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Treaty Override by Administrative Regulation: The Multiparty Financing Regulations

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I. OVERVIEW OF SECTION 7701(*l*) REGULATIONS

Section 7701(*l*), enacted as part of the Omnibus Budget Reconciliation Act of 1993, provides: "The Secretary of the Treasury may prescribe regulations recharacterizing any multiparty financing transaction as a transaction directly among any 2 or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by this title."[1] The provision originated out of a concern "that taxpayers were inappropriately avoiding U.S. tax by intricately structuring financial transactions which utilize multiple entities, where one or more of those entities serve as a conduit."[2]

The Treasury issued regulations in response to this legislation in July of 1995.[3] Under the regulations, various financing arrangements are recharacterized for U.S. tax purposes to disregard a conduit entity or entities. For example, suppose that if *A*, a foreign financing entity, made a loan to *C*, a U.S.-financed entity, interest paid by *C* to *A* would be subject to a 30% withholding tax in the United States.[4] But suppose that pursuant to a financing arrangement, *A* instead makes a loan to *B*, a foreign intermediate entity,[5] which in turn makes a loan to *C*, and suppose further that if the form of the transactions is respected, the interest paid by *C* to *B* will not be subject to a 30% U.S. tax, but rather will be subject to a reduced or zero rate of U.S. tax because of an exemption under U.S. law, such as the portfolio interest exemption of section 881(c), or as a result of the application of a tax treaty.[6] The regulations set out circumstances under which such a financing arrangement may be recharacterized for U.S. tax purposes to disregard the intermediate entity, *B*, as a conduit and treat the interest as paid directly by *C* to *A*, thereby resulting in a 30% U.S. withholding tax.

This article does not discuss the regulations' implementation of the authorizing statute, although the regulations, as proposed, were the subject of

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1. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13238, 107 Stat. 312, 508.

2. H.R. Rep. No. 111, 103d Cong., 1st Sess. 729 (1993), reprinted in 1993 U.S.C.C.A.N. 378, 960.

3. T.D. 8611, 60 Fed. Reg. 40,997 (1995). The regulations were proposed in Oct. of 1994. INTL-64-93, 59 Fed. Reg. 52,110 (1994).

4. IRC §§ 881(a)(1), 1442(a).

5. See Regs. § 1.881-3(a)(2)(i) (defining "financing arrangement").

6. See, e.g., Convention Between the United States of America and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Dec. 18, 1992, U.S.-Neth., art. 12 K.A.V. 3507 [hereinafter U.S.-Neth. Treaty].

substantial criticism.[7] Instead, the focus is on the relationship of the regulations to U.S. treaty commitments. According to the regulations:

> Where the participation of a conduit entity in a conduit financing arrangement is disregarded pursuant to this section, it is disregarded for all purposes of section 881, including for purposes of applying any relevant income tax treaties. Accordingly, the conduit entity may not claim the benefits of a tax treaty between its country of residence and the United States to reduce the amount of tax due under section 881 with respect to payments made pursuant to the conduit financing arrangement. The financing entity may, however, claim the benefits of any income tax treaty under which it is entitled to benefits in order to reduce the rate of tax on payments made pursuant to the conduit financing arrangement that are recharacterized. . . .[8]

In the example, if *B* is a resident of a country with which the United States has an income tax treaty and the treaty exempts interest paid to that country's residents from U.S. tax, the regulations require that the treaty be ignored in determining the U.S. tax on the interest payment from *C* to *B*. Treaty benefits may be claimed only under a treaty between the United States and *A*'s country of residence. For purposes of discussion, this article focuses on the treaty between the United States and the Netherlands.[9]

The regulations thus may override U.S. treaty obligations. Many U.S. treaties contain limitations on benefits provisions that deny certain treaty benefits, usually including reduced withholding rates on interest payments.[10] Where the regulations merely duplicate the effects of a limitation on benefits provision, there is no override problem. However, as discussed below, the regulations' scope goes beyond that of some limitations on benefits provisions, and many income tax treaties do not have such provisions.

The United States is no stranger to treaty overrides. On several occasions, Congress has passed legislation with the intent of overriding tax

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7. See, e.g., Jeffrey M. O'Donnell, et al., Attorneys Suggest Modifications to Conduit Financing Regs, 10 Tax Notes Int'l 134 (Jan. 9, 1995) (arguing that the regulations abandon traditional common law elements of conduit theory in favor of an unauthorized test); see also John J. Coneys, Price Waterhouse Finds Conduit Regs Negative in Tone and Overbroad in Scope, 10 Tax Notes Int'l 134 (Jan. 9, 1995).

8. Regs. § 1.881-3(a)(3)(ii)(C).

9. See U.S.-Neth. Treaty, supra note 6.

10. See e.g., id., art. 26.

treaties.[11] What makes the conduit financing regulations different from previous overrides is that Congress has not explicitly authorized a treaty override, and the override results instead from actions of an administrative agency—the Treasury. This article focuses on whether the Treasury is authorized by the Constitution and by Congress to override U.S. treaty commitments. The article also analyzes the effect of an administrative override, if permissible, under treaties ratified after the enactment of section 7701(*l*).

II. History of Multiparty Financing Regulations and Relationship of Conduit Rules to Treaty Interpretation

A. *Defining Undefined Treaty Terms; Applying Domestic Antiabuse Rules*

It is important to distinguish the use of domestic law to override treaties—a clear violation of international law—from the lawful use of domestic law to define terms left undefined by treaty. Under Article 3(2) of the 1994 OECD Model Treaty, any term not defined in a treaty takes the meaning that it has under the law of the state applying the treaty unless the context otherwise requires.[12] Some version of Article 3(2) appears in every U.S. income tax treaty. Accordingly, in the back-to-back loan example discussed above, the United States must determine whether the interest article of the U.S.-country *B* treaty applies to the interest paid from *C* to *B*. While treaties typically define some terms in the interest article, including "interest,"[13] other terms in the article may be undefined, and domestic law of the state applying the treaty can be consulted to define the undefined terms.

In Aiken Industries, Inc. v. Commissioner,[14] a Bahamian company that had loaned money to its U.S. subsidiary assigned the obligation to a Honduran subsidiary in exchange for the latter's note, which had the same

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11. See, e.g., Richard L. Doernberg, Overriding Tax Treaties: The U.S. Perspective, 9 Emory Int'l L. Rev. 71 (1995); 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); Richard L. Doernberg, Legislative Overrides of Income Tax Treaties: The Branch Profits Tax and Congressional Arrogation of Authority, 42 Tax Law. 173 (1989).

12. See Committee on Fiscal Affairs, Organization for Economic Co-operation and Development Model Tax Convention on Income and on Capital, art. 3, para. 2 (1994) [hereinafter 1994 OECD Model]; John Avery Jones, Article 3(2) of the OECD Model Convention and the Commentary to It: Treaty Interpretation, 33 European Taxation 252 (1993); Klaus Vogel, Double Tax Treaties and Their Interpretation, 4 Int'l Tax & Bus. Law. 1, 62 (1986).

13. 1994 OECD Model, supra note 12, art. 11, para. 3.

14. 56 T.C. 925 (1971), acq., 1972-2 C.B. 1.

interest rate and payment schedule as the obligation from the U.S. subsidiary. The Honduran subsidiary realized no profit from the transaction because the interest it received from the U.S. corporation was immediately payable to the Bahamian corporation. The U.S. subsidiary claimed that no withholding was required on interest payments to the Honduran company under a treaty that then existed between the United States and Honduras. The Tax Court denied the use of the treaty, even though it found that the Honduran corporation was not a sham. The court ruled that the Honduran corporation never "received" the interest as required by the treaty because the receipt of the interest and the obligation to transmit to the Bahamian corporation were inseparable. As stated by the court:

> [W]e interpret the terms "received by" to mean interest received by a corporation of either of the contracting States as its own and not with the obligation to transmit it to another. The words "received by" refer not merely to the obtaining of physical possession on a temporary basis, . . ., but contemplate complete dominion and control over the funds.[15]

Two related revenue rulings, both citing *Aiken*, deny treaty benefits where interest is not "derived by" treaty country residents within the meaning of that treaty term. In Revenue Ruling 84-152,[16] a Swiss corporation (*P*) owned two subsidiaries—*S*, a Netherlands Antilles corporation, and *R*, a U.S. manufacturing corporation. When *R* required an increase in working capital, *P* loaned the funds to *S*, which reloaned the funds to *R*. *R* made timely interest payments at 11% to *S*, which made timely interest payments to *P* at 10%.[17] In Revenue Ruling 84-153,[18] a U.S. holding corporation (*P*) had a wholly-owned Netherlands Antilles subsidiary (*S*) and a wholly-owned U.S. subsidiary (*R*). In order to raise funds for *R*, *S* issued bonds to foreign persons outside the United States and loaned the bond proceeds to *R* at an interest rate 1% higher than the rate payable on the bonds.[19]

In these two rulings, which were issued in tandem, the IRS held that interest payments made by the U.S. subsidiary (of a foreign corporation in Revenue Ruling 84-152 and of a U.S. corporation in Revenue Ruling 84-153)

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15. Id. at 933.

16. 1984-2 C.B. 381, obsoleted by Rev. Rul. 95-56, 1995-36 I.R.B. 20 (Sept. 5).

17. Without further explanation, the IRS noted that neither *R* nor *S* were thinly capitalized, but that *S* was not sufficiently liquid to make the loans to *R* out of its own funds.

18. 1984-2 C.B. 383, obsoleted by Rev. Rul. 95-56, 1995-36 I.R.B. 20 (Sept. 5).

19. The interest payments by *R* did not qualify for the portfolio exemption because the bonds did not meet the requirements of § 163(f)(2)(B).

to a related Netherlands Antilles corporation did not qualify for the interest exemption under the then-existing treaty between the United States and the Netherlands Antilles ("Antilles Treaty").[20] The rulings hold that for purposes of the interest article of the Antilles Treaty, the interest could not be said to have been "derived by" the Antilles subsidiaries merely because they possessed the interest temporarily.[21] Although the subsidiaries had corporate substance and were not shams, they never had dominion and control over the interest payments. The primary purpose of using the subsidiaries was to obtain the benefits of the Antilles Treaty exemption and thus avoid U.S. taxation. Even if the transactions may have served some business purpose, there was not "sufficient business or economic purpose to overcome the conduit nature of the transaction."[22]

Beyond the use of domestic law to define terms left undefined by treaties, contracting states are generally recognized to have authority to apply antiabuse principles of domestic law, including rules that elevate substance over form. This consensus is reflected in the OECD Commentary, which states:

> The large majority of OECD Member countries consider that such measures [e.g., substance-over-form rules] are part of the basic domestic rules set by national tax law for determining which facts give rise to a tax liability. These rules are not addressed in tax treaties and are therefore not affected by them. . . . A dissenting view, on the other hand, holds that such rules are subject to the general provisions of tax treaties against double taxation, especially where the treaty itself

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20. The Antilles Treaty, which was partially terminated as of January 1, 1988, was an extension of the former United States-Netherlands Treaty. Convention Between the United States of America and the Kingdom of the Netherlands with Respect to Taxes on Income and Certain Other Taxes, Apr. 29, 1948, U.S.-Neth. art. VIII, para. 1, T.I.A.S. 1855.

21. The IRS cited Aiken Indus., Inc. v. Commissioner, supra notes 14-15 and accompanying text, for this proposition.

22. Rev. Rul. 84-152, 1984-2 C.B. 381, obsoleted by Rev. Rul. 95-56, 1995-36 I.R.B. 20 (Sept. 5); Rev. Rul. 84-153, 1984-2 C.B. 383, obsoleted by Rev. Rul. 95-56, 1995-36 I.R.B. 20 (Sept. 5). The IRS cited Gregory v. Helvering, 293 U.S. 465 (1935) and *Aiken* on this point.

In Priv. Let. Rul. 8722009 (Feb. 12, 1987), the IRS ruled that interest payments from a U.S. corporation to a Netherlands corporation were not exempt from U.S. taxation under Article VIII of the 1948 United States-Netherlands Treaty. In the ruling, third-country investors, who had made loans to the U.S. corporation directly, restructured the loans through a recently purchased, inactive Netherlands corporation, whose debt-equity ratio was 89:1. The IRS' conclusion was based on both the thin capitalization of the Netherlands corporation and the fact that interest checks received by the Netherlands corporation were deposited in the foreign investors' bank accounts.

> contains provisions aimed at counteracting its improper use.[23]

The United States certainly holds the majority view. Although *Aiken* and the two revenue rulings discussed above rely in large part on domestic law to define undefined treaty terms, they also convey a flavor that domestic substance-over-form (or anti-conduit) rules should apply to transactions that formally come within the reach of treaties.

This view is confirmed by Revenue Ruling 87-89,[24] which did not use domestic law to define an undefined treaty term but instead relied on a domestic substance-over-form argument to deny the use of a treaty. In this ruling, *FP*, a foreign corporation organized in a state having no treaty with the United States, had a domestic subsidiary (*DS*) that required funds for its business. *FP* deposited funds in a demand deposit with *BK*, a publicly-held bank in a state that had a treaty with the United States exempting interest from source-state taxation. *BK* thereafter loaned most of the deposited money to *DS* for use in its business. The difference between the interest paid by *BK* to *FP* on the demand deposit and interest charged by *BK* on the loan to *DS* was less than 1%. Absent the deposit by *FP*, *BK* would have charged a higher interest rate.

The ruling states that the treaty exemption could apply only if the deposit and loan were "independent transactions such that the loan from *BK* would be made or maintained on the same terms irrespective of the deposit."[25] Because *BK* would have charged more interest to *DS* in the absence of the deposit by *FP*, the IRS found this independence lacking and denied *BK* the benefits of the treaty. In such deposit/loan situations, any contractual or statutory right of *BK* to an offset against the deposit in the event of a default by the borrower is presumptive evidence that *BK* would not have maintained the loan on the same terms without the deposit.

B. *Do the Multiparty Financing Regulations Override Treaties?*

In the preamble to the proposed regulations, the Treasury explains its view of the relationship of the regulations to U.S. treaty commitments:

> These regulations are intended to provide anti-abuse rules that supplement, but do not conflict with, the limitation on

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23. 1994 OECD Model, supra note 12, commentary on art. 1, para. 23. The United States is a member of the Organization for Economic Cooperation and Development (OECD).

24. 1987-2 C.B. 195, obsoleted by Rev. Rul. 95-56, 1995-36 I.R.B. 20 (Sept. 5).

25. Id. at 196.

> benefits articles in U.S. income tax treaties. . . . It has been recognized that contracting states may supplement these rules by transactionally-based domestic anti-abuse rules, including rules under which a particular transaction may be recast, in accordance with the substance of the transaction. These regulations, which reflect common law substance over form principles as applied to conduit financing arrangements, complement the limitation on benefits provisions of income tax treaties and are not precluded by the inclusion of such provisions. . . .[26]

From this statement, it seems clear that the Treasury does not view the regulations as a treaty override but merely as treaty supplementation. But, is that claim credible?

1. *Regulations Not Intended as Override*—Suppose we take the Treasury at its word that the regulations are not intended to override treaties. Indeed, there is much to support this conclusion. It is unquestioned doctrine that wherever possible, "a United States statute is to be construed so as not to conflict with . . . an international agreement of the United States."[27] Moreover, Congress stated no intention that the regulations under section 7701(*l*) override conflicting treaties.[28]

If no treaty override is intended, the regulations must be interpreted in a manner that does not nullify any treaty provision.[29] Perhaps this can be done with little problem where a potentially applicable treaty does not contain a provision dealing with conduit entities. The international community seemingly agrees, as the OECD Commentary suggests, that the United States has the right to apply domestic substance-over-form principles to deny treaty benefits where the treaty is silent on the issue. For example, the application of the regulations to deny the benefits of the U.S.-Switzerland Treaty may not be a problem.[30]

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26. 59 Fed. Reg. 52110, 52112-13 (1994) (to be codified at 26 C.F.R. pt. 1) (proposed Oct. 14, 1994).

27. Restatement (Third) of Foreign Relations Law of the United States § 114 & note 2 (1986) (citing Cook v. United States, 288 U.S. 102 (1933)) [hereinafter Restatement].

28. See Trans World Airlines, Inc. v. Franklin Mint Corp., 466 U.S. 243, 252 (1984).

29. Cook v. United States, 288 U.S. 102, 120 (1933).

30. 1994 OECD Model, supra note 12, commentary on art. 1, paras. 25-26. However, some argue that even in this situation, the regulations go beyond the common law principles contemplated by the OECD Commentary. See O'Donnell, et al., supra note 7, at 134.

There may also be no override problem if a treaty contains a limitation on benefits provision that does not specifically address multiparty financing issues. For example, under the limitation on benefits provision of the U.S.-Australian Treaty,[31] treaty benefits are available to an Australian corporation if more than 75% of the beneficial interests in the corporation are owned by individuals residing in Australia.[32] Suppose *B*, an Australian corporation wholly-owned by individual residents of Australia, makes a loan to *C*, a U.S. borrower. Under the Treaty, interest paid by *C* to *B* may be eligible for reduced U.S. withholding, even if much or all of the interest received by the Australian corporation is paid out to *A*, a nontreaty lender.[33] That is, the Treaty contains no base erosion provision that denies treaty benefits if the Treaty resident's income is reduced through deductible payments to recipients outside the treaty country. In this situation, the regulations, in treating *B* as a conduit ineligible for treaty benefits, arguably supplement rather than override the treaty.

The situation is more complicated under a treaty with a base erosion test. For example, the U.S.-Netherlands Treaty contains a very elaborate limitation on benefit provision,[34] under which a Dutch corporation (*B*) that satisfies an ownership test is entitled to treaty benefits only if it also satisfies a base reduction test.[35] *B* meets the base erosion test if less than 50% of its income is used to make deductible payments[36] in the current taxable year to persons other than qualified persons (e.g., nonresidents).[37] For example, suppose that *A*, a treaty nonresident, makes an interest-free demand loan to *B*, a Dutch corporation wholly owned by individual residents of the Netherlands, and *B* makes an interest-bearing loan to *C*, a U.S. borrower. Since none

31. Convention Between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Aug. 6, 1982, U.S.-Austl. art. 16, paras. 1(a)(iii), 3, T.I.A.S. 10773 [hereinafter U.S.-Austl. Treaty].

32. There are other ways to qualify for treaty benefits as well. See U.S.-Austl. Treaty, supra note 31, art. 16, para. 1(a)-(c).

33. U.S.-Austl. Treaty, supra note 31, art. 11.

34. U.S.-Neth. Treaty, supra note 6, art. 26. See also Philip D. Morrisson & Mary C. Bennett, The New U.S.-Netherlands Treaty: Part I-Limitation on Benefits and Related Issues, 6 Tax Notes Int'l 331 (Feb. 8, 1993); Eric M. Overman, Note, The U.S.-Netherlands Tax Treaty: Important Changes, Practitioners' Response, and Primary Effects, 48 Tax Law. 207, 214-25 (1994).

35. U.S.-Neth. Treaty, supra note 6, art. 26, para. 1(d)(i) (ownership test), 1(d)(ii) (base reduction test).

36. See id. art. 26, para. 5(c) (defining "deductible payment").

37. Id. art. 26, para. 5. An alternative base reduction test permits up to 70% of *B*'s gross income to be used for deductible payments to nonqualified persons if less than 30% of the gross income is used to make deductible payments to persons who are not residents of member states of the European Union.

of *B*'s income (interest from *C*) is used to made deductible payments to nonresidents, *B* satisfies the ownership and base reduction tests, and the treaty limitation on benefits does not deny *B* the benefits of the interest article, which, in this case, gives exclusive taxing authority to the Netherlands.[38]

If the regulations apply, *C*'s interest payment to *B* might not qualify for treaty benefits if one of the principal purposes for *B*'s participation is to obtain the withholding exemption under the U.S.-Netherlands Treaty.[39] If the Treasury truly did not intend the regulations to override treaty commitments, the regulations should not be applied to disallow treaty benefits that are clearly permitted by the treaty. The United States and the Netherlands (or at least the United States) clearly perceived that multiparty financing arrangements were being used to obtain treaty benefits inappropriately, but they negotiated a detailed response to the perceived problem.[40] The regulations cannot be considered supplementary to a treaty with a 50% base erosion test if they deny treaty benefits in some circumstances where there is no base erosion. Nothing in the U.S.-Netherlands Treaty suggests that domestic law can alter the bargain struck by the two contracting states.

In sum, the regulations, if not intended to override treaties, cannot be applied in direct conflict with a limitation of benefits provision that includes a detailed base erosion test.[41] The Treasury should clarify that the regulations do not apply where detailed treaty base erosion tests reach a conflicting result.

2. *Regulations Intended as Override*—If the regulations are intended to apply in direct conflict with treaty provisions that address the conduit issue in detail, they must be regarded as a treaty override or an attempted override, notwithstanding the Treasury's contrary claim. The regulations state that a "conduit entity may not claim the benefits of a tax treaty between its country of residence and the United States to reduce the amount of tax due under

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38. Id. art. 12. It is assumed that this transaction is the only relevant transaction for the year.

39. See Regs. § 1.881-3(e) ex. 11.

40. In addition to the base reduction test, the U.S.-Netherlands Treaty contains a conduit company test that applies to companies in a treaty state that are owned by certain publicly-traded corporations. U.S.-Neth. Treaty, supra note 6, art. 26, para. 1(c)(ii)(B).

41. Another example of a conflict between the U.S.-Netherlands Treaty and the regulations: If *B* is an unrelated Netherlands bank with which *A* regularly deposits cash held as working capital, *B* is likely entitled to treaty benefits under the active business test of article 26, paragraph 2. However, if *A* deposits funds substantially in excess of its working capital needs and *B* has a right of offset against *A*'s deposits to satisfy a loan by *B* to *C*, the regulations may deny treaty benefits notwithstanding the treaty. See Regs. § 1.881-3(e) ex. 20.

section 881 with respect to payments made pursuant to the conduit financing arrangement."[42]

There is no doubt that properly enacted domestic law that overrides a treaty provision will be upheld in a U.S. court of law,[43] even though the override is a clear violation of international law.[44] A taxpayer cannot successfully assert breach of a treaty commitment as a defense against the application of U.S. domestic law.[45]

A tax convention is a treaty under the U.S. Constitution.[46] The Supremacy Clause of the Constitution provides in part: "This 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."[47] In a series of early cases, the Supreme Court ruled that under the Supremacy Clause, statutes and treaties have equal status.[48] As a consequence, the Court reasoned, a treaty "may supersede a prior act of Congress, and an act of Congress may supersede a prior treaty."[49] The idea that treaties and the laws of the United States are of equal dignity has been challenged.[50] Indeed, although no one would contend that the Constitution is on equal footing with a statute, they are enumerated together in the Supremacy Clause. Nevertheless, the doctrine of equal status is firmly entrenched.[51] In the Internal Revenue Code, the doctrine of equal status is codified in section 7852(d)(1), which provides:

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42. Regs. § 1.881-3(a)(3)(ii)(C).

43. See, e.g., The Cherokee Tobacco, 78 U.S. 616, 621 (1870); see also Chinese Exclusion Case, 130 U.S. 581, 600 (1889); Whitney v. Robertson, 124 U.S. 190, 195 (1888); Head Money Cases, 112 U.S. 580, 599 (1884).

44. While a statute may supersede a prior treaty as a matter of U.S. domestic law, as a matter of international law, the United States is obligated to fulfill its treaty obligations. See Vienna Convention of the Law of Treaties, May 23, 1969, art. 26, 8 I.L.M. 679, 690; Restatement, supra note 27, § 321 cmt. a. This principle is embodied in the doctrine of *pacta sunt servanda*—agreements of the parties must be observed. The international obligation survives any subsequent restrictions in domestic law. The fact that an override violates international law has obviously not completely deterred the United States from enacting and enforcing overriding legislation.

45. Diggs v. Shultz, 470 F.2d 461, 464-67 (D.C. Cir. 1972), cert. denied, 411 U.S. 931 (1973).

46. Samann v. Commissioner, 313 F.2d 461, 463 (4th Cir. 1963); American Trust Co. v. Smyth, 247 F.2d 149, 153 (9th Cir. 1957).

47. U.S. Const. art. VI, cl. 2.

48. See supra note 43.

49. The Cherokee Tobacco, 78 U.S. at 621.

50. Committee on U.S. Activities of Foreign Taxpayers and Foreign Activities of U.S. Taxpayers of the New York State Bar Association Section of Taxation, Legislative Overrides of Tax Treaties, 37 Tax Notes 931, 932-33 (Nov. 30, 1987); Louis Henkin, Foreign Affairs and The Constitution 163-64 (1972).

51. See Restatement, supra note 27, § 115(1)(a) note 1.

"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."

In Cook v. United States,[52] the Supreme Court found that the mere re-enactment of a statute authorizing the boarding of vessels suspected of smuggling liquor into the United States did not supersede a treaty with the United Kingdom that limited such boarding. Generally, it takes a clear expression of congressional intent—either in the statutory language or in the legislative history—before a court will interpret a statute to override a preexisting treaty.[53] However, even if there is not a clear expression of congressional intent to override, courts may infer the intent if a statute directly takes away a treaty right. In *The Cherokee Tobacco*,[54] a divided Supreme Court ruled that a statute imposing an excise tax on tobacco applied in Cherokee territory even though a preexisting treaty guaranteed to every Cherokee resident the right to sell tax free any products from farming or manufacturing.

Under the U.S. jurisprudence on the relationship of treaties to domestic legislation, at least two requirements must be satisfied in order for a domestic regulation to have the effect of overriding a treaty commitment. First, since the Supremacy Clause refers to "Laws of the United States" and treaties, a treaty-overriding regulation must be a law of the United States. A regulation only has authority as law insofar as it is authorized by statute.[55] There is no independent authority for a regulation to override a treaty provision. If the multiparty financing regulations are to override conflicting treaty provisions, such as Article 26 of the U.S.-Netherlands Treaty, the override must be pursuant to congressional authority.

Second, even if congressional intent to override conflicting treaty provisions can be discerned, the Supremacy Clause merely treats the overriding provision as equal in force to the treaty so that the later-in-time rule applies. Some important conceptual issues relating to the later-in-time rule must be explored in determining whether, as a matter of U.S. domestic law, the regulations override the U.S.-Netherlands Treaty and other treaties that enter into force after the enactment of section 7701(*l*).

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52. 288 U.S. 102 (1993).

53. See Trans World Airlines, Inc. v. Franklin Mint Corp., 466 U.S. 243, 252 (1984) (citing Cook v. United States, 288 U.S. 102, 120 (1933)); see also Rev. Rul. 80-223, 1980-2 C.B. 217.

54. 78 U.S. 616 (1870).

55. Chrysler Corp. v. Brown, 441 U.S. 281, 304 (1978).

III. ESTABLISHING AUTHORITY TO OVERRIDE

A. *Statutory Authority to Override*

Section 7701(*l*) does not directly express a congressional intent to authorize an override. The provision does nothing more than grant authority to promulgate regulations necessary to prevent the avoidance of tax through conduit arrangements. Therefore, if section 7701(*l*) is to be interpreted as authorizing the Treasury to override treaties with these regulations, that intent must be found somewhere other than the statutory language. Congress has sometimes shown its intent to override treaties in the legislative history to a statute.[56] In this situation, there is no direct language in the legislative history showing an intent to override treaties.

The legislative history accompanying section 7701(*l*) describes the problem with which Congress was concerned in enacting this legislation. The various committee reports refer to the *Aiken* case as an example of the problem. Because treaty benefits were denied in *Aiken*, a quick reading might suggest that Congress was authorizing regulations that would also deny treaty benefits. However, as discussed above, *Aiken* was a case where domestic law was used to interpret undefined terms in a treaty and did not involve a treaty override.[57] The regulations seem to go far beyond the interpretation of undefined treaty terms.[58] However, the legislative history contains no ex-

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56. See, e.g., H.R. Rep. No. 658, 94th Cong., 1st Sess. 226 (1975), reprinted in 1976 U.S.C.C.A.N. 2897, 3121-22; S. Rep. No. 938, 94th Cong. 2d Sess. 237 (1976), reprinted in 1976 U.S.C.C.A.N. 3439, 3667-68 (stating that changes to foreign tax credit are intended to apply notwithstanding inconsistent treaty provisions).

57. See supra text accompanying notes 14-15.

58. See Mary C. Bennett, et al., The Proposed Anti-Conduit Regulations Under Section 7701(*l*), 24 Tax Mgmt. Int'l J. 3, 3 (1995).

A Technical Advice Memorandum cited in the legislative history portends an increasingly aggressive posture by the IRS against perceived treaty shopping. In the Memorandum, a U.S. subsidiary paid interest to its shareholder, a foreign financing intermediary that distributed a dividend of the same amount to its foreign parent in the same year. The IRS determined that the interest should be treated as paid to the foreign parent and that the treaty between the United States and the financing intermediary's state could not be applied to reduce the withholding rate. The intermediary was regarded as a conduit, and the interest was deemed to be "paid to" the foreign parent. I.R.S. T.A.M. 9133004 (May 3, 1991).

The legislative history to § 7701(*l*) also suggests that the regulations might go beyond the back-to-back loan situation to cover "multiple-party transactions involving debt guarantees or equity investments." Senate Finance Committee, Report on Revenue Provisions of Omnibus Budget Reconciliation Act of 1993—Foreign Tax Provisions, 103d Cong., 1st Sess. (1993), 93 TNI 120-24 (June 23, 1993) (LEXIS, FEDTAX library, TNI file). See generally Peter C. Canellos, Report of the Tax Section of the New York State Bar Association, 8 Tax Notes Int'l 367 (Feb. 7, 1994). The legislative history also discusses two Revenue

plicit statement that section 7701(*l*) is intended to override treaty commitments.

Even without an explicit statement, the requisite intent could be inferred if section 7701(*l*) had no purpose other than to override treaty commitments.[59] However, regulations under section 7701(*l*) could apply in situations that would not require treaty overrides—in particular, where there is no applicable treaty or an applicable treaty contains no detailed limitation of benefits provision. Assume a foreign corporation (*A*) with a U.S. subsidiary (*C*) makes a loan to an unrelated foreign corporation (*B*), which reloans the proceeds on similar terms to *C*. Interest payments from *C* to *B* might be literally within the statutory portfolio interest exemption of section 881(c),[60] but the regulations would deny the exemption by requiring that *B* be ignored as a conduit. This denial of a tax benefit otherwise available does not involve the denial of treaty benefits.

In sum, neither section 7701(*l*) nor its legislative history explicitly overrides any treaty commitment, and because section 7701(*l*) can operate successfully in situations where no override is involved, there is no implicit override of treaties.

B. *Delegation of Override Authority to Treasury*

Assuming arguendo that Congress expressed an intention to authorize regulations under 7701(*l*) that override treaties, can the authority to override be delegated to Treasury?

Delegation of override authority may assume two forms. First, Congress could explicitly delegate the authority to the Treasury to override treaties. Second, Congress could be silent on the issue of override authority and merely delegate authority to promulgate legislative regulations, which might include override authority if it was found not to be beyond the scope of the enabling act. In either case, an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress.[61]

Rulings dealing with the "beneficial ownership concept." See Rev. Rul. 84-152, 1984-2 C.B. 381, obsoleted by Rev. Rul. 95-56, 1995-36 I.R.B. 20; Rev. Rul. 84-153, 1984-2 C.B. 383, obsoleted by Rev. Rul. 95-6, 1995-36 I.R.B. 20; see discussion supra text accompanying notes 16-22.

59. See The Cherokee Tobacco, 78 U.S. 616 (1870) (finding that the statute flatly took away a right granted by treaty and holding that the statute overrode the treaty).

60. Even in the absence of the regulations, the IRS might deny the portfolio interest exemption on the authority of *Aiken* and Revenue Ruling 84-152, 1984-2 C.B. 381, obsoleted by Rev. Rul. 95-56, 1995-36 I.R.B. 20; see discussion supra text accompanying notes 14-17.

61. Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 208 (1988); see American Standard, Inc. v. United States, 602 F.2d 256 (Ct. Cl. 1979) (holding a legislative regulation invalid because it was inconsistent with the enabling statute).

In Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.[62] the Supreme Court addressed EPA promulgated standards implementing the Clean Air Act Amendments of 1977. The EPA had defined "stationary source" in a manner that was not directly specified in the legislation or the legislative history. The Court upheld the EPA's decision, finding that although Congress expressed no intention regarding the specific concept used by EPA, the concept was an appropriate policy for the EPA to adopt.

With regard to section 7701(*l*), it is not clear that Congress would *not* have wanted the regulations to override treaties, especially since cases dealing with treaties were mentioned in the legislative history and Congress did not say that the regulations were not intended to override treaties. As stated by the court in *Chevron*:

> If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. Sometimes the legislative delegation to an agency on a particular question is implicit rather than explicit. In such a case, a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.[63]

1. *Explicit Delegation.*—Treasury regulations fall into two categories: legislative regulations and interpretative regulations. A legislative regulation is authorized by statute to establish operative rules. Interpretative regulations explain the Treasury's interpretation of the Code, and are issued under section 7805(a), which grants the Treasury power to "prescribe all needful rules and regulations." As between these two types, legislative regulations are entitled to greater weight and deference.[64]

A legislative regulation, if valid, has the effect of law.[65] The regulation is valid if it is consistent with the statute that authorized it, adopted pursuant to proper procedure, and reasonable. In Chrysler Corp. v. Brown, Chrysler sought to enjoin public disclosure of documents it was required to submit to the government. Chrysler argued that the Trade Secrets Act

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62. 467 U.S. 837 (1984).

63. Id. at 843-44 (citations omitted).

64. Rowan Cos., Inc., v. United States, 452 U.S. 247, 253 (1981); see also Tate & Lyle, Inc. v. Commissioner, 103 T.C. 656, 666 (1994).

65. Chrysler Corp. v. Brown, 441 U.S. 281, 304 (1979).

prohibited the government from disclosing the information.[66] The Court of Appeals held that the government was "authorized by law" to disclose the information—that regulations promulgated by the Department of Labor's Office of Federal Contract Compliance Programs provided the law necessary to authorize the disclosure of the documents, in effect overriding the Trade Secrets Act.[67]

The Supreme Court disagreed. Although it recognized that a regulation can have the force and effect of law if "rooted in a grant of such power by the Congress and subject to limitations which that body imposes,"[68] the Court held that the enabling statute did not provide authority for overriding the Trade Secrets Act.[69] Therefore the regulation could not provide the "authorization by law" that was required by the Trade Secrets Act.

Because legislative regulations have the effect of law to the extent that they are consistent with the enabling act, the question arises as to what powers Congress may delegate to an agency to aid in carrying out the necessary functions of government.[70] The Constitution of the United States provides that "[a]ll legislative Powers herein granted shall be vested in a Congress of the United States."[71] As explained by the Supreme Court in Field v. Clark, "[t]hat Congress cannot delegate legislative power to the President is a principle universally recognized as vital to the integrity and maintenance of the system of government ordained by the Constitution."[72]

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66. The Act provides:

> Whoever, being an officer or employee of the United States or of any department or agency thereof, publishes, divulges, discloses, or makes known in any manner or to any extent not authorized by law any information coming to him in the course of his employment or official duties . . . shall be fined . . . or imprisoned . . . and shall be removed from office or employment.

18 U.S.C. § 1905 (1988 & Supp. V 1994).

67. The regulations were authorized by 5 U.S.C. § 301 (1994), which provides:

> The head of an Executive department or military department may prescribe regulations for the government of his department, the conduct of its employees, the distribution and performance of its business, and the custody, use, and preservation of its records, papers, and property. This section does not authorize withholding information from the public or limiting the availability of records to the public.

68. Chrysler Corp., 441 U.S. at 302.

69. Id. at 312.

70. Generally, Congress cannot delegate its legislative power to one of the other branches of government. See Field v. Clark, 143 U.S. 649, 692 (1892).

71. U.S. Const. art. I, § 1.

72. 143 U.S. 649, 692 (1892).

However, for the first 150 years of U.S. history, the Supreme Court uniformly held that challenged statutes did not unconstitutionally delegate legislative power.[73] The classic exposition of the governing test was offered by Chief Justice Taft: So long as Congress "lay[s] down by legislative act an intelligible principle to which the person or body authorized to [exercise delegated authority] is directed to conform, such legislative action is not a forbidden delegation of legislative power."[74]

In 1935, the Supreme Court relied on the delegation doctrine to invalidate portions of the National Industrial Recovery Act of 1933. In Panama Refining Co. v. Ryan, the Court held that "Congress manifestly is not permitted to abdicate, or to transfer to others, the essential legislative functions with which it is thus vested."[75] These essential legislative functions apparently consist primarily of the formulation of legislative policy to guide the executive and judicial branches. As long as the policy is determined by the Congress, it seems that the power to make regulations to enforce that policy may be delegated to the agency of Congress' choice.[76] As stated in *Panama Refining*:

> The Constitution has never been regarded as denying to the Congress the necessary resources of flexibility and practicality, which will enable it to perform its function in laying down policies and establishing standards, while leaving to selected instrumentalities the making of subordinate rules within prescribed limits and the determination of facts to which the policy as declared by the legislature is to apply.[77]

In *Panama Refining*, the Court held that a congressional delegation authorizing the President to interdict interstate transportation of petroleum produced in excess of amounts permitted by state authority was invalid because "Congress has declared no policy, has established no standard, has laid down no rule" to guide the President's discretion.[78] The Court found that, because the statute was devoid of criterion governing the President in his actions and contained no limits to the President's actions, Congress had given

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73. See Synar v. United States, 626 F. Supp. 1374, 1383 (D.D.C. 1986), aff'd sub nom. Bowsher v. Synar, 478 U.S. 714 (1986).

74. J.W. Hampton, Jr., & Co. v. United States, 276 U.S. 394, 409 (1928).

75. 293 U.S. 388, 421 (1935).

76. If Congress is permitted to delegate power to the President then there appears to be no restriction on granting that same power to an agency in the executive branch. Id. at 420.

77. Id. at 421.

78. Panama Refining Co. v. Ryan, 293 U.S. 388, 430 (1935).

the President unlimited authority to declare a policy of his own.[79] The Court was unable to find any criterion that would restrict the President and thus determined that the President was acting more like a "legislature rather than . . . an executive or administrative officer executing a declared legislative policy."[80]

Thus, in order to find a permissible delegation of power, the delegation must provide a policy and standards by which that policy must be implemented. These limits apply whether the delegation of power is express or implied. As the Court stated in *Panama Refining:* "there are limits of delegation which there is no constitutional authority to transcend."[81]

In the same year as *Panama Refining*, the Court struck down another delegation of authority in A.L.A. Schechter Poultry Corp. v. United States.[82] In *Schechter*, the Court found that a provision of the National Industrial Recovery Act delegating to the President the power to approve "codes of fair competition" lacked sufficient standards to guide the President's discretion.[83] These codes were to be approved upon application of a trade or industrial association meeting certain requirements, but if no such code were approved, the President had authority to prescribe a code, the violation of which was punishable as a misdemeanor. The purpose of these codes was to "effect the policies of title I of the National Industrial Recovery Act."[84]

Panama Refining and *A.L.A. Schechter* are the only two cases in which the Supreme Court has invalidated an act as violating the nondelegation doctrine.[85]

The following year, the Court considered the delegation issue in the context of foreign affairs in United States v. Curtiss-Wright Export Corp.[86] Congress, in a Joint Resolution, had delegated to the President the power to prohibit sales of arms or munitions to countries engaged in armed conflict. Before making such a prohibition, the President was to determine if this action might have the effect of bringing about peace. The extent of the prohibition, and its duration, were within the President's discretion. Violation of the prohibition was punishable as a crime. In *Curtiss-Wright*, the Court considered whether this delegation was valid.[87] Citing the long history of

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79. Id. at 415. "The Congress left the matter to the President without standard or rule, to be dealt with as he pleased." Id. at 418.

80. Id. at 418-19.

81. Id. at 430.

82. 295 U.S. 495 (1935).

83. Id. at 541-42.

84. Id. at 523.

85. See Mistretta v. United States, 488 U.S. 361, 373-74 (1989) (citing cases in which the Court has since upheld various delegations of power).

86. 299 U.S. 304 (1936).

87. Id. at 315.

cases allowing broad discretion to be delegated to the President in matters of foreign affairs, the Court found that the delegation was not invalid, despite the breadth of discretion left to the President.[88]

Since 1935, the Supreme Court has repeatedly refused to invalidate statutes under the nondelegation doctrine.[89] However, regulations have been struck down where the Court has determined that they did not reflect congressional intent. In Industrial Union Department v. American Petroleum Institute,[90] the Court struck down a rule issued by the Occupational Safety and Health Administration (OSHA) that banned workplace exposure to benzene. The Court determined that OSHA was required to take costs into account in carrying out its delegated responsibility to "assure" a "safe and healthful" workplace. The Court applied a "clear statement rule," requiring that Congress issue a clear statement before a regulatory agency would be able to assume power to legislate.[91]

The current standards are detailed in a well-reasoned district court case decided by now-Justice Scalia, Synar v. United States.[92] The court found that although a grant of authority to the Comptroller General under the Gramm-Rudman-Hollings Act[93] was unconstitutional due to a separation of powers issue, the power was one that could lawfully be delegated. The delegated power authorized the Comptroller General, if the deficit exceeded a certain amount, to issue a report to the President and to Congress containing deficit estimates and budget reduction calculations. After receiving this report, the President was required to issue a sequestration order containing the budget reductions specified by the Comptroller General. In essence, Congress delegated power to make budget cuts if the deficit exceeded a specified amount.

In *Synar*, the court was faced with two questions: First, did the legislature delegate legislative power that may not be delegated under any circumstance; and second, can the legislative authority be given to the Comptroller General, who is an officer removable by Congress? The court rejected the notion that some powers were inherently nondelegable and held that the true measure of what could be delegated was to be found in how precise the standards governing the delegation were. In doing so, the court rejected the

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88. Id. at 322-29.

89. See cases cited in Synar v. United States, 626 F. Supp. 1374, 1383-84 n.9 (D.D.C. 1986).

90. 448 U.S. 607 (1980).

91. Id. at 645.

92. 626 F. Supp. 1374 (D.D.C. 1986) (per curiam with Scalia, J., sitting as one of the three judges), aff'd sub nom. Bowsher v. Synar, 478 U.S. 714 (1986) (affirming the district court on the separation of powers issue).

93. Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-177, § 200, 99 Stat. 1038 (1985).

notion that there were core legislative functions that could not be delegated under any circumstances.[94] The court stated:

> [T]he ultimate judgment regarding the constitutionality of a delegation must be made not on the basis of the scope of the power alone, but on the basis of its scope *plus* the specificity of the standards governing its exercise. When the scope increases to immense proportions (as in *Schechter*) the standards must be correspondingly more precise.[95]

The court went on to explain what is needed for a permissible delegation. In order to permissibly delegate authority, Congress must provide "adequate standards to restrict administrative discretion."[96] Citing an earlier Supreme Court case, the court found that "[t]he essential inquiry is whether the specified guidance 'sufficiently marks the field within which the Administrator is to act so that it may be known whether he has kept within it in compliance with the legislative will.' "[97]

This standard is also reflected in Mistretta v. United States,[98] where the Supreme Court considered Congress' delegation to the United States Sentencing Commission, by the Sentencing Reform Act of 1984, of the power to fix penalties for violations of federal criminal statutes. In the Act, Congress provided goals and purposes to be met by the Commission in promulgating sentencing guidelines. The Court found that the delegation was constitutional. It stated that "[s]o long as Congress 'shall lay down by legislative act an intelligible principle to which the person or body authorized to [exercise the delegated authority] is directed to conform, such legislative action is not a forbidden delegation of legislative power.' "[99] Although the delegated discretion was broad, the Court found that Congress had provided adequate standards to guide the Commission in the implementation of its discretion.[100] A delegation is not invalid, according to the Court, simply because the agency is required to use its own judgment in exercising the delegated authority. So long as a delegation of power is accompanied by adequate

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94. The Court noted that the Supreme Court has never held a legislative power to be nondelegable due to being a core function. *Synar*, 626 F. Supp. at 1385.

95. Id. at 1386.

96. Id. at 1387.

97. Id. at 1387 (quoting Yakus v. United States, 321 U.S. 414, 425 (1944)).

98. 488 U.S. 361 (1989). The Court in *Mistretta* cited *Synar* with approval. Id. at 373.

99. Id. at 372 (quoting J.W. Hampton, Jr., & Co. v. United States, 276 U.S. 394, 409 (1928)).

100. *Mistretta*, 488 U.S. at 377.

standards to guide the person or agency to which power is delegated, it is not unconstitutional.

Under the foregoing authorities, it seems likely that the power to override treaties can be delegated. However, to make a valid delegation of this power, Congress must issue a clear statement and provide adequate standards. No clear statement and no standards of any sort can be found in section 7701(*l*) or its legislative history.[101]

2. *Implicit Delegation.*—The lack of an explicit delegation raises the question of whether Congress might constitutionally be able to delegate override authority implicitly. Override authority might be implied from legislative history citing cases and rulings involving treaty overrides or perhaps from a statute that could only be applied in an override context.[102]

In Weinberger v. Rossi,[103] the Supreme Court confronted a situation where ambiguous statutory language arguably overrode thirteen international agreements. The statute before the Court prohibited discrimination against U.S. citizens on overseas military bases in employment decisions.[104] An exception provided that the statute would not apply if this type of discrimination was permitted by a "treaty." The issue before the Court was whether the term "treaty" was limited to its meaning under Article II, Section 2, Clause 2 of the U.S. Constitution or had some broader meaning. If the term was construed narrowly, the thirteen international agreements, not rising to the constitutional meaning of treaty, would be overridden.

However, the Court construed the term more broadly to encompass all international agreements, thereby permitting the thirteen international agreements to control. The Court quoted *Schooner Charming Betsy*[105] for the proposition that "an act of Congress ought never to be construed to violate the law of nations, if any other possible construction remains. . . ."[106] The Court stated that "some affirmative expression of congressional intent to abrogate the United States' international obligations is required" before the Court could adopt an interpretation that would have

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101. See supra text accompanying notes 57-60.

102. See The Cherokee Tobacco, 78 U.S. 616 (1870).

103. 456 U.S. 25 (1982).

104. Military Selective Service Act of 1967, sec. 106, 85 Stat. 348, 355 (1971).

105. Murray v. Schooner Charming Betsy, 6 U.S. 64, 118 (1804).

106. The Court cited McCulloch v. Sociedad Nacional de Marineros de Honduras, 372 U.S. 10, 20-21 (1963), as a case applying this principle. In that case, the Court found that without a clearly expressed intention to violate the law of nations, it would not find that Congress intended for the National Labor Relations Board to have jurisdiction over seamen on ships flying the flag of a foreign nation, even though the ships were owned, through a series of corporations, by a U.S. parent corporation and ultimately by U.S. shareholders.

the effect of overriding thirteen international agreements.[107] In *Weinberger*, the Court showed a reluctance to find an override of an international agreement, even one not rising to the level of a treaty within the constitutional sense.

If Congress cannot implicitly override U.S. treaty commitments, an administrative agency surely cannot override a treaty based on implicit congressional authority. In Trans World Airlines v. Franklin Mint Corp.,[108] the Court was faced with regulations that arguably overrode parts of the Warsaw Convention. The regulations were promulgated by the Civil Aeronautics Board (CAB) pursuant to authority granted by Congress in accordance with the Warsaw Convention. The regulations, designed to limit the liability of international air carriers, were originally based on the Par Value Modification Act (PVMA). When the United States went off the gold standard, the PVMA was repealed, but the CAB continued to use the last official price of gold as a conversion factor. The regulations were challenged on the ground that repeal of the PVMA rendered the Convention unenforceable in the United States.

In rejecting this contention, the Court recognized "a firm and obviously sound canon of construction against finding implicit repeal of a treaty in ambiguous congressional action," and stated that "[l]egislative silence is not sufficient to abrogate a treaty."[109] The regulations were legislative regulations, promulgated pursuant to an executive branch determination of the appropriate conversion factor, and the Court was "bound to uphold that determination unless [it found] it to be contrary to law established by domestic legislation or by the Convention itself."[110] Further, "[w]e may overrule the CAB's action only if we conclude that it is inconsistent with the purposes of the Convention or with domestic law."[111]

By finding that the regulations must comply with both domestic law and the Convention, the Court recognized that the regulations themselves had no independent authority to override the Convention. The Court determined that the authority to make the conversion factors was properly delegated by Congress to the Executive Branch, but it nevertheless required the delegation to be exercised in a manner not "inconsistent with domestic or international law."[112] Thus, even with properly delegated administrative authority, the regulations could not override a U.S. treaty commitment.

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107. *Weinberger*, 456 U.S. at 32.
108. 466 U.S. 243 (1984).
109. Id. at 252.
110. Id. at 254.
111. Id. at 255 n.26.
112. Id. at 261.

3. *Regulatory Override Without Delegation*.—Certainly, if Congress cannot implicitly delegate authority to promulgate regulations overriding treaties, the judiciary will not uphold a regulatory override in the absence of any delegation. The Treasury cannot on its own initiative override treaty commitments. Legislative regulations only have the effect of law to the extent they are within a congressional grant of authority.[113]

Indeed, courts will go to great lengths to prevent regulations from limiting a treaty commitment, even indirectly. In Tate & Lyle, Inc. v. Commissioner,[114] the court was faced with regulations that indirectly, but significantly limited the benefits of an income tax treaty with the United Kingdom. The treaty provides that interest payable to a resident of the United Kingdom is not taxable by the United States.[115] The regulations are legislative regulations promulgated under section 267(a)(3), which authorizes regulations applying the matching principle of section 267(a)(2) to payments to related foreign persons.[116] In *Tate & Lyle*, the effect of the regulations was to prevent the domestic subsidiaries of a United Kingdom parent from deducting interest owed to the parent until the interest was paid, even though the subsidiaries used the accrual method of accounting.

The matching principle of section 267(a)(2) only requires that an item payable to a related person not be deducted before the recipient is required under its method of accounting to report it as gross income. In contrast, the regulations require all interest payable to related foreign persons to be deducted on a cash basis if it is not effectively connected with a U.S. business of the recipient, whether or not the recipient is subject to U.S. tax on receipt of the income.[117] In *Tate & Lyle*, the regulations did not directly affect the treaty exemption, but they indirectly impaired its value by deferring the payor-subsidiaries' deductions for the interest beyond the time when it would normally be deductible under the subsidiaries' accrual methods of accounting.

The court held that the regulations went beyond the authority granted by the statute. In the court's view, the U.K. parent corporation had not taken the interest into U.S. gross income because of the treaty, which exempted it

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113. Chrysler Corp. v. Brown, 441 U.S. 281, 304; American Std., Inc. v. United States, 602 F.2d 256, 261 (Ct. Cl. 1979) ("Though legislative regulations are law, they are good law only if enacted in accordance with the authority vested in the Treasury by the enabling Act").

114. 103 T.C. No. 37 (1994).

115. Convention Between the Government of the United States and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Dec. 31, 1975, U.S.-U.K., art. 11, para. 1.

116. Regs. § 1.267(a)-3.

117. Regs. § 1.267(a)-3(b).

from U.S. tax, and not because of the parent's method of accounting. By finding that the regulations went beyond the authority granted by the statute, the court avoided the issue of whether the regulations could override or limit treaty benefits. A similar conclusion—that the regulations go beyond the authority granted in by statute—is warranted in the section 7701(*l*) context.

IV. APPROPRIATE DATE FOR LATER-IN-TIME PURPOSES

From the foregoing, it appears that U.S. domestic law does not support regulations under section 7701(*l*) that override treaty commitments. However, for purposes of this section, it is assumed that (1) Congress may delegate authority to override a treaty to the Treasury and adequately expressed an intention to do so in section 7701(*l*) and (2) the Treasury intends the regulations to override treaties. Even with these assumptions, the regulations will not, under the later-in-time rule, override any treaty made after the regulations are promulgated. It is less clear how the later-in-time rule should apply in case of a conflict between the regulations and a treaty ratified after the enactment of section 7701(*l*) but before the promulgation of the final regulations.[118]

For example, section 7701(*l*) was enacted on August 10, 1993, the U.S.-Netherlands Treaty became effective on January 1, 1994, and the regulations were proposed on October 14, 1994[119] and were issued in final form on August 10, 1995.[120] Which is later in time? Section 7701(*l*) and its accompanying regulations will not override the U.S.-Netherlands Treaty if the relevant date for later-in-time purposes is the date of enactment of section 7701(*l*). However, if the relevant date is the date on which the final regulations are promulgated, the regulations are later-in-time and therefore override the U.S.-Netherlands Treaty.

The later-in-time rule is not constitutionally mandated.[121] It arose out of Taylor v. Morton,[122] one of the first cases to recognize that acts of Congress and treaties had equal status under the Supremacy Clause. In that case, Justice Curtis, in resolving a conflict between an earlier-ratified treaty and a later-enacted statute, commented almost offhandedly that "the act of

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118. See Bennett, et al., supra note 58, at 22 n.98.

119. INTL-64-93, 59 Fed. Reg. 52,110 (1994).

120. The regulations were filed on August 10, 1995 and were published in the Federal Register on Aug. 11, 1995. T.D. 8611, 60 Fed. Reg. 40,997 (1995). The regulations are generally effective for payments made by financed entities after September 10, 1995. Regs. § 1.881-3(f).

121. The Cherokee Tobacco, 78 U.S. 616, 621 (1870) ("The effect of treaties and acts of Congress, when in conflict, is not settled by the Constitution.").

122. 23 F. Cas. 784 (C.C.D. Mass. 1855) (No. 13,799).

congress, *because it is the later law*, must prescribe the rule by which this case is to be determined. . . ."[123] Taylor v. Morton was cited with approval in a series of Supreme Court cases firmly establishing the later-in-time rule.[124] Every application of the rule focuses on the enactment date of "an act of congress"[125] or "an act of legislation."[126] No reference is made to the date of enactment of a regulation.

The judicially developed later-in-time rule is codified in section 7852(d)(1), as follows: "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." The legislative history of this provision states in part:

> In adopting this rule the committee intends to permanently codify (with respect to tax-related provisions) present law to the effect that canons of construction applied by the courts to the interaction of two statutes enacted at different times apply also in construing the interactions of revenue statutes and treaties enacted and entered into at different times. The committee does not intend this codification to alter the initial presumption of harmony between, for example, earlier treaties and later statutes.[127]

The history of another provision perhaps offers some insight into a changed mood in Congress. Prior to amendment in 1988, section 894(a) provided in part: "Income 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." This language seems innocuous enough, but Congress became concerned that it proclaimed that tax treaties were superior to domestic legislation. As amended in 1988, section 894(a) now reads: "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." The change serves as a congressional warning that treaty obligations must give way to later-enacted legislation.

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123. Id. at 785 (emphasis added).

124. Chinese Exclusion Case, 130 U.S. 581, 602 (1889); Whitney v. Robertson, 124 U.S. 190, 194-95 (1888); Head Money Cases, 112 U.S. 580, 585 (1884); The Cherokee Tobacco, 78 U.S. 616, 621 n.9 (1870).

125. Chinese Exclusion Case, 130 U.S. at 602; Head Money Cases, 112 U.S. at 599; The Cherokee Tobacco, 78 U.S. at 621; Taylor v. Morton, 23 F. Cas. at 785.

126. Whitney v. Robertson, 124 U.S. at 194.

127. S. Rep. No. 445, 100th Cong., 2d Sess. 321 (1988), reprinted in 1988 U.S.C.C.A.N. 4515, 4833.

However, neither section 7852(d)(1) nor section 894(a) answers the question of whether the date of the regulation or the date of the authorizing statute should govern for later-in-time purposes.

A. *Legislative Regulations Alone are not Laws in Constitutional Sense*

Although the Supreme Court has never directly addressed this question, it has made clear that a regulation is given the effect of law only because it is authorized by statute. In Chrysler Corp. v. Brown,[128] the Court stated that a regulation can have the "force and effect of law," but further noted: "The legislative power of the United States is vested in the Congress, and the exercise of quasi-legislative authority by governmental departments and agencies must be rooted in a grant of such power by the Congress and subject to limitations which that body imposes."[129]

In Manhattan General Equipment Co. v. Commissioner,[130] the Court considered whether a Treasury regulation could apply to a transaction consummated after the enactment of the authorizing statute but before the regulation was promulgated. The Court held that it could, rejecting the contention that this resulted in the regulation being applied retroactively. "The statute defines the rights of the taxpayer and fixes a standard by which such rights are to be measured. The regulation constitutes only a step in the administrative process. It does not, and could not, alter the statute."[131]

In City of New York v. FCC,[132] the Supreme Court, in the course of deciding whether a federal regulation could preempt a state statute, discussed the role of regulations under the Supremacy Clause. Focusing on the phrase "Laws of the United States" in the Supremacy Clause, the Court concluded: "The phrase 'Laws of the United States' encompasses both federal statutes themselves and federal regulations that are properly adopted in accordance with statutory authorization."[133]

When Congress authorizes an agency to promulgate regulations it is not delegating power to make law; rather, the agency is given power to carry into effect the will of Congress as expressed by the statute.[134] If a nexus is not established between the regulation and the congressional delegation, the

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128. 441 U.S. 281 (1979).
129. Id. at 302.
130. 297 U.S. 129 (1936).
131. Id. at 135.
132. 486 U.S. 57 (1988).
133. Id. at 63.
134. Manhattan General Equip. Co. v. Commissioner, 297 U.S. 129, 134 (1936); see also Dixon v. United States, 381 U.S. 68, 74-75 (1965).

regulation does not have the effect of law.[135] These principles lead to the conclusion that because it is the enabling statute that is the law, the enabling statute's effective date should be controlling for later-in-time purposes.

This conclusion draws additional support from the Supreme Court's decision in Immigration and Naturalization Service v. Chadha[136] to invalidate section 244(c)(2) of the Immigration and Nationality Act, which authorized "one House of Congress, by resolution, to invalidate the decision of the Executive Branch . . . to allow a particular deportable alien to remain in the United States."[137] The House of Representatives had vetoed the Attorney General's decision to allow Chadha to remain in the United States after his visa expired. The Court held the House's action to be legislative in nature and therefore subject to the Presentment Clause of the Constitution, which states that "Every Bill which shall have passed the House of Representatives and the Senate, shall, before it becomes a Law, be presented to the President of the United States."[138] Since the one-house veto process did not follow this procedure, the Court found it invalid.

The Court's emphasis on observing the substance and formalities of legislative power lends support to the conclusion that the date of enabling legislation should control for later-in-time purposes. According to the *Chadha* Court, "the prescription for legislative action in Art. I, §§ 1, 7, represents the Framers' decision that the legislative power of the Federal Government be exercised in accord with a single, finely wrought and exhaustively considered, procedure."[139] Noting the irony that its insistence on the solemnity of legislative acts resulted in upholding an administrative decision of the Attorney General in the face of legislative objections, the Court explained the constitutional effect of an administrative action.

> To be sure, some administrative agency action—rulemaking, for example—may resemble "lawmaking." This Court has referred to agency activity as being "quasi-legislative" in character. Clearly, however, "[in] the framework of our Constitution, the President's power to see that the laws are faithfully executed refutes the idea that he is to be a lawmaker." Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 587 (1952). When the Attorney General performs his duties

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135. Chrysler Corp. v. Brown, 441 U.S. 281, 302 (1979).
136. 462 U.S. 919 (1983).
137. Id. at 923.
138. U.S. Const. art. I, § 7, cl. 2.
139. Immigration and Naturalization Ser. v. Chadha, 462 U.S. at 951.

> pursuant to § 244, he does not exercise "legislative" power.[140]

Likewise, when the Treasury exercises its authority to promulgate regulations, it does not exercise legislative power. It does not pass a "law of the United States" within the meaning of the Supremacy Clause, and it therefore does not establish a date for resolving conflicts arising out of the Supremacy Clause under the later-in-time rule.

The later-in-time rule is intended to resolve a conflict between two acts of the sovereign—a treaty and congressional authorization to override that treaty. The rule is rooted in the common sense notion that the last act of the sovereign is likely to represent its present intentions. Suppose that the United States through an act of Congress enacts a provision which purports to override treaty commitments and subsequently makes a treaty providing that it is to apply notwithstanding the earlier legislation. This later act of the sovereign must prevail because it occurred with full knowledge of the earlier act. This should be so even if subsequent to the effective date of the treaty, the Treasury promulgates regulations carrying out the earlier legislation.

In sum, if Congress wants to override the U.S.-Netherlands treaty, it can do so only by the enactment of a post-treaty law clearly stating that intent.

B. *Statutes Cannot Override Prospectively*

An additional issue that needs to be explored is whether Congress can pass a statute that overrides subsequent treaties.[141] More specifically, can Congress delegate to the Treasury power to promulgate regulations that will override future treaties? If Congress has this power, section 7701(*l*) may provide statutory authority to override the U.S.-Netherlands treaty.

By the later-in-time rule, the Supreme Court has construed the Supremacy Clause to empower Congress to override prior treaties by passing a statute in direct conflict with them, but there is no suggestion in the

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140. Id. at 953 n.16 (some citations omitted).

141. Congress purported to do this in the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1810(a)(4), 100 Stat. 2085, 2822-23, which provides:

> Section 904(g) of the Internal Revenue Code of 1954 shall apply notwithstanding any treaty obligation of the United States to the contrary (whether entered into on, before, or after the date of the enactment of this Act) unless (in the case of a treaty entered into after the date of the enactment of this Act) such treaty by specific reference to such section 904(g) clearly expresses the intent to override the provisions of such section.

Supremacy Clause that a prospective override would be effective. Conversely, nothing in the Supremacy Clause recognizes the ability of treaty partners to agree that a treaty will apply notwithstanding future acts of Congress. In either case, serious constitutional issues arise.

In addition to ignoring the later-in-time rule, a statute that purports to override subsequent treaties raises a constitutional question as to whether the treaty process has been violated.[142] The Constitution provides that the President "shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur."[143] If valid, a statute purporting to override later treaties limits the President's treaty making powers, and the House of Representatives is included in the process by being a part of the enactment of the statute.[144] Conversely, a treaty purporting to deprive Congress of the right to enact future legislation overriding the treaty would arguably usurp the House of Representatives' role in legislation.[145]

Statutes are interpreted, to the extent possible, to avoid troubling constitutional issues. For example, in National Labor Relations Board v. Catholic Bishop of Chicago,[146] the NLRB received petitions seeking union representation for lay teachers at Catholic schools that offered traditional secular education, similar to that in public secondary schools, in addition to religious instruction. The NLRB accepted jurisdiction over the petitions and ordered elections because the schools were not completely religious.[147] The schools refused to recognize the unions, arguing that the NLRB had no jurisdiction over religious schools.

The Supreme Court, in rejecting NLRB jurisdiction, analyzed the legislative history of the National Labor Relations Act of 1935 to determine whether Congress intended the NLRB to have jurisdiction over religious schools. It made this analysis because a construction of the Act that allowed NLRB jurisdiction over these schools would force the Court to determine

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142. Committee on U.S. Activities of Foreign Taxpayers and Foreign Activities of U.S. Taxpayers of the New York State Bar Ass'n Sec. Tax'n, Legislative Overrides of Tax Treaties, 37 Tax Notes 931, 933-34 (Nov. 30, 1987) [hereinafter Committee on U.S. Activities of Foreign Taxpayers].

143. U.S. Const. art. II, § 2, cl. 2.

144. Committee on U.S. Activities of Foreign Taxpayers, supra note 142, at 933-34. Also, such a statute can make treaty negotiations more difficult by inhibiting the negotiators' freedom. Id.

145. U.S. Const. art I, § 1.

146. 440 U.S. 490, 500 (1979).

147. The NLRB's "policy was to decline jurisdiction over religiously sponsored organizations 'only when they are completely religious, not just religiously associated.'" NLRB v. Catholic Bishop of Chicago, 440 U.S. at 493 (quoting Roman Catholic Archdiocese of Baltimore, 216 NLRB 249, 250 (1979)).

whether this jurisdiction violates the Religion Clauses of the First Amendment.[148] Because the Court could not find Congress' clear intent to grant jurisdiction to the NLRB over church-operated schools, the Court interpreted the Act in a way that avoided the constitutional issue.[149]

Similarly, in Murray v. Schooner Charming Betsy,[150] Chief Justice Marshall stated that "an Act of Congress [is] never to be construed to violate the law of nations if any other possible construction remains. . . ."

Thus, a statute that arguably has the effect of overriding subsequent treaties should be interpreted in a way that does not raise the constitutional issues mentioned above. With respect to section 7701(*l*), it is possible to interpret the statute in a way that does not violate the treaty process. Because Congress has not expressed a clear intent to override subsequent treaties, the statute might be read to override treaties already in existence when section 7701(*l*) was enacted but not any subsequent treaties.[151]

V. CONCLUSION

Whenever Congress overrides a treaty, it violates international law—an act that should not be undertaken lightly. In the absence of a direct conflict, every effort should be made to interpret the act of Congress and the treaty in a nonconflicting manner. Congress can override a treaty only by signaling its intent clearly. If it chooses to delegate the actual operation of the override to the Treasury by regulations, the delegation must be clear and must include some guidance on the exercise of the delegated authority. Finally, if Congress has explicitly delegated the authority to override and has provided the constitutionally required guidance, then, once the Treasury has carried out its authority, all treaties whose effective dates precede the legislative act must give way to that act. By the same token, all treaties made after the legislative act must prevail over the legislation to the extent of any conflict.

As applied to section 7701(*l*) and the subsequent U.S.-Netherlands Treaty, these principles yield the following results: Section 7701(*l*) does not on its face or in its legislative history explicitly state an intent to override any treaty. The provision can have a wide range of application even if it does not override conflicting treaty provisions. Notwithstanding the absence of legislative intent to override, the regulations under section 7701(*l*) appear to

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148. The First Amendment provides that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof. . . ." U.S. Const. amend. I.

149. NLRB v. Catholic Bishop of Chicago, 440 U.S. at 507.

150. 6 U.S. (2 Cranch) 64,118 (1804).

151. However, as noted in Part III.B, an intent to override preexisting treaties is neither explicit nor implicit in § 7701(*l*).

apply in an overriding manner, although the Treasury denies that this is the intent or effect. The regulations deny treaty benefits (e.g., exemption of interest payments from U.S. withholding tax) that would otherwise be available. This denial occurs even where the treaty partners confronted the problem addressed by the regulations and responded with a lengthy and detailed limitation on benefits provision.

Finally, even if the requisite intent to override were present in the legislation and carried out by Treasury pursuant to articulated standards, any conflict between the treaty and section 7701(*l*) must be resolved by comparing the date of the treaty with the date of enactment of the statute. Accordingly, a post-statute treaty, such as the important treaty between the United States and the Netherlands, must prevail even though the overriding regulations were promulgated after the treaty was made.

The constitutional authority for Congress to override international agreements is not easily understood or embraced by other countries. While the Supreme Court has recognized this authority on numerous occasions, it has tempered the authority with the admonishment that it will recognize legislation as overriding preexisting treaties only if Congress clearly expresses an intent to override and the domestic legislation presents an insurmountable conflict with the treaties. Section 7701(*l*) does not clearly express an intent to authorize treaty-overriding regulations and conflict with preexisting treaties is not insurmountable. As a policy matter, Congress rather than its delegatee should be the one to violate international law when that is necessary, and any such violation should be clear and explicit.