Isabella*, 19 U.S. at 25.

Justice Johnson dissented because he thought the passport provision applied and that any form substantially complying with the provision should be acceptable. *Id.* at 111-12 (Johnson, J., dissenting).

50. *The Amiable Isabella*, 19 U.S. at 22.

51. *Id.* at 22.

*The Amiable Isabella* distinguishes the character of treaties and their authority to domestic law. The Court states a treaty requires, not just the cooperation of the United States, but the cooperation of another country, and it is not the place of any branch of government to circumvent their obligation under a treaty without first approaching the other country.

The true progenitor of the later-in-time doctrine was Supreme Court Justice Benjamin Curtis, sitting alone on circuit court as trial judge in the case of *Taylor v. Morton*.<sup>52</sup> In 1832, the United States entered into a treaty with Russia, in which the United States granted Russia most-favored-nation treatment with respect to imports.<sup>53</sup> The Tariff Act of 1842 lowered the tax on Bombay hemp to \$25 per ton, while keeping the same tax on Russian hemp at \$40 per ton.<sup>54</sup> Russia brought action against the Boston port

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52. 23 F. Cas. 784, 786-87 (Curtis, Circuit Justice, C.C.D. Mass. 1855). See also David Sachs, *Is the 19th Century Doctrine of Treaty Override Good Law for Modern Day Tax Treaties?*, 47 Tax Law. 867, 869 (1994).

In *Dred Scott v. Sandford*, 60 U.S. 393 (1857), Curtis, in a dissenting opinion, had an opportunity to further profess the later-in-time doctrine. Curtis showed his resentment at the idea the legislature could be constrained by a treaty. *Dred Scott*, 60 U.S. at 629 (Curtis, J., dissenting). He thought the powers of the government must be unimpaired. *Id.* Curtis completely rejected the idea that the United States ceded any sovereignty when it entered into the treaty:

[t]he responsibility of the Government to a foreign nation, for the exercise of those powers, is quite another matter. That responsibility is to be met, and justified to the foreign nation, according to the requirements of the rules of public law; but never upon the assumption that the United States had parted with or restricted any power of acting according to its own free will, governed solely by its own appreciation of its duty.

*Id.* (Curtis, J., dissenting). Curtis further stated:

“[t]his Constitution, and the laws of the United States which shall be made in pursuance thereof, and all treaties made or which shall be made under the authority of the United States, shall be the supreme law of the land.” This has made treaties part of our municipal law; but it has not assigned to them any particular degree of authority, nor declared that laws so enacted shall be irrevocable. No supremacy is assigned to treaties over acts of Congress. That they are not perpetual, and must be in some way repealable, all will agree.

*Id.* (Curtis, J., dissenting).

53. *Taylor*, 23 F. Cas. at 784.

54. The domestic statute imposed a tax of forty dollars per ton on all hemp except hemp imported from Manila and Suera, and on other hems from India, on which a tax of twenty-five dollars was levied. *Id.* at 784-85.



collector of customs seeking repayments for the difference between the two rates.<sup>55</sup>

Judge Curtis acknowledged the Supremacy Clause, but reasoned it was not dispositive of the issue. He believed when a treaty and domestic law conflicted, “the solution of the question was [to be] found, by considering the nature and objects of each species of law, the authority from which each emanated, and the consequences of allowing or denying the paramount effect of the constitution.”<sup>56</sup>

Judge Curtis recognized “[t]he foreign sovereign between whom and the United States a treaty has been made, has a right to expect and require its stipulations to be kept with scrupulous good faith . . . .,”<sup>57</sup> yet, relying on Article I, Section 8 of the Constitution, he found the statute overrode the treaty.<sup>58</sup> He expressly rejected the idea that the House of Representatives’ power to lay taxes had to be exercised in conformity with treaties, as this would deeply affect the independence and sovereignty of the United States.<sup>59</sup> Judge Curtis found the tax statute was within the House’s powers and because a treaty was equivalent to a law, there was nothing that could prevent the House from repealing the treaty since it could repeal laws.<sup>60</sup>

In addition, Judge Curtis stated domestic statutes should receive deference as opposed to treaties, because the creation of domestic laws involves three bodies of government (the House of Representatives, the Senate, and the President), while treaty ratification involves only two (the President and the Senate).<sup>61</sup> Judge Curtis’s opinion wholly ignores and disregards *The Amiable Isabella* case.

Finally, Judge Curtis held certain questions such as whether a treaty had been violated, whether the nations under the treaty were still required to fulfill their obligations, and whether a treaty override was justified, were not

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55. *Id.* at 784.

56. *Id.* at 785.

57. *Id.*

58. *Id.*

59. *Id.* at 786. This reasoning overlooks the fact that by entering a treaty, each country cedes sovereignty in return for a benefit. See Paust, *supra* note 38, at 277 n.547.

60. *Taylor*, 23 F. Cas. at 784-6. Judge Curtis explicitly rejected the idea that the President and the Senate exclusively held the power to modify or repeal treaty provisions. *Id.* He reasoned that because when Congress makes a declaration of war, it has the effect of repealing all “treaties with the hostile nation, inconsistent with a state of war[.]” there is nothing that requires the same government body that enacts the treaty to be the same body that that repeals it. *Id.* at 786. Congress could override a treaty, because if it could not, no one could, and “the power to do so, is prerogative, of which no nation can be deprived, without deeply affecting its independence.” *Id.*

61. *Taylor*, 23 F. Cas. at 786.

questions for judicial review,<sup>62</sup> were questions for the executive and legislative departments of the government.<sup>63</sup>

The Supreme Court addressed statutory overrides of treaties, in the context of “domestic dependent nations,” in *The Cherokee Tobacco* case.<sup>64</sup>

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62. Thus Judge Curtis found that a court could not determine whether a treaty had been violated because it was a political question. See generally *Baker v. Carr*, 369 U.S. 186 (1962), in which a court decided that a right was justiciable before the Supreme Court as arising basically out of their jurisdiction directly under the Constitution.

63. *Taylor*, 23, F.Cas. at 786-87. Curtis thought the remedy was to be found in diplomacy and legislation, not through the administration of existing laws:

Is it a judicial question, whether a treaty with a foreign sovereign has been violated by him; whether the consideration of a particular stipulation in a treaty, has been voluntarily withdrawn by one party, so that it is no longer obligatory on the other; whether the views and acts of a foreign sovereign, manifested through his representative have given just occasion to the political departments of our government to withhold the execution of a promise contained in a treaty, or to act in direct contravention of such promise? I apprehend not. These powers have not been confided by the people to the judiciary, which has no suitable means to exercise them; but to the executive and the legislative departments of our government. They belong to diplomacy and legislation, and not to the administration of existing laws.

*Id.* at 787.

64. *The Cherokee Tobacco*, 78 U.S. 616 (1870). This was a split decision, the opinion was delivered by Justice Swayne, in which Justice Strong, Justice Clifford, and Justice Miller concurred; Chief Justice Chase, Justice Nelson, and Justice Field did not hear the argument; and Justice Bradley and Justice Davis concurred in dissent.

In *Cherokee Nation v. Georgia*, 30 U.S. 1, 17 (1831). Justice Marshall referred to Indian nations as domestic dependent nations and described the relationship between Indian Nations and the United States as one similar to a ward and guardian. 30 U.S. 1, 17 (1831) (Marshall, J.).

Though the Indians are acknowledged to have an unquestionable, and, heretofore, unquestioned right to the lands they occupy, until that right shall be extinguished by a voluntary cession to our government; yet it may well be doubted whether those tribes which reside within the acknowledged boundaries of the United States can, with strict accuracy, be denominated foreign nations. They may, more correctly, perhaps, be denominated domestic dependent nations. They occupy a territory to which we assert a title independent of their will, which must take effect in point of possession when their right of possession ceases. Meanwhile they

The Cherokee nation argued an Internal Revenue Act, enacted in 1868,<sup>65</sup> which taxed liquor and tobacco products, did not apply to the nation due to a treaty it had with the United States.<sup>66</sup> Under the treaty, the Cherokee nation did not have to pay federal taxes on goods produced within the nation.<sup>67</sup> The

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are in a state of pupilage. Their relation to the United States resembles that of a ward to his guardian.

Id.

Marshall also relied on the Commerce Clause in holding that Congress had the power to regulate trade with Indian Nations. Id. at 43 (Marshall, J.). Article I, § 8 of the Constitution gives Congress the power “[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” U.S. Const. art. I, § 8, cl. 3.

In *Johnson v. M’Intosh*, 21 U.S. 543, 586, 592 (1823) (Marshall, J.) decided eight years earlier, Marshall found Indian Nations were subject to the sovereignty of the United States and noted that Indian nations did not have absolute title to their lands, the United States having the power to extinguish it. The Indian nations were first conquered by Great Britain, Spain, and France, but through the Civil War, a treaty with Spain, and the Louisiana Purchase, the United States acquired absolute title to the lands occupied by the conquered Indian Nations and therefore the Indian Nations were subject to the sovereignty of the United States, the conqueror. Id. at 583-88 (Marshall, J.).

Nine years later, Marshall had another opportunity to describe the relationship between the United States and Indian nations, and the lack of sovereignty on the part of the Indian Nations. *Worcester v. Georgia*, 31 U.S. 515, 580 (1832) (Marshall, J.).

At no time has the sovereignty of the country been recognized as existing in the Indians, but they have been always admitted to possess many of the attributes of sovereignty. All the rights which belong to self government have been recognized as vested in them. Their right of occupancy has never been questioned, but the fee in the soil has been considered in the government. This may be called the right to the ultimate domain, but the Indians have a present right of possession.

31 U.S. at 580 (1832) (Marshall, J.). Marshall stated the Indian nations were dependent upon the United States for their protection and for the supply of their essential wants. Id. at 555 (Marshall, J.). Marshall again noted Congress had power over Indian nations pursuant to the commerce clause in the Constitution. Id. at 559 (Marshall, J.).

65. Internal Revenue Act of 1868 § 107.

66. The Internal Revenue Act taxed “distilled spirits, fermented liquors, tobacco, snuff, and cigars . . . produced anywhere within the exterior boundaries of the United States, whether the same shall be within a collection district or not.” *The Cherokee Tobacco*, 78 U.S. at 618.

67. Under the treaty, “[e]very Cherokee Indian and freed person residing in the Cherokee nation shall have the right to sell any products of his farm . . . or any merchandise or manufactured products . . . without . . . paying any tax thereon . . .” Id.

government argued the code provision applied to the Cherokee, as it did in all other territories, and the relevant provisions of the treaty were annulled.<sup>68</sup>

Justice Swayne, much like Judge Curtis,<sup>69</sup> believed the Constitution did not address the issue of when treaties and acts of Congress conflict.<sup>70</sup> Justice Swayne ultimately held the internal revenue statute to supersede the treaty with the Cherokee nation, despite being enacted later-in-time.<sup>71</sup> He believed the consequences of the treaty override were merely political questions outside “the sphere of judicial cognizance.”<sup>72</sup> The Supreme Court’s decision which enacted the first-in-time rule was reflective of the reasoning of that time.<sup>73</sup> Indirectly, the Court found it inconceivable, in its deliberations, that a treaty could in some way impair or supersede the authority or independence of the United States.<sup>74</sup>

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68. *Id.*

69. See *Taylor v. Morton*, 23 F. Cas. at 785.

70. *Worcester v. Georgia*, 31 U.S. at 621.

71. *The Cherokee Tobacco*, 78 U.S. at 621. Drawing from the language in *Taylor v. Morton*, the Court stated that “[in] the case under consideration the act of Congress must prevail as if the treaty were not an element to be considered.” *Id.*

Justice Bradley, in his dissenting opinion, stated that he did not think it was “the intention of Congress to extent [sic] the internal revenue law to the Indian territory [because] . . . [t]hat is an exempt jurisdiction.” *Id.* at 622 (Bradley, J., dissenting). Bradley reasoned that because Congress did not expressly state that the Cherokee Nation, a jurisdiction exempt from U.S. taxation pursuant to numerous treaties, was to be subject to the domestic legislation, it should not have to pay the tax. *Id.* at 622-23 (Bradley, J., dissenting).

72. The Court held that any injuries resulting from the domestic statute overriding the treaty, “the power of redress is with Congress, not with the judiciary, and that body, upon being applied to, it is presumed, will promptly give the proper relief.” *Id.* at 621.

73. This is reflective of Justice Marshall’s view expressed in *Johnson v. M’Intosh*, 21 U.S. 543, 586, 592 (1823), where Justice Marshall found that the Native Americans, although in the United States first, ceded their sovereignty to the United States who came later-in-time.

This case involved a “domestic dependent nation” and, at this time, the U.S. already had a history of poorly treating Indian Nations and disregarding treaty obligations. *Cherokee Tobacco*, *supra* note 63. The Indian Removal Act of 1830 gave President Andrew Jackson the power to enter into treaty agreements with Indians, seeking relocation of Native Americans. The “Trail of Tears,” a product of this relocation plan in which Indian Nations were relocated to Indian Territories at gunpoint, resulted in the deaths of over four thousand Native Americans mostly due to disease, malnutrition, and violence. Essentially, this resulted in the forced relocation of Indian nations onto reservations.

74. See *The Cherokee Tobacco*, 78 U.S. at 621. The U.S. was still expanding westward, developing such states like California and Arizona which were admitted as states in 1850 and 1912.

In 1884, the Supreme Court had the occasion to revisit the issue of treaty overrides in two separate cases, decided in the context of Congress' immigration powers.<sup>75</sup> In *The Head Money Cases*, a consolidation of several

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75. *Chew Heong v. United States*, 112 U.S. 536 (1884); *The Head Money*, 112 U.S. 580 (1884). These cases were decided on the same day, *Chew Heong* first and *The Head Money Cases* second, with the Court reaching different results on very similar facts involving Congress' power over immigration. While *The Head Money Cases* had a unanimous decision, *Chew Heong* was not. 112 U.S. at 580, 600; *Chew Heong*, 112 U.S. at 538, 560.

In *Chew Heong*, the majority held that there was no treaty override because Congress did not intend for the domestic law, which required Chinese laborers returning to the United States to possess a certificate to be readmitted into the country, to apply to those already covered by the earlier treaty, which allowed Chinese laborers to freely leave and return to the United States. *Chew Heong*, 112 U.S. at 542, 560. The majority consisted of the following justices: Chief Justice Waite, Justice Harlan, Justice Miller, Justice Woods, Justice Matthews, Justice Gray, and Justice Blatchford; Justice Field and Justice Bradley provided separate dissenting opinions. *Chew Heong*, 112 U.S. at 538, 560; see United States Supreme Court, <http://www.supremecourtus.gov/about/members.pdf> (last visited Jun. 23, 2008).

Justice Field, in his dissenting opinion, thought that Congress had intended for the domestic law to apply to Chinese laborers despite the treaty. *Chew Heong*, 112 U.S. at 561. Citing *Taylor v. Morton*, Field reaffirmed some of the concerns about sovereignty and independence and stated that a treaty, like any other legislation, may be modified or revoked by a subsequent act of Congress. *Id.* at 562-63 (Field, J., dissenting) ("If the treaty relates to a subject within the powers of Congress and operates by its own force, it can only be regarded by the courts as equivalent to a legislative act. Congress may, as with an ordinary statute, modify its provisions, or supersede them altogether."). Field stated that treaty overrides were not a matter for judicial review,

[i]f the nation with which the treaty is made objects to the legislation it may complain to the executive head of our government, and take such measures as it may deem advisable for its interests. But whether it has just cause of complaint, or whether, in view of its action, adverse legislation on our part be or be not justified, is not a matter for judicial cognizance or consideration.

112 U.S. at 562 (Field, J., dissenting). In support for the domestic law overriding the treaty provision, just as Justice Curtis reasoned in *Taylor v. Morton*, Field reasoned that the Supremacy Clause placed treaties and federal law on equal footing and did not give paramount authority to either over the other, therefore the last expression of the sovereign will must control. *Id.* (Field, J., dissenting); *Taylor v. Morton*, 23 F. Cas. 784, 785 (Curtis, Circuit Justice, C.C.D. Mass. 1855).

Field also based his reasoning that the domestic law override the treaty on Congress' powers over immigration; he stated that "[t]he immigration of foreigners to this country, and the conditions upon which they shall be permitted to come or remain, are proper subjects both of legislation and of treaty stipulation. The power of

lower court opinions, debated a fifty-cent tariff imposed on all non-U.S. passengers arriving aboard ships in the United States.<sup>76</sup> The fifty-cent tax, part of a congressional act known as the Act to Regulate Immigration, conflicted with a pre-existing treaty with Russia. Relying on *The Cherokee Tobacco* and *Taylor v. Morton*, the Court held if a provision of an act is in conflict with any treaty with a foreign nation, the act must prevail in the courts. The Court, reasoning that the Constitution gave treaties no “superior sanctity,” likened it to a statute, and therefore determined that nothing made a treaty “irrepealable” or “unchangeable.”<sup>77</sup>

Several years later, in *Whitney v. Robinson*,<sup>78</sup> the Supreme Court for the first time clearly enunciated the later-in-time rule.<sup>79</sup> Relying primarily on

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Congress, however, over the subject can neither be taken away nor impaired by any treaty.” *Chew Heong*, 112 U.S. at 563 (Field, J., dissenting).

76. *The Head Money Cases*, 112 U.S. at 586.

The suit is brought to recover from Robertson the sum of money received by him, as collector of the port of New York, from plaintiffs, on account of their landing in that port passengers from foreign ports, not citizens of the United States at a rate of 50 cents for each such passengers, under the act of Congress of Aug. 3, 1882, entitled ‘An act to regulate immigration.’

Id.

77. Id. at 598-99.

A treaty, then, is a law of the land as an act of Congress is, whenever its provisions prescribe a rule by which the rights of the private citizen or subject may be determined. And when such rights are of a nature to be enforced in a court of justice, that court resorts to the treaty for a rule of decision for the case before it as it would to a statute. But even in this aspect of the case there is nothing in this law which makes it irrepealable or unchangeable. The Constitution gives it no superiority over an act of Congress in this respect, which may be repealed or modified by an act of a later date. Nor is there anything in its essential character, or in the branches of the government by which the treaty is made, which gives it this superior sanctity.

Id.

78. *Whitney v. Robinson*, 124 U.S. 190 (1888)

79. Id. The *Whitney* Court, which rendered a unanimous decision, had almost an identical composition as the *Chew Heong* and *The Head Money Court*, consisted of Chief Justice Waite, Justice Miller, Justice Field, Justice Bradley, Justice Harlan, Justice Matthews, Justice Gray, Justice Blatchford, and Justice Lamar. See id.; *Chew Heong*, 112 U.S. at 536; *The Head Money Cases*, 112 U.S. at 580; see also United States Supreme Court, supra note 61.

In this case, the importers of sugar from the island of Santo Domingo protested the collection of taxes on those items. They argued that since the United

*Taylor v. Morton*, but also citing *The Head Money Cases*, Justice Field held whenever a conflict exists between a treaty provision and a domestic tax law, the later enacted provision would control:<sup>80</sup>

By the Constitution a treaty is placed on the same footing, and made of like obligation, with an act of legislation. Both are declared by that instrument to be the supreme law of the land, and no superior efficacy is given to either over the other. When the two relate to the same subject, the courts will always endeavor to construe them so as to give effect to both, if that can be done without violating the language of either; but if the two are inconsistent, the one last in date will control the other, provided always the stipulation of the treaty on the subject is self-executing.<sup>81</sup>

Following *Whitney* was *The Chinese Exclusion Case*.<sup>82</sup> It dealt with a conflict between a treaty with the United States and China, permitting

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States had a treaty with the Kingdom of Hawaii that exacted on taxes on the same items, and because the United States' treaty with the Dominican Republic had a clause precluding any "higher or other duty" it should not have to pay those taxes either. *Id.*

The Supreme Court rejected this argument because Congress had subsequently passed a law requiring taxation on the importation of certain items covered by the U.S.-Santo Domingo treaty, notwithstanding the treaty's provisions. The Court found that treaties and statutes were of equal status and when there is an un-resolvable conflict, the last one passed will control. *Id.* at 194.

80. *Whitney*, 124 U.S. at 194

81. *Id.* at 195. As the analysis of this article is confined to treaty overrides in the context of tax conventions, it is important to note that tax treaties are self-executing – no domestic legislation is required to incorporate them into domestic law. *Overriding Tax Treaties*, supra note 7, at 78 (citing *Columbia Marine Services, Inc. v. Reffet Ltd.*, 861 F.2d 18 (2d Cir. 1988); *United States v. Schooner Peggy*, 5 U.S. 103 (1801)).

82. *Chae Chan Ping v. United States*, 130 U.S. 581 (1889) [hereinafter *Ping*]. Plaintiff was a Chinese laborer living in United States until 1887, when he returned to China. Upon returning to the U.S., he presented his certificate allowing him to enter the country when he was taken into custody by the collector of customs. During *Ping's* trip to China, Congress had enacted legislation, which became effective in 1888, that denied Chinese laborers passage into the United States, this legislation became effective several days before *Ping* returned to the U.S. *Id.* at 431; *Ping*, 130 U.S. at 593-94. The new legislation was claimed to be for the common good and protection of the nation. The discovery of gold in California in 1848 caused an influx of Chinese immigrants into the United States and as a result, there was a fear that California "would be overrun by them unless prompt action was taken to restrict their immigration." *Ping*, 130 U.S. at 595. An 1880, U.S.-China

Chinese immigrants to freely return to the United States, and a subsequently enacted statute which placed restrictions on the return of Chinese immigrants.<sup>83</sup> Justice Field delivered the unanimous opinion which held, “Congress has the power to control immigration because such power, although not enumerated in the Constitution, is inherent in the sovereignty and nationhood of the United States.”<sup>84</sup> Secondly, relying on *Taylor v.*

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treaty allowed Chinese to freely return to the United States with a certificate issued by the collector of customs. *Id.* at 589.

The Supreme Court had an identical composition as the *Whitney* Court, which consisted of Chief Justice Waite, Justice Miller, Justice Field, Justice Bradley, Justice Harlan, Justice Matthews, Justice Gray, Justice Blatchford, and Justice Lamar. *See id.* at 581; *Whitney*, 124 U.S. 90.

83. This treaty was not a self-executing treaty, but in 1882, an act of Congress made the treaty effective. *Ping*, 130 U.S. at 597. To resolve the conflict between the treaty and subsequently enacted statute, the Court applied the rule enunciated in *Whitney*, that a treaty which is not self-executing can be overridden by another Congressional act. *Id.* at 600. After applying this rule, the Court went even further and held that “in either case [the treaty being self-executing or not] the last expression of the sovereign will must control. *Id.* at 600.

Distinguishing this case from *Chew Heong*, was Congress’ express intent for the override. *See id.* at 598-99; *Chew Heong v. United States*, 112 U.S. 536, 542 (1884); *see supra* note 61. In *The Chinese Exclusion Case*, Congress had specifically amended the domestic law at issue in *Chew Heong* to make it “unlawful for any Chinese laborer who shall at any time heretofore have been, or who may now or hereafter be, a resident within the United States, and who shall have departed, or shall depart therefrom, and shall not have returned before the passage of this act, to return to, or remain in, the United States” and “every certificate heretofore issued in pursuance thereof is hereby declared void and of no effect, and the Chinese laborer claiming admission by virtue thereof shall not be permitted to enter the United States.” *Ping*, 130 U.S. at 599.

84. *Ping*, 130 U.S. at 603-04. Justice Field found that control over immigration is a right that belongs to every sovereign state and that this right is inherent in state independence and sovereignty. *Ping*, 130 U.S. at 605-06 (Field, J.).

In *The Head Money Cases*, which dealt with the imposition of a tax of fifty-cents per immigrant, found that Congress had the power to impose this under its authority to regulate commerce with foreign nations. 112 U.S. 580, 591 (1884). However, in 1884, immigration was more of a matter of personal choice and not foreign commerce; also, the notion that foreign commerce includes the importation of persons conjures thoughts of the slave trade and was demeaning to immigrants to be thought of in this way. *Ping*, 130 U.S. at 603-04.

But, in *The Chinese Exclusion Case*, even though power over immigration is not expressly granted to the federal government in the Constitution, the Court found support for Congress’ power to control immigration in the sovereignty and independence inherently belonging to the United States. *See id.* at 857.

In *United States v. Curtiss-Wright Export Corp.*, Justice



*Morton*, Justice Field stated “the Constitution does not prohibit Congress from enacting laws inconsistent with the international obligations of the United States and that the courts will give effect to an act of Congress inconsistent with provisions in an earlier treaty.”<sup>85</sup> The Court held treaties and statutes to be of equal status under the Supremacy Clause and found that when in conflict, whichever was enacted later-in-time would triumph.<sup>86</sup> The Court noted that despite the resemblance of treaties as contracts between nations, the Court found them to be just like statutes, able to be repealed or modified by a subsequent Congressional act.<sup>87</sup>

Despite the recognition by the Court that an override may leave international obligations unfulfilled, relying on *Taylor* and notions of inherent sovereignty, the Court found that “[t]he validity of this legislative release from the stipulations of the treaties was of course not a matter for judicial cognizance.”<sup>88</sup>

Historically, courts have addressed conflicts between treaty provisions and statutes, and have ruled that not every provision of a treaty must be dominated by a domestic law. The starting point with cases proclaiming this reasoning began with *Murray v. The Schooner Charming Betsy*.<sup>89</sup> In this case, the Supreme Court declared “an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains . . .”<sup>90</sup> This rule of construction has also been applied

Sutherland expounded the doctrine that the powers of external sovereignty did not derive from the Constitution. These powers, he said, were lodged in the United States, rather than in the individual states, before the Constitution was adopted and remained there – and therefore in the federal government – under the Constitution.

*Id.* at 858 (citing *United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304, 316-18 (1936)). It should be noted that this interpretation would seem to be precluded by the 10th Amendment, which states that “[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” U.S. Const. amend. X.

85. *Ping*, 130 U.S. at 602).

86. *Id.*

87. *Id.*

88. *Id.* (“The question whether our government is justified in disregarding its engagements with another nation is not one for the determination of the courts.”).

89. 6 U.S. 64, 81 (1808). This was a unanimous decision delivered by Chief Justice Marshall; also sitting on the Court at this time were Justice Cushing, Justice Chase, Justice Washington, Justice Johnson, Justice Livingston, and Justice Todd. *Id.* at 64.

90. *The Charming Betsy*, 6 U.S. at 118. Here, a domestic statute prohibited trade with France and authorized the seizure of any vessel bound for French ports. The Court noted that “the building of vessels in the United States for sale to neutrals, in the islands, is, during war, a profitable business, which Congress cannot be intended to have prohibited, unless that intent be manifested by express words or a

to treaties. Therefore, a court should attempt to construe a domestic statute against a treaty provision to prevent conflict.

For example, in *Chew Heong v. United States*, involving a Chinese laborer working in the United States, the Supreme Court held that Congress did not intend for the domestic law to apply to those covered by a pre-existing treaty.<sup>91</sup> In 1880, the United States and China signed a treaty allowing Chinese laborers already in the United States “to go and come of their own free will.”<sup>92</sup> In 1881, Chew left for the Hawaiian Kingdom and, upon attempting to return to the United States in 1884, was denied admission because he did not possess a certificate required of all Chinese laborers entering the country.<sup>93</sup> Congress passed the certificate requirement as part of the Chinese Restriction Act of 1882.<sup>94</sup> The Supreme Court held that when Congress enacted the certificate provision, it did not intend for it to apply to Chinese laborers already covered by the earlier treaty provisions.<sup>95</sup> The inference drawn from this holding is Congress may override an existing treaty, only if there is a clear expression of Congressional intent such result was intended.<sup>96</sup>

In *Cook v. United States*, the Supreme Court addressed a potential override of a treaty with the United Kingdom.<sup>97</sup> In 1930, pursuant to the Tariff Act of 1930, a U.S. Coast Guard stopped the British vessel *Mazel Tov*, eleven and one-half miles from the United States coast.<sup>98</sup> The Tariff Act

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very plain and necessary implication.” Captain Murray, of the United States Navy, captured a vessel, *The Charming Schooner Betsy*, and sold in 1800 pursuant to the statute. The former owner challenged the sale because he was a United States citizen and the current owner, born in Connecticut, swore an oath to Denmark in 1797. Chief Justice Marshall declared the proper construction of the statute was that a citizen must own the vessel, “not at the time of the passage of the law, but at the time when the act of forfeiture shall be committed.” Since the current owner was not a United States citizen at the time of forfeiture, the domestic law did not apply and the forfeiture was illegal. Under this construction, the statute did not violate the naturalization and citizenship laws of the Danish crown.

91. 112 U.S. 536 (1884).

92. *Id.* at 542.

93. *Id.* at 539.

94. *Id.* at 538.

95. *Id.* at 560.

96. *Id.*; Sachs, *supra* note 51, at 870.

97. 288 U.S. 102 (1933). Justice Brandeis delivered the unanimous opinion of the Court, which also consisted of Chief Justice Hughes, Justice McReynolds, Justice Sutherland, Justice Stone, Justice Roberts, Justice Cardozo, Justice Van Devanter, and Justice Butler. See *Id.* at 102.

98. *Cook*, 288 U.S. at 107. The Collector of Customs seized the ship and searched Cook’s cargo, discovering intoxicating liquor, and charged Cook a penalty for failing to disclose the illegal cargo. *Id.* Cook claimed that his cargo, which was

allowed the Coast Guard to stop and inspect any ship coming within twelve miles of the U.S. coast. Cook argued the stop was unjustified because the treaty between the United States and Great Britain only permitted the stopping and inspecting of any ship within three nautical miles of shore.<sup>99</sup>

The Tariff Act of 1922 contained language which the subsequent treaty with Britain sought to address and found relevant in this case.<sup>100</sup> However, when Congress amended the Tariff Act in 1930, they left that specific portion unchanged.<sup>101</sup> While not addressing *Cook v. U.S.*, Justice

being transported from a French colony, was destined for the Bahamas, a British colony, and that his ship was intercepted outside the legal limit of the Tariff Act. *Id.*

99. From 1918 until 1933, under the 18th Amendment, the manufacture, sale, and transportation of alcohol were prohibited in United States. U.S. Const. amend. XVIII, *repealed by* U.S. Const. amend. XXI; see Wikipedia, [http://en.wikipedia.org/wiki/Prohibition#Prohibition\\_in\\_the\\_United\\_States](http://en.wikipedia.org/wiki/Prohibition#Prohibition_in_the_United_States) (last visited Jun. 23, 2008). This is reflected in the U.S.-Britain treaty, which

provided that the high contracting parties should declare “their firm intention to uphold the principle that three marine miles measured from low water mark constitute the proper limits of territorial waters” . . . . Moreover, the arrangement . . . was to be limited specifically to intoxicating liquors; and no reciprocal rights were to be conferred.

*Cook*, 288 U.S. at 117-18 (citations omitted). It was specifically noted that [t]he need of the United States was to be met by providing that His Britannic Majesty “will raise no objection to the boarding,” etc., outside the territorial waters at no “greater distance from the coast of the United States than can be traversed in one hour by the vessel suspected of” smuggling. The need of Great Britain was to be met by our allowing “British vessels voyaging to or from the ports or passing through the waters of the United States to have on board alcoholic liquors listed as sea stores or as cargo destined for a foreign port, provided that such liquor is kept under seal while within the jurisdiction of the United States.”

*Id.*

100. *Id.*

101.

Shortly after the Treaty took effect, the Treasury Department issued amended instructions for the Coast Guard which pointed out, after reciting the provisions . . . [the Tariff Act], that “in cases of special treaties, the provisions of those treaties shall be complied with;” and called attention particularly to the recent treaties dealing with the smuggling of intoxicating liquors. The Commandant of the Coast Guard, moreover, was informed in 1927, as the Solicitor General states, that all seizures of British vessels captured in the rum-smuggling trade should be within the terms of the Treaty and that seizing officers should be instructed to produce evidence, not that the vessel was found within the four-

Brandeis cited *Chew Heong* and held the amendments to the Tariff Act of 1930 did not have a clear expression of congressional intent to abrogate and modify the treaty between the United States and Great Britain.<sup>102</sup> Specifically, Justice Brandeis stated, “[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.”<sup>103</sup>

Distinguishing *Cook*, the Supreme Court in *Trans World Airlines v. Franklin Mint Corp.*<sup>104</sup> held a domestic statute did not override a treaty provision because there was no clear expression of Congressional intent for such effect.<sup>105</sup> The Court was asked to determine the extent of Trans World Airlines’ (“TWA”) liability for losing cargo belonging to Franklin Mint.<sup>106</sup> The district court followed the Warsaw Convention, an international air carriage treaty into which the United States entered in 1934, which limited TWA’s liability to a sum of 250 francs per kilogram; the French franc consisted of “65 1/2 milligrams of gold at the standard of fineness of nine hundred thousandths.”<sup>107</sup> Franklin Mint argued that the repeal of the Par

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league limit, but that she was apprehended within one hour’s sailing distance from the coast.

Id. at 119.

102. Id. at 119-20.

103. Id. at 120.

104. 466 U.S. 243, 251 (1984).

105. *Trans World Airlines, Inc. v. Franklin Mint Corp.*, 466 U.S. 243, 251 (1984).

106. *Franklin Mint*, 466 U.S. at 245-46. The cargo consisted of four packages of numismatic materials that, in total, weighed 714 pounds and was shipped on TWA from Philadelphia to London. Id. Franklin Mint did not declare the value of the cargo, but declared damages of \$250,000 for the subsequently lost packages. Id. at 246. The district court ruled that under article 22 of the Warsaw Convention, TWA’s liability was limited to \$6,475.98. Id.

107. Id. Justice O’Connor noted that “[t]he [Warsaw] Convention was drafted at international conferences in Paris in 1925, and in Warsaw in 1929. The United States became a signatory in 1934. More than 120 nations now adhere to it. The Convention creates internationally uniform rules governing the air carriage of passengers, baggage, and cargo.” Id. at 246-47. Article 18 of the Convention holds carriers liable for the loss of cargo. See Convention for the Unification of Certain Rules Relating to International Carriage by Air, ch. III, Art. 18, Oct. 12, 1929, available at <http://www.jus.uio.no/lm/air.carriage.warsaw.convention.1929/18> (last visited on Jun. 24, 2008). (“The carrier is liable for damage sustained in the event of the destruction or loss of, or of damage to, any registered luggage or any goods . . .”). Article 22 sets the amount of liability equal “to a sum of 250 francs per kilogram, unless the consignor has made . . . a special declaration of the value at delivery[,] . . . [then] the carrier will be liable to pay a sum not exceeding the declared sum, unless he proves that that sum is greater than the actual value to the consignor at delivery.”

Value Modification Act, which had the effect of abandoning the gold standard, rendered the liability limitation in Article 22 of the Warsaw Convention unenforceable in the United States.<sup>108</sup> The court of appeals agreed, as it held the “enforcement of the [Warsaw] Convention requires a factor for converting the liability limit into dollars and . . . there is no United States legislation specifying a factor to be used by the United States courts.”<sup>109</sup>

The Supreme Court disagreed with this reasoning.<sup>110</sup> The Court did not cite to *The Charming Betsy* or *Chew Heong*; instead, the Court relied on *Cook v. United States* and held “[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.”<sup>111</sup> Therefore, the abandonment of the gold standard and the enactment of legislation repealing the Par Value Modification Act did not terminate the United States’ obligation to follow

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Convention for the Unification of Certain Rules Relating to International Carriage by Air, ch. III, art , Oct. 12, 1929. 22, available at <http://www.jus.uio.no/lm/air.carriage.warsaw.convention.1929/22> (last visited Jun. 24, 2008). Article 22 also states that the French franc consists “of 65 milligrams gold of millesimal fineness 900” and provides that the “sums may be converted into any national currency in round figures.” *Id.*

In 1945, the United States became a member of the International Monetary Fund (“IMF”) and agreed to “maintain a ‘par value’ for the dollar and to buy and sell gold at the official price in exchange for balances of dollars officially held by other IMF nations.” *Franklin Mint*, 466 U.S. at 248. In 1945, a price of \$35 per ounce of gold was established, which, under Article 22 of the Warsaw Convention, equaled a cargo limit of \$7.50 per pound. *Id.* at 248-49. This changed in 1978 with the abandonment of the gold standard and the repeal of the Par Value Modification Act. *Id.* at 249.

In 1968, the central banks of most Western nations “instituted a ‘two-tier’ gold standard in 1968[,] the gold-based international monetary system began to collapse” and gold transactions took place at a free market price. *Id.* In 1971, the United States passed the Par Value Modification Act, which set a standard value for gold; eventually the exchange rate was set at \$42.22 per ounce. *Id.* (citing *Aeronautics and Space*, 14 C.F.R. § 221.176 (1975)). “In 1976, Congress passed legislation to . . . [repeal] the Par Value Modification Act effective Apr. 1, 1978.” *Franklin Mint*, 466 U.S. at 249.

108. *Id.* at 251.

109. *Id.* at 251, 254 n.25.

110. 466 U.S. at 251, 254 n.25. *Trans World Airlines, Inc. v. Franklin Mint Corp.* was not a unanimous decision, Justice O’Connor wrote the majority opinion, in which Chief Justice Burger, Justice Powell, Justice Brennan, Justice White, Justice Marshall, Justice Blackmun, and Justice Rehnquist joined. *Id.* at 244. Justice Stevens was the sole dissenter. *Id.*

111. *Id.* at 252 (quoting *Cook v. United States*, 288 U.S. 102, 120 (1933)).

the Warsaw Pact.<sup>112</sup> Thus, the Court construed the domestic law and treaty so as not to be in conflict.

In our view Congress has not abandoned any “unit of conversion specified by the Convention” – the Convention specifies liability limits in terms of gold francs and provides no unit of conversion whatsoever. To the contrary, the Convention invites signatories to make the conversion into national currencies for themselves. In the United States the CAB has been delegated the power to make the conversion, and has exercised the power most recently in Order 74-1-16. We are not called upon to “[substitute] a new term,” but merely to determine whether the CAB’s Order is inconsistent with the Convention. That determination does not engage the “political question” doctrine.<sup>113</sup>

Justice Stevens, in his dissenting opinion, found Article 22 of the Warsaw Convention and the legislation to be in direct conflict with each other.<sup>114</sup> According to Stevens, Article 22 required “that the liability limits be determined by reference to the value of ‘gold at the standard of fineness of nine hundred thousandths’ and then converted into our ‘national currency in round figures.’”<sup>115</sup> Justice Stevens believed the majority held the liability limitation to be unenforceable and the limitation set by the Civil Aeronautics Board (“CAB”) as enforceable thus effectively rewriting the treaty.<sup>116</sup> Under Stevens’ reasoning, Article 22 set the standard for the value of gold in terms

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112. Id. at 253.

113. Id. at 254. Under the order by the Civil Aeronautics Board (“CAB”), TWA’s liability was limited to \$9.07 per pound. Id. CAB Order 4-1-16, issued in 1974, set the minimum acceptable figure for liability limits applicable to ‘international carriage at \$9.07 per pound of cargo. Id. at 251. Because Article 22 was not found to be in conflict with the legislation repealing the Par Value Modification Act, the Supreme Court held that TWA’s liability was limited to \$9.07 per pound.

114. Id. at 261-62 (Stevens, J., dissenting).

115. Id. at 261 (Stevens, J., dissenting) (citing Convention for the Unification of Certain Rules Relating to International Carriage by Air, ch. III, art. 22, Oct. 12, 1929, available at <http://www.jus.uio.no/lm/air.carriage.warsaw.convention.1929/22>) (last visited Jun. 24, 2008).

116. Id. (Stevens, J., dissenting). Stevens thought that the majority had rewritten the treaty and had acted outside the scope of the Judicial Branch’s constitutional powers, as the treaty making power belongs to the Executive Branch. Id. at 263 (Stevens, J., dissenting) (citing *The Amiable Isabella*, 19 U.S. 1, 71-73 (1821)).

of a stated fineness, and then allowed for this sum to be converted into national currencies in round figures.<sup>117</sup> Stevens believed the economic climate changed dramatically since the Warsaw Convention,<sup>118</sup> and in light of the abandonment of the gold standard and the repeal of the Par Value Modification Act, “[t]he rate at which a domestic currency exchanges for gold was and is the only ‘conversion’ permitted or anticipated by the [Warsaw] Convention. That figure *is* the liability limitation of the Warsaw Convention[,]” not the amount set by CAB.<sup>119</sup>

While *The Charming Betsy*, *Cook*, *Chew Heong*, and *Trans World Airlines* require a clear expression of congressional intent in for a domestic law to override a treaty, the *United States v. Palestine Liberation Organization*<sup>120</sup> illustrates that even when congressional intent is clear, courts may still construe a treaty and a statute so as not to conflict.<sup>121</sup> The issue was whether the Palestine Liberation Organization (hereinafter the “PLO”) could maintain its office, as a permanent observer, at the United Nations’ headquarters in New York.<sup>122</sup> The PLO was asked to be an observer

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117. *Id.* at 265-66 (Stevens, J., dissenting).

118. *Id.* at 274-75 (Stevens, J., dissenting). When the Warsaw Convention was entered into, aviation was very dangerous; it was considered an unbelievable feat when Charles Lindbergh flew the Spirit of St. Louis from New York to Paris. *Id.* (Stevens, J., dissenting). Article 22 was intended to calm fears of losing one’s cargo or life in the event of a disaster and to stimulate travel and shipment by airlines. *Id.* at 264-65. Three years after the United States entered the Warsaw Convention, the crash of the Hindenburg occurred in 1937, furthering fears of traveling or shipping on airlines. *Id.* at 265. Stevens noted “[a]ir travel is among the safest forms of transportation and the fledging venture of a half century ago is a major, established international industry today. *Id.* at 273.

119. *Id.* at 275.

120. 695 F.Supp. 1456 (S.D.N.Y. 1988).

121. *The Schooner Charming Betsy*, 6 U.S. 64, 81 (1808); *Cook*, 288 U.S. at 120 (1933); *Chew Heong*, 112 U.S. 536, 560 (1884); *Trans World Airlines, Inc.*, 466 U.S. 243, 251 (1984); *Palestine Liberation Organization*, 695 F. Supp. at 1465-68.

122. *Palestine Liberation Organization*, 695 F. Supp. at 1458. The court referred to the Headquarters Agreement, in which the United States extended an invitation to the United Nations to establish a seat within the U.S. *Id.* (citing H.R. Con. Res. 75, 79th Cong., (1st Sess. 1945)). The United Nations has invited non-member Nations, consisting of intergovernmental organizations and other organizations to maintain “Permanent Observer Missions” in New York. *Id.* The PLO is one of the “other organizations” asked to become an observer at the U.N. *Id.* (citing Headquarters Agreement, § 11, 61 Stat. 756 (1947)); see United Nations, available at <http://www.un.org/Overview/missions.htm#iga> (last visited Jun. 24, 2008).

to the United Nations in 1974 and maintain a Permanent Observer Mission in the U.N.'s New York headquarters.<sup>123</sup>

In 1986, Congress asked the U.S. State Department to close the PLO mission office in New York.<sup>124</sup> The request was unsuccessful and gave rise to the Anti-Terrorism Act of 1987 (hereinafter the "ATA").<sup>125</sup> Under the ATA, the PLO was "stated to be 'a terrorist organization and a threat to the interests of the United States, its allies, and international law, and it should not benefit from operating in the United States.'"<sup>126</sup> The ATA prohibited "the establishment or maintenance of 'an office, headquarters, premises, or other facilities or establishments within the jurisdiction of the United States at the behest or direction of, or with funds provided by' the PLO, if the purpose is to further the PLO's interests."<sup>127</sup>

The ATA was clearly and expressly aimed at removing the PLO from the U.N. headquarters in New York.<sup>128</sup> The Court held the statute did not override the treaty, and cited *The Charming Betsy, Cook, Chew Heong, The Head Money Cases*, and *Trans World Airlines*, when it stated a court is under a duty to interpret statutes in a manner consistent with existing treaty obligations, and a domestic statute enacted later-in-time should not override a treaty provision unless Congress clearly and unequivocally expressed their intent to override the treaty.<sup>129</sup>

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123. *Palestine Liberation Organization*, 695 F. Supp. at 1459. The "observer" status conferred the right upon the representatives of the PLO to admission to the United States and access to the United Nations. *Id.* at 1459, 1465 (citing 61 Stat. 756) ("Section 11 of the Headquarters Agreement reads . . . [t]he federal, state or local authorities of the United States shall not impose any impediments to transit to or from the headquarters district of: (1) representatives of Members . . ., (5) other persons invited to the headquarters district by the United Nations . . . on official business."). Further, "[s]ection 12 requires that the provisions of § 11 be applicable 'irrespective of the relations existing between the Governments of the persons referred to in that Section and the Government of the United States.'" *Id.* (citing 61 Stat. 756). The right to access into the United States, granted under the Headquarters Agreement, was unsuccessfully challenged in the Eastern District of New York and the PLO's right to access was upheld. *Id.*

124. *Id.* (citing Anti-PLO Terrorism Act of 1987, H.R. 2211, 100th Cong., (1st Sess. 1987)).

125. *Id.* at 1459-60.

126. *Id.* at 1460 (citing 22 U.S.C. § 5201(b)).

127. *Id.* (citing 22 U.S.C. § 5202(3)). The ATA also prohibited the spending of PLO funds and proscribed the PLO from receiving, in New York, anything of value except material information from the PLO. *Id.* (citing 22 U.S.C. §§ 5202(1)-(2)).

128. *Palestine Liberation Organization*, 695 F. Supp. at 1465.

129. *Id.* at 1465. The PLO argued that application of the ATA would violate the Headquarters Agreement. The district court agreed and held that the ATA was



In reaching their decision, the district court analyzed the language of both the Headquarters Agreement and the ATA. It referred to the United States' past practice regarding the Headquarters Agreement and the interpretation each party gave to such agreement.<sup>130</sup> The district court reasoned Congress did not clearly express its intention to abrogate the Headquarters Agreement because neither the Mission nor the Headquarters Agreement was mentioned in the ATA. It stated, "[s]uch an inclusion would have left no doubt as to Congress' intent on the matter which had been raised repeatedly with respect to this act, and its absence here reflects equivocation and avoidance, leaving the court without clear interpretive guidance in the language of the act."<sup>131</sup>

*Palestine Liberation Organization* is a glaring illustration of the efforts a court will exert to harmonize a treaty with the subsequent enactment of a statute, without applying the later-in-time rule to override the treaty.<sup>132</sup>

Up to this point, this article has examined statutory overrides of treaty provisions in the context of "domestic dependent nations," commerce with Indian nations, immigration, and trade with foreign nations.<sup>133</sup>

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"inapplicable to the PLO Mission to the United Nations." *Id.* at 1466-68.

130. *Id.* at 1466-68, 1471. The district court noted that in the forty years since the United States had accepted the Headquarters Agreement, it had taken numerous "actions consistent with its recognition of a duty to refrain from impeding the functions of observer missions to the United Nations." *Id.* at 1466. Further, after the PLO was asked to establish a permanent observer mission, the Department of State took the position that it was required to grant access to the United Nations by the PLO. *Id.* (citations omitted). The district court reasoned that the ATA's language that it should apply "notwithstanding any provision of law to the contrary[.]" did not apply "notwithstanding any treaty." *Id.* at 1468. The district court also thought it was important that the Department of State, part of the Executive Branch, took the position that the Headquarters Agreement should remain effective when petitioned by Congress to remove the PLO from the U.N. headquarters in New York. *Id.* at 1466.

131. *Id.* at 1468.

132. See generally Curtis A. Bradley, *The Charming Betsy Canon and Separation of Powers: Rethinking the Interpretive Role of International Law*, 86 *Geo. L.J.* 479 (1998) (providing a thorough examination *The Charming Betsy* doctrine).

133. *Taylor v. Morton*, 23 F. Cas. 784 (Curtis, Circuit Justice, C.C.D. Mass. 1855) (involving the domestic override of a treaty in the context of Congress' power to regulate commerce with foreign nations); *The Cherokee Tobacco*, 78 U.S. 616 (1870) (involving the statutory override of a treaty with a "domestic dependent nation" and pursuant to Congress' power to regulate commerce with Indian Nations); *Chew Heong v. United States*, 112 U.S. 536 (1884) (involving Congress' power over immigration); *Edye v. Robertson*, 112 U.S. 580 (1884) (involving Congress' power over immigration); *Whitney v. Robinson*, 124 U.S. 190 (1888) (involving Congress' power to regulate commerce with foreign nations); *Chae Chan Ping v. United States*,

However, the issue of domestic law overriding treaty provisions also arises in the context of the Internal Revenue Code and tax conventions.

## VI. TREATY OVERRIDES AND THE INTERNAL REVENUE CODE<sup>134</sup>

Initially, the Code declared treaty obligations prevailed over domestic tax laws; “[i]ncome of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.”<sup>135</sup> However, in the 1962 Revenue Act, Congress changed how treaty obligations would be treated for domestic tax purposes when it provided that “[s]ection 7852(d) of the Internal Revenue Code of 1954 (relating to treaty obligations) shall not apply in respect to any amendment made by this Act.”<sup>136</sup> At this time, the United States had an estate tax treaty with Greece which included a real estate exemption provision that was in conflict with the 1962 Revenue Act.<sup>137</sup> The conflict never became an issue because the effective date of the domestic tax law was deferred for two years, allowing for the renegotiation of the treaty.<sup>138</sup>

The Code further gave treaties preference over domestic law through the Foreign Investors Tax Act of 1966; “[n]o amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States.”<sup>139</sup> However, favorable treatment was short

130 U.S. 581 (1889) (involving Congress’ power over immigration).

134. Hereinafter referred to as the “Code.”

135. IRC §§ 894(a), 7852(d) (1954) (“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.”).

The Code’s former treatment of treaty obligations should be contrasted with how the Internal Revenue Service currently views such obligations; now the Code applies “to any taxpayer with due regard to any treaty obligation . . . which applies to such taxpayer.” IRC § 894(a). The 1954 language was changed in 1988, and allows Congress to give due regard to any treaty obligation and still tax an item that is exempt from taxation under the treaty. Also in 1988, the House of Representatives amended § 7852(d) and officially adopted the later-in-time doctrine therein. *Overriding Tax Treaties*, supra note 7, at 80-81; § 7852(d) (1988) (“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.”).

136. The Revenue Act of 1962, Pub. L. No. 87-834 § 31, 76 Stat. 960, 1069 (1962).

137. H.R. Rep. No. 2508, 87th Cong., 2d Sess. 48 (1962), *reprinted in* 1962 U.S.C.C.A.N. 3732, 3771; Sachs, supra note 51, at 870-71.

138. *Id.*

139. Foreign Investors Tax Act of 1966, Pub. L. No. 89-809 § 110, 80 Stat.

lived.

The Tax Reduction Act of 1975 reduced the amount of credit to income arising from foreign oil and gas.<sup>140</sup> This Act failed to state whether it was to apply notwithstanding any conflicting treaty obligations. The House and the Senate failed to provide for such application in the legislative history, but the Service ruled that these changes would override any conflicting treaty provisions.<sup>141</sup> Furthermore, the Tax Reform Act of 1976 gave preference to domestic tax laws over treaty obligations.<sup>142</sup>

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1539, 1575 (1966).

140. Tax Reduction Act of 1975, Pub. L. No. 94-12 § 601, 89 Stat. 26, 54-58 (1975). Section 907(a) provided for a reduction in the amount of credit allowed under § 901, which gives a credit to foreign oil and gas income. *Id.* at § 601(d)(1)–(2). During this time period, the unemployment rate was rising and the economy was declining. *Id.* at § 501. The purpose of this amendment was, *inter alia*, to counteract the aforementioned negative factors by stimulating the economy, while creating jobs. *Id.*

141. Sachs, *supra* note 51, at 871; Rev. Rul. 80-223, 1980 C.B. 217 (1980) (“§§ 901(f) and 907 of the Code by the 1975 Act supersede inconsistent provisions of all income tax treaties, those in effect on the date of the enactment of the 1954 Code as well as those in effect after this date.”).

142. Tax Reform Act of 1976, Pub. L. No. 94-455 § 1031, 90 Stat. 1520, 1620-24 (1976); Sachs, *supra* note 51, at 871. The Service took the position that § 1031 of the Tax Reform Act of 1976, which amended Code § 904(a) to provide that the limitation on the foreign tax credit shall be computed using only the overall method, overrides the foreign tax credit per-country limitation provided in United States income tax treaties. Rev. Rul. 80-201, 1980-2 C.B. 221 (1980); Sachs, *supra* note 51, at 872.

[T]he method for determining the limitation on foreign tax credits has taken a variety of forms over the years, having been computed based on a taxpayer’s overall foreign source income when first enacted in 1921, limited to the lesser of an overall or per-country amount in the 1930’s, 1940’s, and early 1950’s, and computed country by country in the latter half of the 1950’s. Beginning in 1960, taxpayers were given the option of an overall or per country limitation until 1976 when the per country limitation was repealed and the law returned to its 1921 shape. There it rested until 1986 when today’s system, which categorizes various types of income into so-called baskets for purposes of calculating the foreign tax limitation, came into effect. Whenever the limitation has changed, Congress has expressed concern with protecting the U.S. tax on U.S. source income from erosion.

Michael J. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 26 *Brook. J. Int’l L.* 1357, 1359-60 (2001) (citations omitted).

Throughout the last several decades, Congress promulgated a number of treaty overrides.<sup>143</sup>

A. *Congressional Treaty Overrides*<sup>144</sup>

The following is an exhaustive list of treaty overrides enacted during the past 45 years:

- A) *Revenue Act of 1962 – Section 27. Treaties.* Senate amendment No. 203: The bill as passed by the House provided section 7852(d) of the code, relating to treaty obligations, was not to apply in respect of any amendment made by the Revenue Act of 1962. Senate amendment No. 203 provides no provision of this Act will apply in any case where its application would be contrary to any treaty obligation of the United States;<sup>145</sup>
- B) *Foreign Investors Tax Act of 1966 – Section 110. Treaty Obligations.* The section provides no amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States. However, granting a benefit provided by an amendment made by this bill is not to be considered to be contrary to a treaty obligation. Thus, even though a nonresident alien or foreign corporation has a permanent establishment in the United States, income which is not effectively connected with this business is to be taxed at the applicable treaty rate rather than at the regular individual or corporate rate;<sup>146</sup>
- C) *Tax Reduction Act of 1975 – Section 601. Limitations On Foreign Tax Credit For Taxes Paid In Connection With Foreign Oil And Gas Income.* The Act was to amend the Internal Revenue Code of 1954 to provide for a refund of 1974 individual income taxes, to increase the low income allowance and the percentage standard deduction, to provide a credit for personal exemptions and a credit for certain earned

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143. Overriding Tax Treaties, *supra* note 7, at 83. Prior to the 1980s, statutory overrides of tax treaties were rare. Harry G. Gourevitch, *Tax Treaties: The Legislative Override Problem*, 93 *Tax Notes Int'l* 172-15 (1993).

144. See Anthony C. Infanti, *Curtailing Tax Treaty Overrides: A Call To Action*, 62 *U. Pitt. L. Rev.* 677, 682-683 (2001). This article contributed general information and citations for this list.

145. See *Revenue Act of 1962*, *supra* note 137.

146. See *Foreign Investors Tax Act of 1966*, *supra* note 135.

income, to increase the investment credit and the surtax exemption, to reduce percentage depletion for oil and gas, and for other purposes;<sup>147</sup>

- D) *Tax Reform Act of 1976 – Section 1031. Requirement That Foreign Tax Credit Be Determined On Overall Basis.* The Senate Finance Committee provided it was the Committee's understanding that the per-country limitation was not required under the provisions of any recent income tax treaty between a foreign country and the United States. It was the committee's intent for consistent application of all existing treaties with this amendment by using the overall limitation in computing the allowable foreign tax credit. The committee further intends that, as was the case with other recent legislation modifying the foreign tax credit. The amendments made by the committee's bill are to be used in computing the credit allowed under all treaties;<sup>148</sup>
- E) *Foreign Investment in Real Property Tax Act of 1980 – Section 1445 Concerning disposition of United States Real Property Interest. – Gains, profits, and income from the disposition of a United States real property interest (as defined in section 897 (c)). Section 1125 (c). Special Rule for Treaties.* Except as provided in paragraph (2), after December 31, 1984 nothing in section 894(a) or 7852(d) of the Internal Revenue Code of 1954 or in any other provision of law shall be treated as requiring, by reason of any treaty obligation of the United States, an exemption from (or reduction of) any tax imposed by section 871 or 882 of such Code on a gain described in section 897 of such Code;<sup>149</sup>
- F) *Tax Reform Act of 1984 – Section 127 Repeal of 30% tax on portfolio interest paid to foreign persons.* Payments of passive income (interest, dividends, royalties, etc.) to foreign persons generally are subject to a 30% U.S. withholding tax if the payments are not effectively connected with a U.S. trade or business conducted by the foreign person. Exemptions from the tax are provided in certain situations. Some U.S. tax treaties reduce the tax. Some treaties eliminate the tax. The conference agreement generally repeals the 30% withholding tax on interest paid on portfolio indebtedness by U.S. borrowers to nonresident alien individuals and foreign corporations;<sup>150</sup>

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147. See Tax Reduction Act of 1975, *supra* note 139.

148. See Tax Reform Act of 1976, *supra* note 141.

149. See Foreign Investment in Real Property Tax Act of 1980, *infra* note 157.

150. See Tax Reform Act of 1984, *infra* note 161.

- G) *Tax Reform Act of 1986* – Section 1241 *Branch-level interest tax*. This section states any interest paid by a branch’s U.S. trade or business is U.S. source and subject to U.S. withholding tax of 30%, unless the tax is reduced or eliminated by a specific Code or treaty provision. For purposes of determining whether the tax on the excess interest is to be reduced or eliminated by treaty, the applicable treaty generally is any income tax treaty between the United States and the country of the corporation’s home office. However, any treaty benefits available in this case are subject to the agreement’s prohibition against treaty shopping. The conference agreement generally follows the Senate amendment in providing that existing U.S. income tax treaties may modify, reduce, or eliminate the branch profits tax, the second-level withholding tax on dividends, or the branch-level tax on interest except in cases of treaty shopping;<sup>151</sup>
- H) *Technical and Miscellaneous Revenue Act of 1988* – Section 1012 (aa). *Coordination with Treaties. (2) Certain Amendments To Apply Notwithstanding Treaties*. This section provides in part the following amendments made by the Reform Act “apply notwithstanding any treaty obligation of the United States in effect on the date of the enactment of the Reform Act. (A) The amendments made by section 1201 of the Reform Act, and (B) The amendments made by title VII of the Reform Act to the extent such amendments relate to the alternative minimum tax foreign tax credit;”<sup>152</sup>
- I) *Omnibus Budget Reconciliation Act of 1989* – Section 7210. *The Earnings Stripping Rules*. Section 7403. *Information With Respect To Certain Foreign-Owned Corporations*. (a) *25% Foreign-Owned Corporations Required to Report*. Section 7815(d)(14). *The Estate Tax Marital Deduction For Non-Citizen Spouses*;<sup>153</sup>
- J) *Omnibus Budget Reconciliation Act of 1993* – Section 13238. *Authorizing the promulgation of regulations re-characterizing multiple-party financing transactions*;<sup>154</sup>

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151. See Tax Reform Act of 1986, *infra* note 167.

152. Technical and Miscellaneous Revenue Act of 1988, Pub L No 100-647 § 1012, 102 Stat. 3342, 3531 (1988). See TAMRA *infra* note 171.

153. See Omnibus Budget Reconciliation Act of 1989, *infra* note 194.

154. See Omnibus Budget Reconciliation Act of 1993, *infra* note 195.

- K) *Health Insurance Portability and Accountability Act of 1996* – Section 511. Taxation of expatriates;<sup>155</sup>
- L) *Taxpayer Relief Act of 1997* – Section 1054(a). Denial of Treaty Benefits For Certain Payments Through Hybrid Entities. A foreign person shall not be entitled under any income tax treaty of the United States with a foreign country to any reduced rate of any withholding tax imposed by this title on an item of income derived through an entity which is treated as a partnership for purposes of this title if – (A), (B), & (C) of the title are raised;<sup>156</sup>
- M) *American Jobs Creation Act of 2004* – Section 801(a). Anti-Inversion Provision. Section 804. Taxation of Expatriates.<sup>157</sup>

The Foreign Investments in Real Property Tax Act of 1980 (hereinafter “FIRPTA”) authorized the United States to tax non-residents on the sale of U.S. real property, and on the gain from the sale of shares in certain U.S. real property holding corporations.<sup>158</sup> Notably, most treaties entered into with the United States specifically exempted foreigners from gain on domestic stock.<sup>159</sup> However, FIRPTA expressly provided,

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155. See Health Insurance Portability and Accountability Act, *infra* note 199.

156. See Taxpayer Relief Act of 1997, *infra* note 202.

157. American Jobs Creation Act of 2004, Pub L No 108-357 § 804, 118 Stat. 1418, 1565, 1569-73 (2004). See also *supra* note 172.

158. Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, § 1121, 96 Stat. 2682 § 1121, 94 Stat. 2599 (1980). Section 1122 of FIRPTA amended the 1954 Code to include a new section, § 897. *Id.* Section 897 taxes non-resident aliens or foreign corporations on the gains upon the dispositions of direct or indirect interests in United States real property. *Id.* A report from the Senate Finance Committee is instructed on the Act’s purpose, noting that the Finance Committee

believes that it is essential to establish equity of tax treatment in U.S. real property between foreign and domestic investors. The committee does not intend by the provisions of this bill to impose a penalty on foreign investors or to discourage foreign investors from investing in the United States. However, the committee believes that the United States should not continue to provide an inducement through the tax laws for foreign investment in U.S. real property which affords the foreign investor a number of mechanisms to minimize or eliminate his tax on income from the property while at the same time effectively exempting him from U.S. tax on the gain realized on disposition of the property.

S. Rep. No. 96-499, at 8-9 (1979).

159. Doernberg, *super* note 7, at 83.

nothing in section 894(a) or 7852(d) of the Internal Revenue Code of 1954 or in any other provision of law shall be treated as requiring, by reason of any treaty obligation of the United States, an exemption from (or any reduction of) any tax imposed by section 871 or 882 of such Code on a gain described in section 897 of such Code.<sup>160</sup>

FIRPTA had a clear expression of congressional intent to override any prior inconsistent treaty provisions. However, a five year delayed effective date allowed the Treasury Department to renegotiate treaties containing conflicting tax-exemption provisions.<sup>161</sup>

Section 269B was enacted with the passage of the Tax Reform Act of 1984.<sup>162</sup> Under section 269B, the stock of a foreign corporation was “stapled” to the stock of a domestic corporation because a shareholder could not buy or sell the stock of one corporation without buying or selling the stock of the other.<sup>163</sup> Section 269B superseded tax treaty provisions which conferred tax-exempt status, under domestic law, on corporations from the partner nation of the treaty.<sup>164</sup> Moreover, section 904(g), added by section 121(a) of the Act, re-characterizes “the source of certain United States-owned foreign corporations.”<sup>165</sup> Section 7701(b), also enacted as part of the Act, orders an alien individual to be taxed as a U.S. resident, under certain

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160. Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, § 1125(c), 94 Stat. 2690 (1980). Recall that § 894(a) and § 7852(d) of the 1954 Code mandated that treaty obligations shall prevail over domestic tax laws. IRC §§ 894(a); 7852(d) (1954); *supra* note 124.

161. Gourevitch, *supra* note 142, at 2; *Overriding Tax Treaties*, *supra* note 7, at 83.

162. Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (1984); Gourevitch, *supra* note 142, at n.2.

163. Pub. L. 98-369 § 136, 98 Stat. 669–72 (1984).

164. Gourevitch, *supra* note 142, at 2; § 269B(d); Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 1175 (1984). If the foreign corporation has a permanent establishment in the United States, it would then be subject to U.S. taxation.

165. Sachs, *supra* note 51, at 872. Section 904(g), “provided that interest, dividends and certain other payments by a U.S. owned foreign corporation are to be treated in the hands of the recipient as U.S. source rather than foreign source income to the extent the payments are attributable to income of the U.S. owned foreign corporations from U.S. sources.” Gourevitch, *supra* note 142. Following enactment, it was not clear whether § 904(g) was to prevail over inconsistent treaty provisions; however, this was resolved “in the Tax Reform Act of 1986 and related Senate Finance Committee report which retroactively expressed a congressional intent that [the] initially inadvertent statutory changes [of §§ 904(g) and 7701(b)] were to override inconsistent tax treaties.” *Id.*



circumstances, thus conflicting with definitions of what constitutes a U.S. resident under the terms of a treaty.<sup>166</sup> Congress still determined these conflicting treaty provisions should triumph over the domestic law definition.<sup>167</sup>

Additionally, the Tax Reform Act of 1986 contained further provisions affecting international commerce.<sup>168</sup> The Act added Code section 865, which taxes a nonresident maintaining an office or other fixed place of business in the United States, on “any sale of personal property (including inventory property) attributable to such office or other fixed place of business . . .”<sup>169</sup> If the nonresident does not maintain an office or other fixed place of business in the U.S., the taxpayer is not subject to U.S. taxation because the source of his or her income is the country of residence.<sup>170</sup>

Section 904(d) increased “the number of separate categories of foreign source income for purposes of the foreign tax credit limitation.”<sup>171</sup> This expansion conflicts directly with tax treaties; however, there is no congressional expression as to whether domestic law or the conflicting treaty provisions are to prevail in the event of a conflict.<sup>172</sup> In 2004, as part of the American Jobs Creation Act, Congress amended section 904(d),<sup>173</sup> limiting

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166. Gourevitch, *supra* note 142.

167. See Staff of Joint Committee on Taxation, 98th Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 468 (Comm. Print 1985) (“[A]n alien who is a resident of the United States under the new statutory definition but who is a resident of a treaty partner of the United States (and not a resident of the United States) under a U.S. income tax treaty is eligible for the benefits that the treaty extends to residents of the treaty partner.”)

168. IRC § 1, 11, 38, 46-48 (1986). “The 1986 Act lowered individual and corporate income tax rates, and reduced total expected tax payments from individuals while increasing those from corporations. Familiar features of the Internal Revenue Code like the investment tax credit and full deductibility of contributions into individual retirement accounts (IRAs) disappeared. Many new provisions appeared, such as the passive loss limitation rule aimed at curbing tax shelters.” Richard L. Doernberg & Fred S. McChesney, *Doing Good or Doing Well? Congress and the Tax Reform Act of 1986*, 62 N.Y.U. L. Rev. 891, 891 (1987). (citations omitted)

169. IRC § 865(e)(2)(A).

170. *Id.*

171. Gourevitch, *supra* note 142.

172. *Id.* Congress enacted the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (1988), (hereinafter TAMRA) to retroactively express its intent that the changes made to § 904(d) in the Tax Reform Act of 1986 were to override inconsistent treaties. Gourevitch, *supra* note 142 (citing H.R. Rep. No. 100-1104 at 204-206 (1988) (Conf. Rep.) The Tax Reform Act of 1986 “also limited the alternative minimum foreign tax credit to 90% of the tentative U.S. alternative minimum tax.” Gourevitch, *supra* note 142.

173. P.L. 108-357, §404(a), 118 Stat. 1418, 1494 (2004) (Hereinafter

foreign source categories to either the passive income category or the general income category. Despite the re-characterization of the categories, the definition of “passive category income” as contained in section 904(d)(2),<sup>174</sup> may still conflict with international treaty provisions.

Internal Revenue Code sections 884(a) and (f), known as the branch profits tax, were also enacted as part of the Tax Reform Act of 1986.<sup>175</sup> The

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American Jobs Creation Act].

174. Passive income “means any income received or accrued by any person which is of a kind which would be a foreign personal holding company income (as defined in § 954(c)). IRC § 904(d)(2)(B)(i).

175. Pub. L. No. 99-514, § 1241(a), 100 Stat. 2285, 2576 (1986). Before the branch profits tax,

a foreign corporation owned by foreign investors and doing business in the United States was taxed at the corporate level under the regular graduated corporate rates on income effectively connected with a U.S. trade or business. If the foreign investors operated in the United States through a domestic corporation, the outcome was the same. Differences in treatment arose when the corporation distributed its corporate earnings to foreign investor-owners.

Doernberg, *supra* note 7, at 84. (citations omitted). At this time, dividends paid by foreign corporations to foreign investors were rarely subject to U.S. taxation because many treaties exempted such dividends paid by foreign corporations to non-U.S. residents. *Id.* at 84-85. In contrast, dividends paid by domestic corporations to non-U.S. residents were subject to a 30% tax. See §§ 871(a)(1) (withholding tax on nonresident alien individuals) 881(a) (withholding tax on non resident alien corporations). The resulting effect was that domestic corporations were subject to two levels of taxation while foreign corporations were subject to only one level of taxation.

IRC § 884(a), the branch profits tax on earnings, imposes “on any foreign corporation a tax equal to 30% of the dividend equivalent amount for the taxable year.”). Section 884(f)(1), the branch profits tax on interest provides:

In the case of the foreign corporation engaged in a trade or business in the United States (or having gross income treated as effectively connected with the conduct of a trade or business in the United States), for purposes of the subtitle – (A) any interest paid by such trade or business in the United States shall be treated as if it were paid by a domestic corporation, and (B) to the extent that allocable interest exceeds the interest described in subparagraph (A), such foreign corporation shall be liable for tax under § 881(a) in the same manner as if such excess were interest paid to such foreign corporation by a wholly owned domestic corporation on the last day of such foreign corporation’s taxable year. the amount of interest allowable as a deduction under § 882 in computing the effectively connected taxable income of such foreign corporation

branch profits tax has specific provisions dealing with treaty obligations. Section 884(e) limits the effect of an income tax treaty provision, “[n]o treaty between the United States and a foreign country shall exempt any foreign corporation from the tax imposed by subsection (a) (or reduce the amount thereof) unless . . . such treaty is an income tax treaty, and . . . such foreign corporation is a qualified resident of such foreign country.”<sup>176</sup> A similar

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exceeds the interest described in subparagraph (A), such foreign corporation shall be liable for tax under § 881(a) in the same manner as if such excess were interest paid to such foreign corporation by a wholly owned domestic corporation on the last day of such foreign corporation’s taxable year.

See Doernberg, *supra* note 7, at 85 (providing a comprehensive analysis of the branch profits tax on interest). The purpose of the branch profits tax is to subject foreign corporations to two levels of taxation, just as domestic corporations are taxed at two levels – the corporate level (with a maximum rate of 35%) and the shareholder level (with a maximum rate of 35%). See *id.* Under the branch profits scheme, the foreign corporation’s income is taxed at the corporate rate when it is earned and then the foreign corporation is taxed again, the branch profits tax, when the income is repatriated by the foreign corporation. *Id.* The effect is to treat foreign corporations equally as domestic corporations. *Id.* However, the branch profits tax is levied solely upon the corporation and not the shareholder.

There are special rules for when a domestic corporation makes a distribution to a non-U.S. resident and foreign corporation. Dividends received by non-resident shareholders are subject to a 30% tax. Sections 871(a)(1) (imposing “a tax of 30% of the amount received from sources within the United States by a nonresident alien individual”); § 881(a) (imposing “a tax of 30% of the amount received from sources within the United States by a foreign corporation”). Section 1441(a) lays out the general withholding rule:

all persons, in whatever capacity acting (including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States) having the control, receipt, custody, disposal, or payment of any of the items of income specified in subsection (b) (to the extent that any of such items constitutes gross income from sources within the United States), of any nonresident alien individual or of any foreign partnership shall . . . deduct and withhold from such items a tax equal to 30% thereof, except that in the case of any item of income specified in the second sentence of subsection (b), the tax shall be equal to 14% of such item.

Section 1441(b) covers items such as interest, “dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income . . .” Section 1442(a) states that “[i]n the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in § 1441 a tax equal to 30% thereof.”

176. For § 884(e)(1) purposes, “qualified resident”

means, with respect to any foreign country, any foreign

requirement in section 884(f)(3) states “no benefit under any treaty between the United States and the foreign country of which such corporation is a resident shall apply unless . . . such treaty is an income tax treaty, and . . . such foreign corporation is a qualified resident of such foreign country.” However, there is an exception to these two provisions, making them inapplicable where a foreign corporation is engaged in treaty shopping.<sup>177</sup>

Despite seeming to pay respect to treaty obligations in regards to tax treaties and qualified residents, the branch profits tax, in fact, overrides other provisions.<sup>178</sup> One such provision is the non-discrimination requirement, requiring foreign entities to receive the same tax treatment as domestic entities engaged in the same activities.<sup>179</sup> Domestic corporations do not pay a branch profits tax rather, they are taxed at the corporate level when they earn income, and shareholders are taxed in their individual brackets when they receive distributions.<sup>180</sup> In contrast, foreign corporations are taxed at the corporate level when they earn income and are taxed again, with the branch profits tax, on distributions to foreign shareholders.<sup>181</sup> Therefore, non-discrimination provisions are violated because foreign corporations receive

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corporation which is a resident of such foreign country unless (1) 50% or more (by value) of the stock of such foreign corporation is owned . . . by individuals who are not residents of such foreign country and who are not United States citizens or resident aliens, or (ii) 50% or more of its income is used (directly or indirectly) to meet liabilities to persons who are not residents of such foreign country or citizens or residents of the United States.

IRC § 884(e)(4)(A). It is important to note that the term “qualified resident” is defined under U.S. domestic law and not under the negotiated terms of the treaty.

177. Section 884(e)(4)(D). Gourevitch, *supra* note 142. The definition of “qualified resident” in § 884(e) “prevents non-treaty country foreign investors from treaty shopping by capitalizing a treaty corporation with a large amount of debt while residents of the treaty country hold shares of the corporation having little or no value.” Section 884(e)(4)(A) (1986); *Overriding Tax Treaties*, *supra* note 7, at 90. To fall under the terms of that definition, a foreign treaty corporation must use 50% or less of “its income . . . to meet liabilities to persons who are not residents of the treaty country or the United States.” Section 884(e)(4)(A)(ii) (1986).

178. See Doernberg, *supra* note 7, at 88-90.

179. *Id.*, at 88 (explaining and applying the non-discrimination provision).

180. See IRC § 11 (relating to Subchapter C corporate tax rates); 301 (relating to taxation of Subchapter C corporate shareholders upon corporate distributions).

181. Section 884(a) imposes a 30% tax on the “dividend equivalent amount.” Section 884(b) defines “dividend equivalent” amount as the foreign corporation’s effectively connected earnings and profits, with some U.S. net equity adjustments. Therefore, if a foreign owned corporation pulls profits out of its U.S. business they will incur the branch profits tax.

unfavorable tax treatment in comparison to domestic corporations. Congress, however, does not believe that foreign corporations are taxed unfavorably because foreign corporations and their shareholders are taxed “no worse than U.S. corporations and their shareholders . . . .”<sup>182</sup>

The Technical and Miscellaneous Revenue Act of 1988 (“TAMRA”) continued the Code’s trend of placing domestic law in a superior position to treaty obligations.<sup>183</sup> First, TAMRA was expressly provided to apply, notwithstanding any treaty obligation of the United States.<sup>184</sup> TAMRA also codified the later-in-time doctrine by amending section 7852(d) to read, “[f]or 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 a law.”<sup>185</sup> An equally significant change commanded by TAMRA, was the amendment of section 894(a) to read “[t]he provisions of this title shall be applied to any taxpayer *with due regard* to any treaty obligation of the United States which applies to such taxpayer.”<sup>186</sup> Prior to 1988 and TAMRA, section 894(a) gave preference to treaty obligations over domestic tax laws.<sup>187</sup> TAMRA also added section 6114, which required a taxpayer to disclose on his tax return his reliance on a treaty provision superseding a domestic tax statute.<sup>188</sup>

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182. Id. (citing Staff of J. Comm. on Tax’n, 99th Cong., General Explanation of the Tax Reform Act of 1986, at 1038 (Comm. Print 1987); Tim N. Vettel, Branch-Level Tax and Treaty Overrides, 35 Tax Notes 632, 633 (1987)). “[S]ince U.S. corporations are taxed on their earnings, and U.S. shareholders of such corporations are taxed on dividend distributions, it is not discriminatory to subject foreign corporations and their shareholders to two taxes – one on a corporation’s earnings and the other on the repatriation of those earnings.” Overriding Tax Treaties, *supra* note 7, at 89 (providing an analysis of the non-discrimination provisions found in many treaties and their relationship with the branch profits tax).

183. TAMRA, *supra* note 171.

184. Pub. L. No. 100-647, § 1012, 102 Stat. 3531 (1988).

185. IRC § 7852(d) (1988). The Senate noted that the amendment to § 7852(d) was intended to codify the judicial doctrine of the later-in-time rule and was not meant “to alter the initial presumption of harmony between . . . earlier treaties and later statutes.” Overriding Tax Treaties, *supra* note 7, at 80. S. Rep. No. 445 at 376-77 (1988), *as reprinted in* U.S.C.C.A.N. 4515, 4829-33. Prior to TAMRA, § 7852(d) gave preference to treaty obligations over domestic tax statutes, “[n]o 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.” Section 7852(d) (1954).

186. IRC § 894(a) (1988) (emphasis added).

187. IRC § 894(a) (1954). Before TAMRA, § 894(a) read, “[i]ncome of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.”

188. TAMRA, *supra* note 171 at § 1012(aa)(3). Section 6114 requires:

In 1989, treaty obligations further lost ground to domestic tax statutes within the Code. The Omnibus Budget Reconciliation Act of 1989 continued the trend, as seen by FIRPTA, the Tax Reform Acts of 1984 and 1986, and TAMRA, by amending section 6038A to require foreign-owned domestic corporations to file reports with the Secretary of the Treasury.<sup>189</sup>

The Revenue Reconciliation Act of 1989 enacted section 163(j), the earnings stripping provision.<sup>190</sup> This section denies a corporation an interest deduction for interest payments made to a related tax-exempt entity. The deduction is denied only if the corporation has an “excess interest expense”<sup>191</sup> at the end of the year.<sup>192</sup> The earnings stripping provision

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[e]ach taxpayer who, with respect to any tax imposed by this title, takes the position that a treaty of the United States overrules (or otherwise modifies) an internal revenue law of the United States shall disclose (in such manner as the Secretary may prescribe) such position . . . on the return of tax for such tax (or any statement attached to such return), or . . . if no return of tax is required to be filed, in such form as the Secretary may prescribe.

IRC § 6114(a) (1988).

189. Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7403, 103 Stat. 2106, 2358-61 (1989). According to the Senate report, § 6038A “should not violate any treaty, but if it did, the statutory provision should prevail.” Sachs, *supra* note 51, at 874.

190. IRC § 163(j) (1989).

191. Excess interest expense is defined as the excess of the corporation’s net interest expense less the sum of 50% of the adjusted taxable income of the corporation plus any excess limitation carry forward (as defined by IRC § 163(j)(2)(B)(ii).

192. Section 163(j) (1989); see *Overriding Tax Treaties*, *supra* note 7, at 92-95 (providing a comprehensive examination of § 163(j)). Before the earnings stripping provision, a corporation could limit its tax liability by borrowing from a related foreign lender; thus generating interest deductions on a transaction which, economically, is otherwise a wash. *Overriding Tax Treaties*, *supra* note 7, at 92.

Congress was concerned that taxable U.S. corporations were limiting their tax liabilities by taking interest deductions for payments to lenders who were exempt from U.S. taxation. The provision [§ 163(j)] is aimed primarily at interest payments from U.S. subsidiaries to foreign parent corporations when such parent corporations are not subject to U.S. taxation on the interest received, because the interest is not income effectively connected with a U.S. trade or business. Code § 163(j) also applies to interest payments from corporations related to U.S. tax-exempt corporations, such as charitable foundations.

*Id.* (citing IRC § 882 (1998)). Under most treaties, in regards to receiving interest payments, exclusive taxing jurisdiction is given to the country in which the lender resides.

seemingly violates non-discrimination provisions in treaties by allowing certain interest payments to related U.S. lenders, while denying the same payments to foreign lenders.<sup>193</sup> Congress naturally takes the position that the earnings stripping provision does not violate non-discrimination provisions found in treaties.<sup>194</sup>

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Section 163(j) operates, under certain circumstances, to deny an interest deduction for interest payments made to a related tax-exempt party. IRC § 163(j) (1989). It is known as the earnings stripping provision “because it prevents shareholders from using deductible interest payments to ‘strip’ a corporation of its earnings.” Julie A. Roin, *Adding Insult to Injury: The “Enhancement” of § 163(j) and the Tax Treatment of Foreign Investors in the United States*, 49 *Tax L. Rev.* 269, 270 (1994). A related tax-exempt party includes:

[a]n individual and a corporation more than 50% in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual; . . . [t]wo corporations which are members of the same controlled group; . . . [a] person and an organization to which § 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual; . . . [a] corporation and a partnership if the same persons own . . . more than 50% in value of the outstanding stock of the corporation, and . . . more than 50% of the capital interest, or the profits interest, in the partnership . . . .

IRC § 267(b) (1989).

193. IRC § 163(j)(3); Richard L. Doernberg & Kees van Raad, *The Legality of the Earnings Stripping Provision under U.S. Income Tax Treaties*, 35 *Tax Notes* 793 (1987). Within a non-discrimination clause, there are typically two provisions, “[t]he first provides that a treaty partner shall not impose more burdensome taxes on a company controlled by residents of the other treaty country than are imposed on other domestic companies” and “[t]he other provides that interest and other payments by a domestic corporation to a corporation resident in the other treaty country shall be deductible under the same conditions as if they had been made to another domestic corporation.” *Gourevitch*, *supra* note 142, at 4 (citations omitted). The earnings stripping provision violates the deductibility clause, the second provision; foreign corporations are denied a deduction for certain interest payments made to related parties while domestic corporations are allowed the deduction for the same payment made to a domestic lender. *Id.*, *Overriding Tax Treaties*, *supra* note 7, at 93.

194. H.R. Conf. Rep. to the Omnibus Budget Reconciliation Act of 1989, *cited in* [1995 Binder] 953 *Stand. Fed. Tax. Rep.* (CCH) ¶ 9102 at 23,528; *Gourevitch*, *supra* note 142 (citing 136 *Cong. Rec. S.* 15629 (1990)). According to Congress, the earnings stripping provision does not discriminate because it treats “similarly situated persons similarly.” *Overriding Tax Treaties*, *supra* note 7, at 101 (citing H.R. Conf. Rep. to the Omnibus Budget Reconciliation Act of 1989, *cited in* [1995 Binder] 953 *Stand. Fed. Tax. Rep.* (CCH) ¶ 9102 at 23,528). However, the deductibility portion of non-discrimination provisions require “interest and other

Once again, in line with the Code's discriminatory treatment of treaty obligations, the Omnibus Budget Reconciliation Act of 1993 ("OBRA 1993") provided for the statutory override of such obligations with its amendment to section 7701(l).<sup>195</sup> Following OBRA 1993, section 7701(l) provides that "[t]he Secretary may prescribe regulations re-characterizing any multiple-party financing transaction as a transaction directly among any 2 or more of such parties where the Secretary determines that such re-characterization is appropriate to prevent avoidance of any tax imposed by this title."<sup>196</sup> This allows the Service to deny treaty benefits to the nominal recipient of a payment who "is not the 'beneficial owner.'"<sup>197</sup> OBRA 1993 also amended section 163(j)(3)(B) to deny an interest deduction, under section 163, for interest payments made by a domestic corporate borrower to an unrelated lender if the loan repayment was guaranteed by a foreign party related to the borrower.<sup>198</sup>

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payments by a [foreign-owned] domestic corporation to a corporation resident in the other treaty country shall be deductible under the same conditions as if they had been made to another domestic corporation." Gourevitch, *supra* note 142, at 4 (citations omitted). Therefore, the non-discrimination provision is not satisfied in light of Congress' reasoning that there is no discrimination because the § 163(j) treats similarly situated persons similarly. H.R. Conf. Rep. to the Omnibus Budget Reconciliation Act of 1989, *cited in* [1995 Binder] 953 Stand. Fed. Tax. Rep. (CCH) ¶ 9102 at 23,528).

If, in analyzing for discriminatory treatment one compares the same lender, only changing its country of residence, the earnings stripping provision violates a non-discrimination provision. *Id.* at 97. If one compares a tax-exempt entity in the United States to a tax-exempt entity in a foreign country, as Congress seemingly does, there is no discrimination. *Id.* at 97, 101 (citing H.R. Conf. Rep. to the Omnibus Budget Reconciliation Act of 1989, *cited in* [1995 Binder] 953 Stand. Fed. Tax. Rep. (CCH) ¶ 9102 at 23,528); Gourevitch, *supra* note 142, at 4 (citing 136 Cong. Rec. S. 15629 (1990)).

195. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 508 (1993).

Before OBRA 1993, there was an Omnibus Budget Reconciliation Act of 1990, which added § 6038C to the Code. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11315(a), 104 Stat. 1388, 1456-58 (1990). Congress expressed an opinion that this Act did not override any treaty positions and failed to indicate the consequences if such a conflict were to exist. Sachs, *supra* note 51, at 874 (citing H.R. Rep. No. 101-881 at 325-26 (1990)).

196. IRC § 7701(l) (1993).

197. Overriding Tax Treaties, *supra* note 7, at 111, n. 144.

198. IRC § 163(j)(3)(B) (1993). Prior to this amendment, a corporation could deduct interest payments to an unrelated tax-exempt lender for a loan which is guaranteed by a third party that is related to the borrower. Overriding Tax Treaties, *supra* note 7, at 102. Corporations would take advantage of this loop-hole and take



The Health Insurance Portability and Accountability Act of 1996 followed suit by amending its expatriation tax provisions to expand and substantially strengthen the present-law provisions targeting U.S. citizens who lose their citizenship for tax avoidance purposes.<sup>199</sup> The House bill affirmed that “it is intended that the purpose of the expatriation tax

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interest deductions by having the U.S. subsidiary finance through an unrelated lender with the foreign parent corporation guaranteeing the loan. For example,

USCO, a U.S. corporation, borrows money from FORBANK, a foreign bank unrelated to USCO. Interest payments from USCO to FORBANK are not subject to Code § 163(j). Suppose, instead, that USCO’s foreign parent, FORCO guarantees the loan from FORBANK. Prior to OBRA 1993, as long as USCO paid interest to FORBANK, the interest would have been deductible.

Id. at 102-03. The OBRA 1993 amendment to § 163(j)(3)(B) intended to end this type of behavior. Id. Congress determined that “[a]lthough the interest on guaranteed debt is paid to an unrelated lender, the debt serves as a substitute for a direct related party loan to the extent that money is fungible.” Id. (quoting Committee on Ways and Means, Fiscal Year 1994 Budget Reconciliation Recommendations of the Committee on Ways and Means, WMCP Doc. No. 11, 103d Cong., 1st Sess. 244-45 (May 18, 1993)). Congress reasoned “[a]n affiliated group requires funding for all of its activities and assets, and has flexibility as to the source and use of its funds. Even money borrowed for a specific purpose frees up funds for other purposes.” Id. (quoting Committee on Ways and Means, Fiscal Year 1994 Budget Reconciliation Recommendations of the Committee On Ways and Means, WMCP Doc. No. 11, 103d Cong., 1st Sess. 244-45 (May 18, 1993)).

199. Health Insurance Portability and Accountability Act, H.R. Conf. Rep. 104-736, 1996 U.S.C.C.A.N. 1990, 2136.

First, the House bill extends the expatriation tax provisions to apply not only to U.S. citizens who lose their citizenship but also to certain long-term residents of the United States whose U.S. residency is terminated. Second, the House bill subjects certain individuals to the expatriation tax provisions without inquiry as to their motive for losing their U.S. citizenship or residency, but allows certain categories of citizens to show an absence of tax-avoidance motive if they request a ruling from the Secretary of the Treasury as to whether the loss of citizenship had a principal purpose of tax avoidance. Third, the House bill expands the categories of income and gains that are treated as U.S. source (and therefore subject to U.S. income tax under § 877) if earned by an individual who is subject to the expatriation tax provisions and includes provisions designed to eliminate the ability to engage in certain transactions that under current law partially or completely circumvent the 10-year reach of § 877. Fourth, the House bill provides relief from double taxation in circumstances where another country imposes tax on items that would be subject to U.S. tax under the expatriation tax provisions.

Id.

provisions, as amended, not be defeated by any treaty provision.”<sup>200</sup> However, “beginning on the tenth anniversary of the enactment of the House bill, any conflicting treaty provisions that remain in force would take precedence over the expatriation tax provisions as revised.”<sup>201</sup>

The Taxpayer Relief Act of 1997 was a denial of treaty benefits for certain payments through hybrid entities. Regarding the application to certain payments, it stated,

A foreign person shall not be entitled under any income tax treaty of the United States with a foreign country to any reduced rate of any withholding tax imposed by this title on an item of income derived through an entity which is treated as a partnership (or is otherwise treated as fiscally transparent) for purposes of this title if (A) “such item is not treated for purposes of the taxation laws of such foreign country as an item of income of such person, (B) the treaty does not contain a provision addressing the applicability of the treaty in the case of an item of income derived through a partnership.”<sup>202</sup>

26 USCA section 894 (relating to income affected by treaty) is amended by inserting subsection (C) which states “the foreign country does not impose tax on a distribution of such item of income from such entity to such person.”<sup>203</sup>

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200. Id. at 2142.

201. Id.

202. Taxpayer Relief Act of 1997, 111 Stat 788, 943 (1997).

203. Id. The section also added a regulations subsection.

(2) Regulations. – The Secretary shall prescribe such regulations as may be necessary or appropriate to determine the extent to which a taxpayer to which paragraph (1) does not apply shall not be entitled to benefits under any income tax treaty of the United States with respect to any payment received by, or income attributable to any activities of, an entity organized in any jurisdiction (including the United States) that is treated as a partnership or is otherwise treated as fiscally transparent for purposes of this title (including a common investment trust under § 584, a grantor trust, or an entity that is disregarded for purposes of this title) and is treated as fiscally nontransparent for purposes of the tax laws of the jurisdiction of residence of the taxpayer.

Id. at 943, 944.

As one can see, not only is case law filled with statutory overrides of treaty provisions, but the Code also contains numerous overrides.<sup>204</sup> The justification and flawed analysis allowing for such effect stems from several poorly analyzed cases from the mid-nineteenth and early-twentieth centuries, all of which can easily be distinguished from each other.<sup>205</sup>

## VII. CONCLUSION

Although the United States champions globalization, its conflicting priorities are evidenced by the treaty enactment process. The inherent tension regarding the later-in-time doctrine among the Senate and the House of Representatives is not conducive to developing and sustaining the United States' foreign relations. While globalization is one of the United States' main priorities, the U.S. still favors its domestic economy with protectionist actions.<sup>206</sup>

Commitment to globalization may be seen through United States' membership in several international organizations: the United Nations (UN); the World Trade Organization (WTO); the World Bank; and the International Monetary Fund. These organizations promote the idea of trade liberalization as a means to eradicate poverty, achieve sustained economic growth, and promote a sustainable development that will eventually lead to a fully inclusive and equitable global economic system.<sup>207</sup> As a member of these organizations, the United States is expected to fulfill the obligations it assumes in good faith so that all participating nations may benefit from their membership.<sup>208</sup>

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204. See Richard L. Doernberg, *Hi Ho Silver! Congress Rides, or Rather Overrides, Again: The Proposed Tax on Capital Gains of Foreign Shareholders*, 2 *Tax Notes Int'l* 464 (1990) (providing an examination of proposed Code amendments which would override existing treaty provisions); *Overriding Tax Treaties*, supra note 7, at 105-09 (examining proposed Code legislation that would override existing treaty provisions).

205. *Taylor*, 23 F. Cas. at 784; *The Cherokee Tobacco*, 78 U.S. at 616; *Chew Heong*, 112 U.S. at 536; *Edye*, 112 U.S. at 580; *Whitney*, 124 U.S. 190); *Chae Chan Ping*, 130 U.S. at 581.

206. Developed countries want to protect their declining industries and gain market access for their expanding industries. However the declining industries are declining largely because of competitive pressures from the developing countries. Therefore, the sectors that they are most interested in protecting are precisely the sectors that are of the greatest concern to the developing world. Protection elicits concerns about equity and social justice within the developed countries – but the failure to extend these concerns to developing countries shows a particularly narrow vision which is out of step with economic globalization.

207. *The Monterrey Consensus on Financing for Development*, Mar. 2002.

208. *Charter of the United Nations and Statute of the International Court of Justice*, Chapter 1, Purposes and Principles, Article II, Sec 2.

As previously stated, the twin aims of tax treaties are the avoidance of double taxation and the prevention of tax evasion, which have the effect of promoting investment, growth, and commerce.<sup>209</sup> There are a number of incidental effects and benefits outside of these aims. For example, if taxes imposed on foreign investors are kept to a minimum, foreign firms will have a greater profit margin after taxes have been assessed. Of course, any change in tax rates, or a reclassification of taxable income that changes the original terms of the tax treaty relied upon,<sup>210</sup> lowers the profit margin that foreign investors expect.

Another consequence of Congress' conflicting priorities is the alteration of domestic tax law leading to overrides of existing treaty obligations and increases in the amount of taxes foreign corporations and nonresident investors pay on income derived from their foreign investments. This action reduces profit for a wealthy individual purchasing investment properties within the United States, and reduces the appeal of the United States for potential treaty partners. For example, when a property is sold, the gross profit will be reduced by income taxes paid on that profit. For foreign corporations, the allowable tax credit limitations will also have a similar reduction on gross profits.

The World Bank, through various empirical studies, has found that increasing corporate taxes has a substantial adverse effect on investments, entrepreneurship, and foreign direct investment.<sup>211</sup> Congress' decision to

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209. Newman, *supra* note 8. "Double taxation occurs when two jurisdictions, due to overlapping authority, tax the same income or assets. The effect discourages investment and creates artificial barriers to the free flow of commerce. Both international cooperation and goodwill are correspondingly undermined." *Id.* "Tax treaties also limit fiscal evasion by authorizing close administrative coordination and mutual exchange of information between contracting jurisdictions." *Id.* at 1004. Another form of tax evasion occurs through treaty shopping. "[T]reaty shopping is the practice of rerouting income through one or more artificial entities in different countries for the main or sole purpose of obtaining treaty benefits that are not directly available to the true earner of income." Haug, *supra* note 8.

210. Such as in the Tax Reduction Act of 1975, which provided a reduction in the tax credit allowed; Tax Reform Act of 1976, which changed the method of computing the foreign tax credit; The Foreign Investment in Real Property Act of 1980, which taxed foreign corporations and non resident individuals on the disposition of direct or indirect interests in the U.S. real property; and the Omnibus Budget Reconciliation Act of 1993, which allowed for the secretary to prescribe regulations to re-characterize any financing transactions in order to prevent the avoidance of taxes.

211. The effect of corporate taxes on investments and entrepreneurship, available at <http://www.doingbusiness.org/documents/AEJ-Manuscript.pdf>. The Doing Business project of The World Bank established through their extensive research that raising the first year effective tax rate by 10% points reduces the

increase U.S. tax revenues by overriding tax treaties that provide tax credits to foreign investors and by excluding certain forms of income substantially reduces foreign investments.

Such effects are thought to have fueled the United States' Great Depression during the 1930's and quite conceivably contributed to the frictions ultimately helping to ignite World War II.<sup>212</sup> This is very alarming considering the current recession which has striking similarities to the U.S. economy of the 1930's.

On October 29, 1929, the stock market crashed and Black Tuesday became synonymous with the Great Depression. In June, 1930, the Senate passed the Smoot-Hawley Tariff Act,<sup>213</sup> of which President Herbert Hoover announced his support. The Tariff Act was designed to raise tariffs on over 20,000 imported goods to a tax rate of 60%. Two days after the announcement, the Dow Jones Industrial Average sank 8%<sup>214</sup> as a direct response of the Senate's passage of the Act. The protectionist measures taken by the Act, ultimately had the effect of radically decreasing international trade and retaliatory tariffs, causing the world economy to contract and

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investment rate by 2.2 percentage points and the foreign direct investment rate (FDI) by 2.3 percentage points.

This paper presents basic statistical relationships between corporate taxes, investment and entrepreneurship using two new data sets. The first data set computes effective 1st year and 5 year corporate income tax rates for 85 countries, using a survey of Price Waterhouse Coopers' local offices. The second data set, collected from national statistical offices, presents official registration rates by new firms in 62 countries. The research ultimately suggests that government regulatory and tax policies may have large consequences for the business environment as well as for economic development. *Id.* at 24-25.

212. Foreign Capital: Friend or Foe? William H Peterson paraphrases French economist Frederic Bastiat: When goods – and capital – can't cross frontiers, armies will.

213. The Smoot-Hawley Tariff Act was signed into law on Jun. 17, 1930, and raised U.S. tariffs on over 20,000 imported goods to record levels, and, in the opinion of most economists, worsened the Great Depression. Smoot-Hawley imposed an effected tax rate of 60% on more than 3,200 products and materials imported into the U.S. quadrupling previous tariff rates. The Act was the successor of the Fordney-McCumber Tariff Act, which was intended to increase the market share of domestic firms. The weakening labor markets in 1927 prompted the need for another round of tariff hikes. Although the Tariff Act was passed after the stock market crash of 1929, many economic historians consider the political discussion leading up to the passing of the Act as a factor in causing the crash and/or recession that began in 1929, and its eventual passage led to the deepening of the Great Depression. Unemployment after the Act was passed jumped from 7.8% in 1930, to 16.3% in 1931, 24% in 1932, and 25% in 1933.

214. Pat Toomey, Economist against Protectionism, *The Wall Street Journal*, Aug. 1, 2007.

unemployment to sky rocket. The international trade war<sup>215</sup> continued to drive the market down until the Dow hit a 41 low on July 8, 1932. It took the Dow Jones 25 years to recover its 1929 peak.

In comparison to actions taken by Congress in response to the Great Depression, the United States is currently in the process of eradicating tariffs on U.S. exports to Colombia.<sup>216</sup> Congress, with the Great Depression in mind, has realized the important role that taxes play with regard to foreign countries and their contribution to our economy, resulting in economic growth. Congress' realization and actions taken in furtherance of this awareness, signifies the necessity for binding tax law and encouraging foreign investment in our country. This also exemplifies the problems associated with the instability of tax treaty overrides and their effect on deterring foreign relations.

Over the past fifty years, the United States increased its public national debt to over eleven trillion dollars.<sup>217</sup> This amount is not expected to decrease due to projected deficits.<sup>218</sup> This debt is composed of money the United States government owes itself, private investors, and foreign investors. In 2007, 46% of the National debt was held by foreign nations.<sup>219</sup> This form of external debt has the effect of directly reducing the available lifetime consumption of the individual taxpayer and reducing his disposable income, savings, and thus, capital stock.<sup>220</sup> At best, the effect of this national debt will reduce the amount of money Americans could invest in business,

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215. Id.

216. Department of Commerce, <http://www.commerce.gov/> (last visited Jun. 9, 2008).

217. Treasury Direct, Monthly Statement of the Public Debt of the United States (2009), <http://www.treasurydirect.gov/govt/reports/pd/mspd/2009/opds052009.pdf>. See also, Recovery.Gov, <http://www.recovery.gov/?q=content/act>. (last visited Jun. 9, 2009) which provides a summary of the American Recovery and Reinvestment Act of 2009. To view the Recovery Act in its' entirety, visit <http://www.treasurydirect.gov/recovery.htm>, which provides access to Act in PDF format.

218. Historical Tables, Office of Management and Budget, Budget of the United States Government, Fiscal year 2009, available at <http://www.whitehouse.gov/omb/budget/fy2009/pdf/hist.pdf>.

219. The top ten nations holding the U.S. national debt are Japan (\$571 billion), China (\$405 billion), UK (\$299 billion), Brazil (\$128 billion), Oil Exporters (including Ecuador, Venezuela, Indonesia, Bahrain, Iran, Iraq, Kuwait, etc.) (\$126 billion), Caribbean Banking Centers (including The Bahamas, Bermuda, Cayman Islands, Netherlands Antilles, and Panama)(\$81 billion), Luxembourg (\$76 billion), Hong Kong (\$54 billion), Taiwan (\$51 billion) and Korea (\$45 billion).

220. Peter A. Diamond, National Debt in a Neoclassical Growth Model, 1. A national debt of 9 trillion dollars equates to about \$79,000 on average for each American taxpayer.

resulting in an economic slow down, which could then end in a recession. At worst, the United States could lose its international power, allowing for other economically thriving countries to take the lead.

These issues are of greater concern than ever before as the United States' recession has developed into a full fledged depression.<sup>221</sup> Overriding tax treaties may deter foreign countries from financing our national debt, since these countries have rightfully come to expect that the tax benefits promised to them by the United States in international treaty agreements may possibly be extinguished.

In 2006, foreign investors spent \$184 billion investing in U.S. business and real estate. Foreign Direct Investment creates new jobs,<sup>222</sup> boosts wages,<sup>223</sup> strengthens U.S. manufacturing,<sup>224</sup> brings new research and technology,<sup>225</sup> increases U.S. productivity,<sup>226</sup> contributes to tax revenues,<sup>227</sup> keeps interest rates low,<sup>228</sup> and can help U.S. companies penetrate foreign markets and increase U.S. exports.<sup>229</sup> The United States is unique in its status

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221. An Independent Streak, *The Economist*, Jan. 26, 2008. This threat of American recession hits close to home for the middle-class elements of the country as one of the principal concerns arising from the recession is the major hit taken by the housing market, causing a huge "mortgage mess" and "great financial losses." A Long Slog, *The Economist*, Jan. 12, 2008.

222. U.S. Department of State, Fact Sheet, Mar. 13, 2006, <http://www.state.gov/r/pa/prs/ps/2006/63041.htm>. Bureau of Economic Analysis (BEA), U.S. Department of Commerce: U.S. affiliates of foreign companies employ 5.5 million U.S. workers, or 4.7% of private industry employment.

223. *Id.*, National Bureau of Economic Research – Robert Lipsey working paper 9293: U.S. affiliates of foreign companies tend to pay higher wages than U.S. Companies. Foreign companies support an annual U.S. payroll of \$318 billion, with an average annual compensation per employee of over \$60,000. Average foreign companies pay up to 15% more than wages paid by U.S. companies.

224. *Id.*, BEA: 41% of the jobs related to U.S. affiliate of foreign companies are in the manufacturing sector.

225. *Id.*, BEA: Affiliates of foreign companies spent \$30 billion on research and development in 2003 and \$109 billion on plants and equipment.

226. *Id.*, Bureau of Economic and Business Affairs, U.S. Department of State: The increased investment and competition from FDI leads to higher productivity growth, a key ingredient that increases U.S. competitiveness abroad and raises living standards at home.

227. *Id.*, Internal Revenue Service: In 2002, foreign affiliates paid \$17.8 billion in taxes, representing 12% of U.S. corporate tax revenue and in 2004 paid \$44 billion in taxes.

228. *Id.*, Bureau of Economic and Business Affairs, U.S. Department of State: The inflow of foreign capital also decreases the cost of borrowing money for domestic entrepreneurs, especially in the small to medium sized enterprise sector.

229. *Id.*, BEA: U.S. companies can use multinationals' distribution networks and knowledge about foreign tastes to export into new markets.

as the largest Foreign Direct Investor in the world and the largest recipient of Foreign Direct Investment. This dual role signifies globalization's prominent role in the U.S. economy.<sup>230</sup>

By overriding tax treaties, the United States places an unnecessary strain on its international relations without realizing the significance of those relationships to its economic well being. As stated above, overriding tax treaties causes an unexpected fluctuation in profit margins to foreign investors. Consequently, this changes the investment climate which can lead to a decrease in overall Foreign Direct Investment.

If there are no tax incentives, security, or stability in the tax legislation for foreign investors in the United States, the \$184 billion will be lost to more attractive investment climates. "Capital is not free, nor permanent; it must be nurtured and it is highly sensitive in that it is at once risk-tolerant and risk adverse. It can be sullied and bullied, but not for long. It can flee to safer climes."<sup>231</sup>

On March 7, 2007, the Investment Trade Administration (ITA) announced it would undertake a new Invest in America initiative<sup>232</sup> aimed at attracting Foreign Direct Investment. ITA's main concern was if the United States does not play an active role in promoting inward investment, its investment climate is in danger of being perceived around the world only by its growing difficulties.<sup>233</sup>

With a current recession, and our economy continuing to weaken while facing a growing national debt and national widespread inflation, Foreign Direct Investment seems to be our only hope for surviving the impending depression. The dramatic increases of real estate foreclosures, surges in oil prices, sky rocketing levels of unemployment, and increases in commodity goods, are further causing fear and apprehension in the U.S. In

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Approximately 21% of all U.S. exports come from U.S. subsidiaries of foreign companies.

230. CRS Report for Congress; Foreign Direct Investment: Current Issues, Apr. 27, 2007.

231. Foreign Capital: Friend or Foe, quote by William H. Peterson, Member of California State Assembly 2nd District. <http://www.theadvocates.org/freeman/8901pete.html>.

232. Lavin, Frank L., Role of Foreign Investment in U.S. Economic Growth, Mar. 7, 2007. The initiative will have 3 key responsibilities: (1) outreach to the international investment community, (2) serve as an ombudsman in Washington D.C. for the concerns of the international investment community as well as work on policy issues that affect the attractiveness of the United States in foreign investments, and (3) supporting state and local governments engaged in foreign investment promotions.

233. Lavin, Frank L., Role of Foreign Investment in US Economic Growth, Mar. 7, 2007, P. 1. [http://trade.gov/press/speeches/lavin\\_030707.asp](http://trade.gov/press/speeches/lavin_030707.asp).



today's U.S. economy, much like in 1929, people are being forced to drastically cut expenditures to keep up with their payments, ultimately resulting in an economic slow down. As businesses are failing, construction work and factory orders plunge. U.S. banks are claiming huge losses, as debtors default on their debts. This pattern is identical to the Great Depression, save the fact that in the late 1920's, Foreign Direct Investment was not a dominating force in the United States.

Research conducted by the NBRE finds that direct investors, chiefly those who operate manufacturing facilities in foreign countries, are much more likely to ride out economic squalls than those involved in foreign bonds, equities, bank loans, and other forms of investments.<sup>234</sup> Direct investment is bound up in enterprises that, in times of instability, can redirect sales from the country's local markets to export markets. The drop in the currency value of a troubled country makes national products cheaper to foreign buyers and easier to export. This may allow for a host country to maintain levels of sustainable employment. It may ease the riding out of the economic storm.

With so much to gain from Foreign Direct Investment, it is difficult to rationalize why the United States is willing to bite the hand that feeds it. It is inevitable that foreign countries must pay taxes. However, how and what should be taxed should be established by the tax treaties negotiated between the United States and the foreign country. Congress' position that the later-in-time rule applies to tax treaties that contradict the tax code is not conducive to Foreign Direct Investments, international relations, or to globalization as a whole. Congress needs to act pragmatically by reinstating section 7852(d) of the 1939 Tax Code which respected treaty obligations and declared that treaty obligations prevailed over domestic tax laws.

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234. Foreign Direct Investors in Three Financial Crises, Mathew Davis, available at <http://www.nber.org/digest/jun01/w8084.html>.