



What Happens if H.R. 1 Conflicts with U.S. Tax Treaties?

Erika K. Lunder

Legislative Attorney

December 19, 2017

When a provision in the Internal Revenue Code (IRC) conflicts with a U.S. tax treaty, which takes precedence over the other? This question may be of interest to Congress as it considers the [Tax Cuts and Jobs Act](#) (H.R. 1), [amid reports discussing](#) whether certain provisions in the bill may be inconsistent with existing U.S. tax treaties. The United States has bilateral tax treaties with [approximately 65 countries](#) that are [intended](#) to reduce the incidence of double taxation and prevent tax evasion. These treaties are negotiated by the Treasury Department and ratified by the President [with the advice and consent of the Senate](#). As discussed below, Congress has the authority, if it so chooses, to address expressly the relationship between the provisions in legislation and potentially conflicting tax treaties. In the absence of such express language, if a provision in H.R. 1 was found to conflict with an existing tax treaty, it is likely that a court would determine that H.R. 1 takes precedence over the treaty based on relevant Supreme Court precedent. These issues are discussed below, followed by considerations for Congress as it continues to debate H.R. 1.

Conflicts Between Tax Statutes and Tax Treaties, Generally

Conflicts between provisions in the Internal Revenue Code (IRC) and tax treaties are generally resolved based on which is “last in time.” The [U.S. Constitution](#) provides that the Constitution, acts of Congress, and treaties are “the supreme Law of the Land” When the Constitution conflicts with a federal law or treaty, the Supreme Court [has held](#) that the Constitution is controlling. The issue is more complicated when a federal statute and treaty are in conflict and Congress has not indicated that the statute should be subject to the treaty. The Supreme Court [has ruled](#) that statutes and [self-executing treaties](#) that do not require implementing legislation to be given effect (which generally include tax treaties) are on equal footing under the Constitution so that “[a treaty may supersede a prior act of Congress, and an act of Congress may supersede a prior treaty.](#)” In order to determine which controls, the Court [has explained](#) that treaties and statutes should generally be construed to be harmonious, but [when they do conflict](#), the one

Congressional Research Service

7-5700

www.crs.gov

LSB10047

that is [last in date](#) takes precedence over the earlier one. As discussed below, the IRC [contains a provision](#) that reflects these principles regarding the equal relationship between IRC statutes and tax treaties.

Based on these principles, courts have held that tax statutes override inconsistent treaty provisions when the statute was enacted after the treaty was in effect. While this issue is infrequently litigated, examples of such holdings include: (1) the Supreme Court's holding [in an 1870 case](#) that a federal statute imposing a tax on alcohol and tobacco overrode an earlier treaty with the Cherokee nation; (2) two cases, in [2003](#) and [2009](#), by the U.S. Court of Appeals for the D.C. Circuit that held an IRC provision overrode a provision in the U.S.-Canada income tax treaty because the statute was enacted after the treaty was ratified; and (3) a [1992 case](#) by the U.S. Tax Court which held that an IRC provision overrode a provision in an earlier tax treaty with Switzerland.

Possible Considerations for Congress

While the later-in-time rule is firmly established in the tax context under the precedent discussed above, Congress, if it so chooses, may expressly indicate whether a legislative provision is to override any existing tax treaty, either by providing a general rule on the matter or by addressing it on a case-by-case basis. H.R. 1 is generally silent as to how the bill's provisions would interact with the existing bilateral tax treaties. Accordingly, if the bill were enacted into law, a court would likely interpret its provisions to override any conflicting treaties under the later-in-time rule. Congress might be interested in considering whether this outcome is consistent with its intent, and, if not, whether to address the relationship between tax statutes and treaties in general, or specifically as to H.R. 1, or whether to address the treatment of treaty partners and taxpayers in the event of a treaty override. These options are discussed below.

First, Congress could legislatively address the relationship between tax statutes and treaties in general by, for example, articulating the circumstances in which IRC amendments would take precedence over existing treaties. [Some commentators](#) have argued that the later-in-time standard should be reexamined, in part:

because taxation touches so directly matters of the basic commercial structure through which international trade is conducted and because of the difficulty of revising such structures to adjust to changes without incurring what are in effect retroactive financial penalties in the form of tax liabilities . . . there is, if anything, greater need for long-term stability and predictability in the case of international taxation than may be the case in other areas

On the other hand, it appears that Congress has rejected this concept in the past. Prior to 1988, the IRC had expressly deferred to treaties when an IRC provision and treaty were in conflict. However, Congress amended this language [in 1988](#) to [codify](#) the later-in-time rule and recognize the equal relationship between IRC provisions and tax treaties. A [committee report](#) accompanying the 1988 act explained the reason for the change:

The committee does not believe that Congress can either actually or theoretically know in advance all of the implications for each treaty, or the treaty system, of changes in domestic law, and therefore Congress cannot at the time it passes each tax bill address all potential treaty conflict issues raised by that bill. This complexity, and the resulting necessary gaps in Congressional foreknowledge about treaty conflicts, make it difficult for the committee to be assured that its tax legislative policies are given effect unless it is confident that where they conflict with existing treaties, they will nevertheless prevail.

Secondly, Congress might consider, in lieu of amending the general interpretative rule codified in the IRC, whether to address the interaction of specific provisions in H.R. 1 with the treaties. Congress has occasionally expressed its intent with respect to the treatment of specific IRC amendments. For example, the [American Jobs Creation Act of 2004](#) imposes negative tax consequences on [corporate inversions](#) and [expressly states](#) that no provision of law “shall be construed as permitting an exemption, by reason of any treaty obligation of the United States heretofore or hereafter entered into, from the provisions of this

section.” Congress could, if it so chose, expressly address how the provisions in H.R. 1 and the tax treaties should interact in legislation. However, it might not be clear how such a provision would be interpreted to apply to future tax treaties. Such an interpretation might depend on a variety of factors, including the provision’s specific language and whether a treaty stated that it superseded domestic law requirements.

A third possible option for Congress might be to consider whether to address legislatively the remedies available to treaty partners and taxpayers in the event that a particular provision in H.R. 1 is later found to conflict with an existing treaty. While the case law discussed above indicates that interpreting an IRC provision to override a provision in an existing tax treaty is permissible under U.S. law, such an override may place the United States in the position of violating its treaty obligations. In response, a treaty partner might take action such as unilaterally terminating the treaty (tax treaties [generally allow](#) either country to terminate by giving notice through diplomatic channels); attempting to negotiate a modification to the treaty with the United States; or amending its own tax laws to address or mitigate the effects for its taxpayers. Taxpayers may be negatively affected by treaty overrides because they would no longer be able to claim the benefits under the treaty and thus might have higher tax liability to one or both countries. Congress could, if it so chose, legislatively address the remedies for treaty partners and taxpayers affected by statutory overrides of treaty provisions. For example, Congress might propose transition rules to assist affected taxpayers; encourage the executive branch to work with treaty partners to renegotiate the treaties; allow taxpayers negatively affected by these conflicts to claim monetary damages (as at [least one commentator](#) has argued); or take steps to develop some type of international dispute settlement procedure to address tax treaty violations.
