Will the US Impose Double US Tax Rates on EU Companies from Countries that Retroactively Impose State Aid Claw Backs?

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On January 15, 2016, in a joint (bi-partisan) letter of Senate Finance Committee Republicans and Democrats to US Treasury, one that will certainly be of interest to our friends at Wolters Kluwer (a Netherlands parent multinational enterprise), the Senate Finance Committee members encouraged Treasury to use a tit-for-tat strategy against the EU Commission. The letter stated that if the EU Commission imposes retroactive state aid penalties that impact US MNEs, then the US should respond with IRC Section 891 that allows the USA to double the tax rates on companies and individuals based within European countries whose governments impose a retroactive "re-capture" of that state aid from US owned MNEs. IRC Section 891 states:

> *Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax ... shall ... be doubled in the case of each citizen and corporation of such foreign country.... In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 percent of the taxable income of the taxpayer ...*

IRC Section 891 allows up to nearly an 80 percent federal individual tax rate and 70 percent corporate one to be applied to members of MNE groups of countries.

Netherlands, Belgium, Luxembourg, and Ireland will need to tread cautiously through this mine-field between their supra-national obligations to the EU Commission (that many pundits say is being pushed by a small, influential group of EU states led by France) and the wrath of US Treasury which is being pushed by an influential group of Republican and Democratic Senators (imagine the response by a "President Trump" to the EU Commission trying to soak up past earnings of US companies).

My blog colleagues will likely retort that US double tax agreement obligations will protect such EU companies and citizens from such discriminatory treatment. Most U.S. tax treaties provide that the treaty country cannot discriminate by imposing more burdensome taxes on the other countries citizens who are residents of the treaty country than it imposes on its own citizens in the same circumstances. By example, the US – Netherlands Double Tax Agreement reads in pertinent part –

> *ARTICLE 28 Non-discrimination*
>
> *1. Nationals of one of the States shall not be subjected in the other State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.*

Perhaps, after extensive refund litigation, non-resident source based income may indeed be protected by a Court from an imposition of a doubling of the applicable tax rates. Why refund litigation? The US withholding agent will look to the Presidential Order pursuant to IRC Section 891 and simply double-up the withholding rate on Form 1042-S and withhold accordingly. As a matter of practice, no matter of argument and attorney's opinion will convince that withholding agent to ignore a Presidential Order. My banking colleagues in the world of sorting out (incorrect) imposition of Chapter 4 [FATCA] know that I am correct in this regard. If the income in question is exempt from withholding or the normal (generally 30 percent) withholding rate has been eliminated by a treaty article, then a doubling of 'nil' remains 'nil'. But for other income whereby a withholding rate applies, typically the case for dividends income, then Section 891 may sting but for any foreign tax credit applicable back home. Yet, likely, a refund will eventually be forthcoming, after litigation.

But will a U.S. court stretch the same non-discrimination protection of a double tax agreement to the underlying US subsidiaries of these EU MNEs who are filing Form 1120? Technically, yes. But what about the "Last-in-Time doctrine? When the effect of two U.S. statutes create a conflict of application, then the Last-in-Time doctrine is applied by a US court to suppress the legal effect of the former statute with that of a most recent statute. The US Supreme Court ruled that a treaty, for US rule-of-law purposes, is just another statute. In Whitney v Roberson, 124 US 190 (1888) the Court stated, in relevant parts:

> *By the Constitution a treaty is placed on the same footing, and made of like obligation, with an act of legislation. Both are declared by that instrument to be the supreme law of the land, and no superior efficacy is given to either over the other. When the two relate to the same subject, the courts will always endeavor to construe them so as to give effect to both, if that can be done without violating the language of either; but if the two are inconsistent, the one last in date will control the other, provided always the stipulation of the treaty on the subject is self-executing. If the country with which the treaty is made is dissatisfied with the action of the legislative department, it may present its complaint to the executive head of the government, and take such other measures as it may deem essential for the protection of its interests. The courts can afford no redress. Whether the complaining nation has just cause of complaint, or our country was justified in its legislation, are not matters for judicial cognizance.*

The US courts have been generally criticized by foreign and domestic academics for application of the "Last-in-Time" doctrine, but in the US the doctrine has proponents besides being the 'law of the land'.

The current IRC Section 891 dates to the enactment of the 1986 Internal Revenue Code, albeit the section has been carried over from original enactment in 1938 and not yet actually employed by a US President. Thus, from a Last-in-Time perspective, the Netherlands DTA prevails over this IRC Section. And a presidential order, which is not enacted by Congress, does not rise to the level of a statute for application of Last-in-Time.

But application of IRC Section 891 in these circumstances has popular, bipartisan support. Thus, is it possible, however unlikely in a presidential election year, that in a show of bipartisanship, Congress unites to enact such a Presidential order in a statutory form. Then that 2016 statute, by Last-in-Time doctrine, will prevail over the Netherland 1992 treaty.

Is such bi-partisanship likely? Robert Stack, US Treasury official responsible for International Tax Affairs, stated to the Senate Finance Committee on December 1, 2015 that the US Treasury is concerned that the EU Commission appears to be disproportionately targeting U.S. companies.

Moreover, US Treasury is of the opinion that these actions potentially undermine U.S. rights under our tax treaties, and lead to discriminatory treatment. Thus, could argue US Treasury in a tit-for-tat brief to a Court, '*what's good for the goose is good for the gander*' and '*they discriminated first*'. Not perhaps winning legal arguments, but sometimes the court of public opinion is just as important.

U.S. Treasury stated that it is concerned that the EU Commission is reaching out to tax income that no member state had the right to tax under internationally accepted standards. Rather, from all appearances to the eyes of the US Treasury, the EU Commission is seeking to tax the income of U.S. multinational enterprises that, under current U.S. tax rules, is deferred until such time as the amounts are repatriated to the United States. Robert Stack stated "The mere fact that the U.S. system has left these amounts untaxed until repatriated does not provide under international tax standards a right for another jurisdiction to tax those amounts."

After all, Senator Orrin Hatch (Utah), Chairperson of the Senate Finance Commt, stated in December 2015 that the EU Commissions "state aid" remedies and recent activities in the Eurozone look like attempts to ***impose retroactive taxation on a number of U.S.-based multinational companies***. And about BEPS he stated: "At the same time, while international efforts to align tax systems are worth exploring, we shouldn't be negotiating agreements that undermine our own interests for the sake of some supposedly higher or nobler cause. **The interests of the United States – our own economy, our own workers, and our own job creators – should be our sole focus**."

If the EU Commission is playing a poker hand that depends on the US Treasury and Congress folding, then just like with FATCA, I'd bet on the US winning this hand.

My fortune telling? This card game has three players at the table: the EU Commission, the US Treasury, and the EU Member States. After upping-the-bets by the EU Commission and US Treasury/Congress, meetings will occur between the leaders at the G7. The EU will back-track through a Commission decision to the member governments that mitigates the retroactive application of State Aid imposed collections, in exchange for the member governments dropping their appeals. The EU will demand that if it fold, its members fold. The EU Commission will have achieved victory because its *Marbury v Madison* objective of establishing itself as the supreme authority regarding each member's fiscal system and implementation thereof will now have its precedent. And the EU Commission will promote itself the hero for having avoided the cost of a tit-for-tat trade war with the US its members can hardly afford, that the members would have brought on themselves by tax competitive behavior. A well-played hand by the EU Commission.

But will the EU members fold (drop the appeal)? Only one country has the steady demeanor to play out this hand – the Netherlands. The Dutch are known for their calm pragmatism, but also for their stubborn resolve. I look forward to watching this high stakes poker game play out.

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International Law and Agreements: Their Effect upon U.S. Law (Congressional Research Service, Feb 18, 2015)

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