

Texas Law Review

See Also

Response

Optimal Tax Treaty Administrative Guidance

Craig M. Boise*

I. Introduction

With the advent of economic globalization, U.S.-based multinational enterprises have developed increasingly complex international tax-reduction strategies that frequently rely on provisions of one or more of the sixty-odd bilateral income tax treaties to which the United States is a party.¹ Unfortunately, U.S. tax treaties are infrequently updated, even as cross-border business structures and transactions—and the views of U.S. tax administrators as to how tax treaty provisions should apply to them—continue to evolve.² Consequently, the appropriate interpretation of U.S. tax treaties often is uncertain, a situation that on the one hand invites aggressive tax planning by multinational enterprises, and on the other hand poses challenges for federal courts that must determine whether such planning has crossed the line from legitimate to abusive.³

In interpreting and applying tax treaties, federal courts generally rely on the treaty text unless the language is ambiguous. Where ambiguity exists, they may turn for assistance to administrative guidance such as the technical explanation of the treaty at issue or technical explanations of other U.S. tax

* Professor of Law, Director of Tax Programs, and Director, Institute for Offshore Financial Studies, DePaul University College of Law. B.A., University of Missouri-Kansas City; J.D., University of Chicago Law School; LL.M (Taxation), New York University School of Law. Justin Lesko provided excellent research assistance.

1. Michael S. Kirsch, *The Limits of Administrative Guidance in the Interpretation of Tax Treaties*, 87 TEXAS L. REV. 1063, 1066–67 (2009).

2. *See id.* at 1067–68 (discussing the pressure placed on contextual interpretation of U.S. tax treaties that results from the difficulties of updating the treaties).

3. *See id.* at 1069 (arguing that the increased complexity of international relations and greater sophistication of corporate taxpayers have raised concerns about the lack of guidance given to courts regarding tax treaty interpretation).

treaties, including the U.S. Model Tax Treaty.⁴ In an article that provides an important contribution to the tax treaty literature, Professor Michael Kirsch thoroughly explores the extent to which courts use technical explanations for guidance in interpreting treaties.⁵ He concludes that although multinational enterprises frequently employ select provisions of technical explanations to support aggressive tax structuring, courts give those same technical explanations little or no deference in interpreting and applying treaty provisions.⁶

Professor Kirsch argues that the Treasury should respond to the limited utility of technical explanations in this context by issuing administrative guidance in the form of Treasury regulations.⁷ For reasons explored in this Response, I believe it is unlikely that Treasury regulations would significantly transcend the limitations of technical explanations.⁸ Nonetheless, Professor Kirsch has begun an important conversation about how best to provide tax treaty guidance that is useful to courts and taxpayers alike. This Response is intended to advance that conversation. Part II identifies three criteria that are essential to theoretically optimal tax treaty guidance⁹ by examining the shortcomings of technical explanations, which currently are the most common form of administrative treaty guidance, and evaluates whether Treasury regulations would satisfy those criteria. Part III concludes with some brief thoughts about possible forms of administrative tax treaty guidance other than Treasury regulations.

4. U.S. DEP'T OF THE TREASURY, UNITED STATES MODEL INCOME TAX CONVENTION OF Nov. 15, 2006 [hereinafter U.S. MODEL TAX TREATY], *available at* <http://www.ustreas.gov/press/releases/reports/hp16801.pdf>. The technical explanation of a proposed tax treaty is prepared by the Treasury Department and sent, along with the treaty, to the Senate Foreign Relations Committee in advance of hearings on the proposed treaty. *See* ALI, FEDERAL INCOME TAX PROJECT: INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION II: PROPOSALS OF THE AMERICAN LAW INSTITUTE ON UNITED STATES INCOME TAX TREATIES 1–2 (1992).

5. Kirsch, *supra* note 1, at 1069–70.

6. *See id.* at 1134.

7. *Id.*

8. Professor Kirsch both recognizes and addresses the limitations of his proposal. *See id.* at 1114–34. Where we differ is in our views of the residual utility of issuing administrative guidance in the form of Treasury regulations given those limitations.

9. Obviously, other criteria might be important for treaty guidance. *See* Kristen A. Parillo, *Treasury Considering Supplemental Treaty Guidance, Official Says*, 238 TAX NOTES TODAY 3 (Dec. 10, 2008) (citing a comment by Treasury deputy international tax counsel Gretchen Sierra that issuing supplemental treaty guidance in the form of regulations would enable Treasury to “get reporting from taxpayers that take positions contrary to the regs”).

II. The Essentials of Optimal Tax Treaty Guidance

A. *Authoritativeness*

The most important criterion of optimal administrative tax treaty guidance is that it be authoritative. An authoritative source of treaty guidance would, of course, directly benefit U.S. federal courts, which play a central role in tax treaty interpretation through their resolution of tax treaty disputes, but it also would give taxpayers greater certainty about the treatment of particular tax structures and transactions. Such guidance also would sharply curtail aggressive tax planning by multinational enterprises that exploits the differences among current sources of treaty guidance.¹⁰ For administrative treaty guidance to be authoritative, however, it must satisfy certain interpretational norms. Because treaties are simultaneously international agreements and a part of U.S. law, such norms must be derived from principles of public international law as well as provisions of domestic law.¹¹

The principal source of international treaty interpretation norms is the Vienna Convention on the Law of Treaties.¹² Treaty interpretation under the Vienna Convention begins with assigning treaty terms their ordinary meaning “in their context.”¹³ Context, for this purpose, includes “any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty” and “any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.”¹⁴ In addition, treaty interpretation may take into account a “subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions” and “any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation.”¹⁵ Thus, the touchstone of authoritativeness for interpretive

10. See Kirsch, *supra* note 1, at 1113 (describing how, under the current standard, corporations can pick and choose among technical explanations from various treaties to establish standards, whereas regulations would provide a limiting principle on how standards would be established).

11. See Ernest A. Young, *Treaties as “Part of Our Law,”* 88 TEXAS L. REV. 91, 95 (2009) (“Treaties have a dual existence: they are part of international law and, by virtue of the Supremacy Clause, simultaneously part of ‘the supreme Law of the Land.’ They are thus necessarily *shared* law among multiple jurisdictions and multiple interpreters . . .”). The Supremacy Clause of the U.S. Constitution states that “[A]ll Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land.” U.S. CONST. art. VI, cl. 2.

12. Vienna Convention on the Law of Treaties, *opened for signature* May 23, 1969, 1155 U.N.T.S. 331.

13. *Id.* art. 31(1).

14. *Id.* art. 31(2)(a)–(b).

15. *Id.* art. 31(3)(a)–(b).

guidance under the Convention is whether such guidance reflects the mutual understanding of the parties to the treaty.

Although the Vienna Convention does not bind the United States,¹⁶ domestic law on treaty interpretation as developed by U.S. courts generally is consistent with the Convention's principles.¹⁷ Like the Convention, U.S. courts require that the text of the treaty be followed except where it is ambiguous or where a literal application of the treaty language would produce a "result inconsistent with the intent or expectations of its signatories."¹⁸ And consistent with the Convention, U.S. courts have permitted reliance on non-treaty materials, such as the history of treaty negotiations or post-treaty practices of the signatories, to supplement the treaty text, when doing so fulfilled the "judicial obligation . . . to *satisfy the intention of both of the signatory parties*."¹⁹ Thus, under both the Vienna Convention and U.S. case law, administrative treaty guidance is authoritative only if it satisfies what may be referred to as the "mutuality imperative."

Because they generally do not reflect the mutual understanding of the treaty signatories, technical explanations—the most important current form of administrative guidance—fail to satisfy the mutuality imperative and thus lack authoritativeness.²⁰ As Professor Kirsch points out, with one recent notable exception, technical explanations are prepared unilaterally by the Treasury Department after a treaty has been negotiated and signed.²¹ Under

16. The United States has signed but never ratified the Vienna Convention. *See* Kirsch, *supra* note 1, at 1078. The United States considers many provisions of the Convention to "constitute customary international law on the law of treaties." U.S. DEP'T OF STATE, *Frequently Asked Questions: Vienna Convention on the Law of Treaties*, <http://www.state.gov/s/l/treaty/faqs/70139.htm>.

17. Kirsch, *supra* note 1, at 1083 n.96.

18. *Sumitomo Shoji Am., Inc. v. Avagliano*, 457 U.S. 176, 180 (1982) (quoting *Maximov v. United States*, 373 U.S. 49, 54 (1963)); *see also* *O'Connor v. United States*, 479 U.S. 27, 31 (1986) (articulating a higher threshold for supplementing the treaty text where a literal reading would produce an "implausible" outcome).

19. *Xerox Corp. v. United States*, 41 F.3d 647, 652 (Fed. Cir. 1994) (emphasis added) (reviewing the negotiation history of the U.S.–U.K. tax treaty); *see also* *United States v. Stuart*, 489 U.S. 353, 369 (1989) (considering the conduct of treaty signatories as evidence of a mutual understanding of the treaty).

20. I refer to technical explanations here as being the most important form of administrative guidance because they are frequently consulted by taxpayers and their advisors, as well as by the courts. As Professor Kirsch points out, however, their use may be of little actual consequence to the extent that courts in practice rely on them merely to confirm an interpretation of a treaty reached by some other method. Kirsch, *supra* note 1, at 1101–02 & nn. 200–02.

21. Treasury departed from its unilateral approach when it consulted with Canada in preparing the technical explanation of the 2007 Protocol to the U.S.–Canada tax treaty. *See* U.S. DEP'T OF THE TREASURY, TECHNICAL EXPLANATION OF THE PROTOCOL DONE AT CHELSEA ON SEPTEMBER 21, 2007 AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND CANADA WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL DONE AT WASHINGTON ON SEPTEMBER 26, 1980, AS AMENDED BY THE PROTOCOLS DONE ON JUNE 14, 1983, MARCH 17, 1995, AND JULY 29, 1997, at 1 (2008) [hereinafter TECHNICAL EXPLANATION OF PROTOCOL AMENDING CONVENTION BETWEEN THE UNITED STATES AND CANADA], available at <http://www.ustreas.gov/press/>

these circumstances, there can be no assurance that the other signatory to the treaty shares the U.S. understanding of the treaty that is reflected in the technical explanation. This lack of mutuality is even more pronounced in the technical explanation to the U.S. Model Tax Treaty because Treasury alone drafts both the treaty and its explanation.²² Indeed, any form of unilateral extra-treaty administrative guidance issued by Treasury—including revenue rulings, revenue procedures, notices, and even Treasury regulations—necessarily will fail to satisfy the mutuality imperative.²³ This alone would appear to be fatal to Professor Kirsch’s proposal for treaty guidance in the form of Treasury regulations. Professor Kirsch skirts the mutuality issue, however, by limiting his proposal to what might be called “treaty-based” guidance.

Treaty-based guidance relies on those provisions of a tax treaty that explicitly defer to the laws of the contracting states. For example, Article 3(2) of the U.S. Model Tax Treaty states that any term not defined in the treaty will “have the meaning which it has at [the time the treaty is applied] under the law of that State.”²⁴ The law of a state, for this purpose, may include not only statutes but also regulations and any other directives having the force of law.²⁵ Thus, administrative guidance in the form of a valid Treasury regulation defining a term not defined in the U.S. Model Tax Treaty would be authoritative under the terms of the treaty.²⁶ It is critical to note that treaty-based guidance still derives its authority from the fact that it

releases/reports/tecanada08.pdf (outlining the history of negotiations of the 2007 United States and Canada protocol); *see also infra* text accompanying note 54. Because the technical explanation would satisfy the mutuality imperative, this approach may provide a viable model for future administrative guidance. *See infra* Part III.

22. By contrast, interpretation of the OECD Model Treaty is aided by published guidance in the form of commentaries, which are drafted by the OECD Committee on Fiscal Affairs. *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *Model Tax Convention on Income and on Capital: History*, <http://www.itinet.org/mtcwebsite/history.htm> (outlining the creation of Commentaries on the OECD Model Treaty, prepared by the body’s Fiscal Committee). The committee is comprised of senior officials from all OECD member governments who play an active role in formulating and implementing tax policies. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *Centre for Tax Policy and Administration: About*, http://www.oecd.org/about/0,3347,en_2649_34897_1_1_1_1_1,00.html.

23. Professor Kirsch skirts the mutuality issue by limiting administrative guidance in the form of Treasury regulations to those treaty provisions that explicitly defer to the law of the United States. Kirsch, *supra* note 1, at 1115.

24. U.S. MODEL TAX TREATY art. 3(2).

25. *See* Kirsch, *supra* note 1, at 1118 (discussing circumstances under which regulations have the “force and effect of law” and concluding that such regulations should be considered “law” with respect to “those treaty provisions . . . that explicitly defer to the law of the United States”).

26. *See* United States v. Mead Corp., 533 U.S. 218, 219 (2001) (holding that, when Congress has explicitly delegated authority to an agency, any ensuing regulation is binding on courts unless it is “procedurally defective, arbitrary or capricious in substance, or manifestly contrary to the statute”).

satisfies the mutuality imperative.²⁷ In this case, the contracting states' mutual understanding regarding treaty definitions is reflected in Article 3(2) of the treaty itself.

The persistence of the mutuality imperative imposes some limitations on Professor Kirsch's treaty-based guidance approach. Article 3(2) of the U.S. Model Tax Treaty, which provides perhaps the widest latitude for issuing regulatory guidance, contains an important qualifier. A contracting state's definition of a term not defined in the treaty may only be used where "the context otherwise requires."²⁸ A similar contextual limitation appears in Article 23(2), which permits the United States to amend the limitations on the allowance of the foreign tax credit only to the extent that such amendments do not "chang[e] the general principle" of the foreign tax credit.²⁹

With regard to the Article 3(2) qualifier, Professor Kirsch suggests that it should negate a contracting state's internal law definition only when "weighty arguments" favor such a departure.³⁰ As to Article 23(2), Professor Kirsch argues that given the breadth of the principle underlying the foreign tax credit, the United States may make substantial changes in this area without running afoul of the treaty.³¹ Even if Professor Kirsch is correct (and he may well be), each of these narrow, "contextual" limitations does inject a measure of uncertainty into the authoritativeness of treaty-based regulatory guidance while reinforcing the mutuality imperative—the fundamental requirement that treaty guidance reflect the mutual understanding of the treaty signatories.

In sum, administrative guidance is authoritative if it reflects the shared understanding of the signatories to the treaty and thus satisfies the mutuality imperative embedded in both international treaty interpretation norms and U.S. domestic law on treaty interpretation. Treaty-based guidance like that proposed by Professor Kirsch accomplishes this if it constitutes the "law" of a contracting state to which the treaty explicitly defers. Thus, the regulations that Professor Kirsch proposes Treasury issue as treaty guidance would likely satisfy the criterion of authoritativeness.

27. Indeed, only by limiting his proposal for Treasury regulations to situations where a treaty specifically defers to the law of a contracting state is Professor Kirsch able to avoid violating the mutuality imperative. However, this means that guidance in the form of Treasury regulations will be less than comprehensive. *See infra* subpart II(B).

28. U.S. MODEL TAX TREATY art. 3(2).

29. *Id.* art. 23(2).

30. Kirsch, *supra* note 1, at 1121 (quoting KLAUS VOGEL ET AL., KLAUS VOGEL ON DOUBLE TAXATION CONVENTIONS 215 (John Marin & Bruce Elvin trans., 3d ed. 1997)).

31. *Id.* at 1123.

B. Comprehensiveness

A second requisite of optimal administrative tax treaty guidance is that it be comprehensive. This means that treaty guidance potentially should be useful across the entire spectrum of issues that might arise in tax treaty interpretation. Technical explanations, the most common current form of administrative guidance, are comprehensive in this sense; that is, they provide detailed guidance with respect to each article of the specific tax treaty with which they are issued. The critical shortcoming of technical explanations is that they lack authoritativeness because they do not satisfy the mutuality imperative. Treasury regulations, by contrast, likely are authoritative, but the source of their authority severely limits their comprehensiveness.

As noted above, the authoritativeness of treaty guidance in the form of Treasury regulations derives from provisions in the treaty itself that permit the application of the law of the contracting states in interpreting the treaty. In most U.S. tax treaties, there are only two such provisions: Articles 3(2) and 23(2).³² The former permits the use of contracting-state law to define terms not defined in the treaty, while the latter permits U.S. law to govern the allowance of a foreign tax credit to U.S. residents and citizens.

The function of administrative treaty guidance quite often may be to define terms that appear in the treaty.³³ The term “business,” for example, is not defined in the U.S. Model Tax Treaty and thus could be susceptible to definition in a Treasury regulation under Professor Kirsch’s proposal. Similarly, guidance is sometimes needed with respect to the proper application of the U.S. foreign tax credit.³⁴ However, the need for treaty guidance extends well beyond the limits of Articles 3(2) and 23(2) of the U.S. Model Tax Treaty.³⁵ Consequently, Treasury regulations that satisfy the authoritativeness component of optimal treaty guidance will not satisfy the comprehensiveness component because they will be limited to providing

32. *See, e.g.*, U.S. MODEL TAX TREATY arts. 3(2), 23(2).

33. *See* Parillo, *supra* note 9, at 3 (commenting on the need for application of “modern definition[s]” of treaty terms).

34. *See, e.g.*, Prop. Treas. Reg. § 1.901-2(f), (h), 71 Fed. Reg. 44,240, 44,243–47 (Aug. 4, 2006) (proposing guidance in determining who is considered to pay a foreign tax for purposes of the U.S. foreign tax credit).

35. *See, e.g.*, N.Y. CITY BAR, REPORT OFFERING PROPOSALS REGARDING THE “DERIVATIVE BENEFITS” PROVISIONS FOUND IN THE LIMITATION ON BENEFITS ARTICLE OF CERTAIN U.S. INCOME TAX TREATIES 1 (2008), available at http://www.nycbar.org/pdf/report/Derivative_Benefits052108.pdf (seeking tax treaty guidance on a nondefinitional issue); Lisa M. Nadal, *More Generic Treaty Guidance Likely in Next Business Plan, IRS Official Says*, 92 TAX NOTES TODAY 32 (May 12, 2008) (citing Michael Mundaca, Deputy Assistant Secretary for International Tax Affairs, as acknowledging the need for treaty guidance on nondefinitional treaty issues such as “beneficial ownership, limitation on benefits provisions, and other broad issues that cut across treaties”).

definitions of particular undefined treaty terms and governing the limitations on the foreign tax credit.

C. *Timeliness*

In addition to being both authoritative and comprehensive, optimal tax treaty guidance must be current and timely, or in the terminology of the Organisation for Economic Co-operation and Development (OECD),³⁶ “ambulatory” in nature.³⁷ Specifically, optimal treaty guidance should be provided on a periodically updated basis so that taxpayers are apprised of tax administrators’ evolving views of the application of tax treaty provisions to newly developed, cross-border business structures and transactions.³⁸ This is essential because U.S. tax treaties themselves—even those with important trading partners—are infrequently updated and renegotiated.³⁹ For example, the U.S.–Japan tax treaty, which entered into force in 1972, was neither amended nor replaced for over thirty years.⁴⁰ Similarly, the U.S.–South Korea tax treaty has not been amended since it entered into force in 1979.⁴¹ New protocols to the U.S.–Canada tax treaty have been concluded, on

36. The OECD is a Paris-based intergovernmental organization comprised of some thirty of the world’s most economically developed countries (plus the European Commission as a member international organization). ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *About OECD*, http://www.oecd.org/pages/0,3417,en_36734052_36734103_1_1_1_1_1,00.html; ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *Member Countries*, http://www.oecd.org/countrieslist/0,3351,en_33873108_33844430_1_1_1_1_1,00.html. OECD member states are committed to democracy and the market economy and, through the OECD, share expertise and exchange views with more than one hundred other countries. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *About OECD*, http://www.oecd.org/pages/0,3417,en_36734052_36734103_1_1_1_1_1,00.html.

37. See OECD COMM. ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL 9 (2008), available at <http://www.oecd.org/dataoecd/14/32/41147804.pdf> (hereinafter OECD MODEL TREATY) (“In 1991, recognizing that the revision of the Model Convention and the Commentaries had become an ongoing process, the Committee on Fiscal Affairs adopted the concept of an ambulatory Model Convention providing periodic and more timely updates and amendments without waiting for a complete revision.”). Ambulatory is defined as “capable of being altered.” MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 39 (11th ed. 2003).

38. See, e.g., Dustin Stamper, *DiFronzo Defends Forthcoming Regs on Triangular Reorganizations*, 108 TAX NOTES TODAY 2 (June 5, 2007) (quoting the IRS deputy associate chief counsel (international-technical) as calling for flexible treaty guidance rather than “the usual static treaty explanations”).

39. Each of the countries referred to in this paragraph is one of the United States’ top twenty trading partners. OFFICE OF FREIGHT MGMT. & OPERATIONS, U.S. DEP’T OF TRANSP., FREIGHT FACTS AND FIGURES 16 tbl.2-7 (2009), available at http://ops.fhwa.dot.gov/freight/freight_analysis/nat_freight_stats/docs/09factsfigures/pdfs/fff2009_highres.pdf.

40. IRS.GOV, *Japan—Tax Treaty Documents*, <http://www.irs.gov/businesses/international/article/0,,id=169530,00.html>.

41. IRS.GOV, *Korea—Tax Treaty Documents*, <http://www.irs.gov/businesses/international/article/0,,id=169602,00.html>.

average, only every six years,⁴² while the U.S.–Netherlands tax treaty has been amended only once since it entered into force in 1994.⁴³

A Treasury deputy international tax counsel and the secretariat of the OECD have recently noted,

[M]ost tax treaties last many years—sometimes 25 to 30—and that using the definition of a tax term as it existed when a treaty was signed can sometimes “bastardize” the treaty negotiators’ original intent, given that business structures are constantly developing and that international consensus on issues can change.⁴⁴

In short, the often vague provisions of tax treaties may remain unchanged for decades, making it difficult to discern how such provisions should be applied to new structures and transactions.⁴⁵

Here again, tax treaty technical explanations have proven deficient. Technical explanations are prepared and published by the Treasury Department for the use of the Senate in approving U.S. tax treaties. Since U.S. tax treaties are negotiated and renegotiated on an infrequent basis, it follows that the technical explanations that accompany them are infrequently updated. Likewise, technical explanations to the U.S. Model Tax Treaty are published only when it is updated, something that has occurred only twice in the last twenty-five years.⁴⁶ Thus, existing forms of treaty guidance are not particularly helpful in determining the appropriate application of treaties to rapidly evolving international tax-planning strategies.

42. See IRS.GOV, *Canada—Tax Treaty Documents*, <http://www.irs.gov/businesses/international/article/0,,id=169503,00.html>. Professor Kirsch offers the U.S.–Canada tax treaty as evidence that the United States “*frequently renegotiates* its existing treaties to reflect ever-changing developments in the global economy” Kirsch, *supra* note 1, at 1071 (emphasis added). Our disagreement on this point is probably relative, but the frequency of U.S. tax treaty updates does not, in any event, keep pace with developments in business and tax structures; hence the critical need for administrative guidance. See *id.* at 1067 (“[T]he United States must take other steps to ensure that its actual tax treaties keep pace with [global economic developments and increasingly sophisticated methods of tax avoidance and evasion].”).

43. See IRS.GOV, *Netherlands—Tax Treaty Documents*, <http://www.irs.gov/businesses/international/article/0,,id=169565,00.html>.

44. Parillo, *supra* note 9, at 3 (citing comments by Treasury deputy international tax counsel Gretchen Sierra and OECD secretariat Patricia Brown).

45. A current major priority of the Treasury Department is the renegotiation of tax treaties that contain “significant flaws” or that are “very old.” Kristen A. Parillo, “*Flawed*” *Treaties a High Priority*, *Treasury Official Says*, 92 TAX NOTES TODAY 33 (May 9, 2008).

46. A U.S. model treaty was first drafted in 1977, followed by a model treaty adopted in 1981. That model was withdrawn in 1992 and replaced with new models in 1996 and again in 2006. U.S. DEP’T OF THE TREASURY, UNITED STATES MODEL INCOME TAX CONVENTION OF SEPTEMBER 20, 1996 TECHNICAL EXPLANATION 1 (1996), available at <http://www.irs.gov/pub/irs-trty/usmtech.pdf>. See generally IRS.GOV, *United States Model—Tax Treaty Documents*, <http://www.irs.gov/businesses/international/article/0,,id=169597,00.html> (listing all U.S. tax treaties).

The timeliness criterion for optimal tax treaty guidance argues against Professor Kirsch's proposed use of Treasury regulations for this purpose.⁴⁷ For decades, the Treasury has faced a serious backlog of regulation projects that it lacks the time or resources to complete.⁴⁸ Presently, there are both temporary and proposed regulations in effect that have been awaiting publication in final form for over thirty years.⁴⁹ Congress would have to commit substantial fiscal resources to the Treasury Department to facilitate the drafting and publication of the volume of new temporary regulations that would be necessary to provide meaningful guidance on tax treaty issues.⁵⁰

Second, past reliance by Treasury on the use of temporary regulations to mitigate backlogs raised concerns about compliance with the notice-and-comment requirements of the Administrative Procedure Act.⁵¹ Congress responded to these concerns by enacting as part of the 1988 Taxpayer Bill of Rights,⁵² I.R.C. section 7805(e), which provides that all temporary regulations expire within three years of being issued.⁵³ Thus, whatever

47. New Treasury regulations typically are issued in proposed form first, accompanied by a request for public comment. After considering any response received from the public, Treasury then publishes the proposed regulations in final form. Michael Asimow, *Public Participation in the Adoption of Temporary Tax Regulations*, 44 TAX LAW. 343, 343 (1991). Alternatively, if there is a need for urgent regulatory guidance, Treasury may instead publish temporary regulations and simultaneously issue the same regulations in proposed form. See I.R.C. § 7805(e)(1) (2006) ("Any temporary regulation issued by the Secretary shall also be issued as a proposed regulation."). The result of this alternative approach is that the temporary regulations are immediately effective and are treated as though they are final. *Nissho Iwai American Corp. v. Commissioner*, 89 T.C. 765, 776 (1987). Thus, they are more immediately useful than proposed regulations that courts give little or no deference. See *Zinnel v. Commissioner*, 89 T.C. 357, 369 (1987) ("[P]roposed regulations are merely suggestions made for comment."). Given the need for timeliness, Treasury likely would publish regulations providing tax treaty guidance as temporary regulations.

48. See Juliann Avakian-Martin, *The Regulations Backlog: 20 Years and Still Growing*, 57 TAX NOTES 845, 845-47 (Dec. 2, 1992) (discussing the scope of the regulations backlog problem as it existed eighteen years ago); Amandeep S. Grewal, *Substance Over Form? Phantom Regulations and the Internal Revenue Code*, 7 HOUS. BUS. & TAX L.J. 42, 91 (2006) (noting the effect of the growing backlog of regulation projects on the timeliness of regulation issuance).

49. See, e.g., Temp. Treas. Regs. §§ 7.465-1 to 5, 42 Fed. Reg. 42,185, 42,197-98 (Aug. 22, 1977); Prop. Treas. Regs. § 1.72-4, 25 Fed. Reg. 11,402 (Nov. 26, 1960) (as amended by T.D. 7352, 40 Fed. Reg. 16,663 (Apr. 14, 1975)); T.D. 8115, 51 Fed. Reg. 45,691 (Dec. 19, 1986); 52 Fed. Reg. 10,223 (Mar. 31, 1987); Prop. Treas. Regs. § 1.101-2, 40 Fed. Reg. 16,641, 16,663-64, 16,666 (Apr. 14, 1975); Prop. Treas. Regs. § 1.72-13, 25 Fed. Reg. 11,402 (Nov. 26, 1960) (as amended by T.D. 6497, 25 Fed. Reg. 10,021 (Oct. 20, 1960)); T.D. 6676, 28 Fed. Reg. 10,135 (Sept. 17, 1963); T.D. 7043, 35 Fed. Reg. 8477 (June 2, 1970); Prop. Treas. Regs. § 1.122-1, 35 Fed. Reg. 8478 (June 2, 1970) (as amended by T.D. 7562, 43 FR 38819 (Aug. 31, 1978)); Prop. Treas. Regs. § 1.405-3, 28 Fed. Reg. 10,131 (Sept. 17, 1963).

50. See Parillo, *supra* note 9, at 3 (citing a comment by Treasury deputy international tax counsel Gretchen Sierra that issuing supplemental treaty guidance such as regulations would be "a resource-intensive project"); see also Avakian-Martin, *supra* note 48, at 845 (discussing possible staffing solutions to the backlog problem).

51. 5 U.S.C. § 552(a) (2006).

52. Pub. L. No. 100-647, § 6232(a), 102 Stat. 3342, 3734-35 (1988) (codified at I.R.C. § 7805).

53. I.R.C. § 7805(e)(2); see also Asimow, *supra* note 47, at 363-64 (discussing the legislative history of § 7405(e)).

authority would be provided by tax treaty guidance in the form of temporary regulations would be short-lived unless such regulations were made final, which, as noted above, Treasury would likely find it difficult to accomplish without a substantial infusion of new resources.

In sum, the rapidly evolving complexity of international tax avoidance and evasion strategies requires that optimal administrative tax treaty guidance—in whatever form provided—be timely. Given limitations on Treasury Department resources and regulatory procedural requirements, it would be difficult for Treasury to issue timely tax treaty guidance in the form of regulations as Professor Kirsch proposes.

Given that Treasury regulations arguably would satisfy only one of what I believe to be three essential criteria for optimal tax treaty administrative guidance, other formats for providing such guidance should be explored. The following part identifies two possibilities that warrant exploration.

III. Optimal Tax Treaty Guidance

There are two alternative forms of purposive administrative guidance that would satisfy the essential elements of optimal tax treaty guidance discussed in Part II. Neither alternative may ultimately prove viable, but they offer possible avenues for further research and thought.

A. *Joint Technical Explanations*

One possibility for providing administrative guidance that would hew more closely to the criteria described in this Response is for Treasury to expand its use of technical explanations prepared jointly with its treaty partners. As noted in Part II, the 2007 Protocol to the U.S.–Canada tax treaty was sent to the Senate for ratification accompanied by a technical explanation that was unusual in that Canada had reviewed it and had consented to its interpretations of the Protocol.⁵⁴ Although Treasury drafted the Technical Explanation, which is an official U.S. guide to the Protocol, the Canadian Minister of Finance issued a press release stating the Technical Explanation “accurately reflects understandings reached in the course of negotiations with respect to the interpretation and application of the various provisions in the Protocol.”⁵⁵ The technical explanation itself states, “In the view of both governments, this document accurately reflects the policies behind particular Protocol provisions, as well as understandings reached with respect to the application and interpretation of the Protocol and the

54. TECHNICAL EXPLANATION OF PROTOCOL AMENDING CONVENTION BETWEEN THE UNITED STATES AND CANADA, *supra* note 21, at 1.

55. Press Release, Canada Department of Finance, Canada Supports U.S. Technical Explanation of the Fifth Protocol to the Canada-United States Income Tax Convention (July 10, 2008), available at <http://www.fin.gc.ca/n08/08-052-eng.asp>.

Convention.”⁵⁶ Canada’s formal letter of consent to the explanation effectively made it a jointly prepared document.

Importantly, joint technical explanations reflect the mutual, shared understanding of the contracting states. Consequently, as administrative guidance, they would satisfy the mutuality imperative articulated both in the Vienna Convention and by U.S. courts. Because U.S. courts can rely on them in this regard, joint technical explanations meet the authoritative criterion described in Part II(A). Moreover, the format of technical explanations provides an extended, specific explanation of each separate article of the treaty in question. Thus, joint technical explanations would meet the comprehensiveness criterion of optimal tax treaty guidance.

The chief shortcoming of joint technical explanations is that they likely would be issued only with a new treaty or when treaty partners are renegotiating, or issuing a new protocol to, an existing treaty. If so, joint technical explanations would be no more useful than unilateral technical explanations in resolving the critical need for current treaty interpretation guidance. As one IRS associate chief counsel has observed “even when technical explanations offering treaty guidance are mutually agreed upon by both treaty countries, they are ‘treaty- and point-in-time-specific.’”⁵⁷ To deal with this problem, Treasury would have to commit, along with U.S. treaty partners, to periodically revisit and, where necessary, update the joint technical explanation to reflect the contracting states’ evolving, shared understanding of the treaty’s application to new developments in international tax planning and structuring.

B. Mutual Competent Authority Process

Another possibility is for the United States to work jointly with its treaty partners to provide administrative treaty guidance under the mutual agreement procedures set out in Article 25 of the U.S. Model Tax Treaty and most other U.S. treaties. Article 25 states as follows:

The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. *They also may consult together for the elimination of double taxation in cases not provided for in the Convention. . . .*⁵⁸

The italicized language implicitly recognizes that the treaty itself is not comprehensive enough to address every fact situation and that there may be a need for interstitial interpretative advice where treaty language is inadequate.

56. TECHNICAL EXPLANATION OF PROTOCOL AMENDING CONVENTION BETWEEN THE UNITED STATES AND CANADA, *supra* note 21, at 1.

57. *See* Nadal, *supra* note 35, at 32 (quoting IRS associate chief counsel (international) Steven Musher).

58. U.S. MODEL TAX TREATY art. 25, para. 3 (emphasis added).

It is also permits collaboration between the United States and its treaty partners to produce timely administrative guidance. The Model Treaty also states,

The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission, for the purpose of reaching an agreement in the sense of the preceding paragraphs.⁵⁹

This provision would authorize the competent authorities⁶⁰ of the United States and a treaty partner to create a treaty guidance commission that could meet regularly to produce administrative guidance on the interpretation of tax treaty provisions.

Treaty guidance produced by a treaty guidance commission under the authority of the Article 25 competent authority provisions clearly would meet the authoritativeness criterion. Contracting states that “consult together” as contemplated by Article 25 will produce guidance that reflects the mutuality imperative. Moreover, as such guidance would not be limited in the way that Articles 3(2) and 23(2) are, it could address the full range of issues arising under the treaty and thus satisfy the comprehensiveness criterion. Finally, administrative guidance issued under Article 25 could be as timely as necessary, given the broad authority it grants for consultation and direct communication between the competent authorities of the contracting states.

Each of the two possibilities described above comes closer to satisfying the criteria that are essential for optimal tax treaty guidance than does the unilateral issuance of guidance in the form either of technical explanations or Treasury regulations. More research as to the practical viability of these and other potential forms of administrative guidance is needed if the multinational enterprises that rely on tax treaties and the U.S. courts that interpret them are to have the tools necessary for their proper interpretation.

59. *Id.* art. 25, para. 5.

60. The U.S. competent authority for purposes of this provision is the I.R.S. Deputy Commissioner (International), Large and Mid-Size Business Division. The Deputy Commissioner administers the operating provisions of tax treaties, reaches mutual agreements in specific treaty cases, and interprets and applies tax treaties. Rev. Proc. 2006-54, 2006-2 C.B. 1035, § 1.02. An equivalent official within the treaty partner’s tax administration would serve as that jurisdiction’s competent authority.