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Global View

Controversy over Tax Treaties: More of the Same

By Robert Misey*

The United States has income tax treaties to ensure that there is a single tax on a transaction—avoiding both double taxation and preventing tax evasion. The U.S. tax treaties cover approximately 69 of our largest trading partners,¹ but the United States has not had a new treaty or protocol ratified since 2010.

The ongoing tax treaty controversy stems from the objection of Senator Rand Paul. When newly-elected in 2011, Senator Paul announced that the exchange of information articles in tax treaties violated taxpayers' Fourth Amendment rights to privacy in their banking and financial data, such that disclosure by the United States of these data would violate the due process rights of taxpayers. Over the last nine years, Senator Paul has prevented votes that would ratify many tax treaties and protocols due to his objection over these exchange of information articles.

Under an exchange of information article in a tax treaty,² a foreign country can request information from the United States that is either in the IRS's possession or available under the U.S. tax laws.³ As with all tax treaty articles, an exchange of information article is reciprocal, such that the IRS can similarly request information from a foreign tax authority. As a cautionary measure, an exchange of information article does not require disclosing any trade or business secret. The IRS can use any method available (*e.g.*, information document requests, summonses, *etc.*) under U.S. tax law to obtain information for a treaty partner making a request.

For example, suppose a distributor of "Crazylegs" sports shoes, JSub, is a Japanese subsidiary of USAco. USAco sells the sports shoes to JSub, which resells them in Japan. The Japanese tax authority (the "NTA") conducts a transfer pricing audit of JSub. After JSub fails to respond to the NTA's request for all agreements between USAco and JSub, the NTA requests the information from the IRS pursuant to the exchange of information article in the U.S.–Japanese tax treaty. The IRS obtains the agreements and the IRS provides them to the NTA.

Senator Paul's concerns over exchange of information articles are part of a long history of controversies between treaties and internal U.S. law.

Due to the different parties involved with the entering of treaties and with the enactment of tax legislation, tension between the treaties and the Internal Revenue Code is only natural. More specifically, controversies regarding treaties will always occur because of the different procedures by which the United States enters treaties and enacts tax legislation.

Tax legislation originates in the House Ways and Means Committee before going to the full House of Representatives. In the Senate, the Senate Finance Committee evaluates legislation before going to the full Senate floor. If the legislation in the House of Representatives and the Senate differs, Congress convenes a conference committee to reconcile those differences. Once Congress passes the tax legislation, the President signs the legislation to enact the changes to the Internal Revenue Code.

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In contrast, the Executive Branch (the Treasury Department, under the authority of the President) negotiates tax treaties with foreign countries. After negotiated by the Treasury Department, the tax treaty goes to the Senate. The Foreign Relations Committee of the Senate

must approve all treaties before ratification by two-thirds of the Senate.

Therefore, the tax treaty process ignores the entire House of Representatives, including its Ways and Means Committee, where tax legislation originates. Moreover, in the Senate, the process excludes the Senate Finance Committee, which has expertise on tax legislation, and includes the Senate Foreign Relations Committee, of which Senator Paul is a member, but which does not have tax expertise.⁴

The Senate could end Senator Paul's logjam by invoking cloture. If 60 senators vote for cloture, a ratification vote would occur after an additional 30 hours of debate. Over the past eight years, the Senate has not deemed it worthwhile to incur the additional 30 hours of debate cloture requires to vote on ratification. However, the pressure is mounting as in late April over 80 U.S.-based multinational corporations urged the Senate to pursue ratification of these treaties and protocols, which would require invoking cloture.

Even though tax treaties are not a partisan issue, with a split Congress and with the same party controlling both the Executive Branch and the Senate, tax treaties are one way to advance tax law. Moreover, the lack of ratification raises the mistrust of our treaty partners, who negotiated the treaties in good faith and are restlessly awaiting ratification. The time is now for the Senate to invoke cloture and ratify the treaties and protocols.

ENDNOTES

* The author is also the Chair of the International Tax Committee for the American Bar Association.

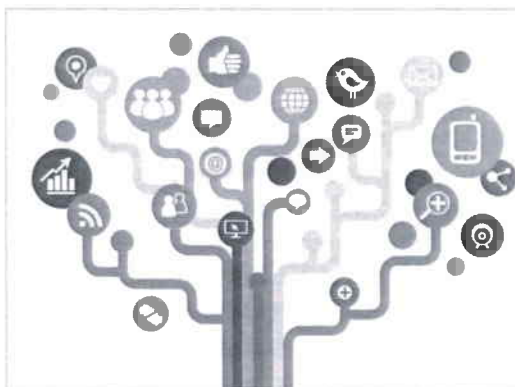
¹ The U.S. tax treaty with China does not cover Hong Kong, Macao, or Taiwan. Moreover, the United States does not have tax treaties with the Cayman Islands, Bermuda, and the British Virgin Islands, which in addition to having low taxation, have weather that makes all of us who live in the upper Midwest wondering why we do so in the

winter months. Even though the Soviet Union dissolved in the early 1990s and the United States has a tax treaty with Russia, the United States still has a tax treaty with the Soviet Union, which covers Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan.

² See, for example, Article 26 of the U.S. Model Tax Treaty.

³ The exchange does not violate the tax disclosure rules. Code Sec. 6103(k)(4).

⁴ When this columnist once asked the late Senator Fred Thompson how closely the Senate Foreign Relations Committee scrutinizes tax treaties, Senator Thompson said "Rob, I'm the only attorney on Foreign Relations and tax was my worst class in law school. We just do whatever our staff tells us to do."



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