tax notes international

Volume 69, Number 6 ■ February 11, 2013

The Dubious Legal Pedigree of IGAs (And Why It Matters)

by Allison Christians

Reprinted from *Tax Notes Int'l*, February 11, 2013, p. 565

THE BIG PICTURE

The Dubious Legal Pedigree of IGAs (and Why It Matters)

by Allison Christians

Allison Christians is the H. Heward Stikeman Chair in Tax Law at McGill University in Montreal, where she writes and teaches in the area of national and international tax law and policy. You can follow her on the Tax, Society & Culture blog at taxpol.blogspot.com or on Twitter @taxpolblog.

When Congress enacted the Foreign Account Tax Compliance Act as part of the Hiring Incentives to Restore Employment Act in 2010, it made no mention of any internationally agreed alternative to its enforcement. Since then, Congress has made no authorization for the president to override FATCA's statutory provisions by international agreement. Yet due to difficulties in implementing FATCA abroad, Treasury has entered into several "intergovernmental" agreements (IGAs) to essentially bypass the hurdles and even gone so far as to draft model IGAs with the intent of streamlining their enactment globally.

What are these agreements as a matter of U.S. law? And does it matter what they are in legal terms so long as they do the job of binding the parties to their terms? The answer is that the legal pedigree of IGAs is tenuous, and this matters for two reasons. The first reason is practical: If the IGAs are not good law in the U.S., FATCA partners incur the risk of penalties should the statute they seek to override apply in default. The second is more fundamental: The IGAs violate the rule of law, unnecessarily so, and this undermines U.S. credibility in the international community.

To understand this landscape, we must first determine what IGAs *are* from a legal perspective. In order to make that determination, let us consider what they *are not*.

Not Treaties

IGAs are not, strictly speaking, treaties. Every country has internal rules and procedures that determine how it binds itself to agreements with other countries. The Vienna Convention on the Law of Treaties defines any such duly enacted agreement as a treaty, but in the U.S., a treaty is defined only as those international agreements that are signed by the president and ratified only after receiving the advice and consent of two-thirds of the Senate, under Article II of the U.S. Constitution. That is the process by which all U.S. income tax treaties become the law of the land. It is sometimes a contentious process, and it is often a lengthy process.

Since IGAs are not submitted to the Senate for advice and consent, they are not treaties in the U.S. constitutional sense of that word. That is not necessarily fatal for these agreements as a matter of law, however. There are some alternative means by which the U.S. can bind itself to agreements with other countries that, according to most constitutional scholars, are equivalent in status and force of law to treaties. These range from the fairly uncontroversial to the very controversial in constitutional law scholarship.

Not Congressional-Executive Agreements

The most recognizable and perhaps least controversial alternative to the treaty power vested in the president under Article II of the U.S. Constitution is the power reserved to Congress under Article I of the Constitution to "regulate Commerce with foreign Nations" and "to make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers." While some scholars have argued that this cannot be read to override the treaty-making process outlined Article II, most constitutional scholars view so-called executive agreements as interchangeable with the treaty power if they are undertaken under statutory pre-authorization by Congress. Agreements entered into under pre-authorization are typically referred to as congressional-executive agreements to distinguish them from agreements entered into by the president without such pre-authorization (discussed more below).

Thus, when Congress views it as expedient to pre-authorize the president to enter into international agreements, it enacts a statute that lays out content guidelines and a streamlined means of passing these signed agreements by the full legislature. Usually this takes the form of automatic passage within a specified time frame unless Congress raises an objection. Some of the more well-known congressional-executive agreements in the U.S. are trade related: These include the WTO agreements and the North American Free Trade Agreement, as well as bilateral and multilateral free trade agreements, which are authorized under 19 U.S.C. section 3803.

Congress has also pre-authorized Treasury to enter into tax information exchange agreements in this manner. IRC section 274(h)(6)(C)(i) provides the grant of authority, and it does so in very specific terms. It authorizes Treasury to ''negotiate and conclude an agreement for the exchange of information with any beneficiary country,'' and clearly delineates the content of these agreements. Congress has also authorized the State Department to enter into social security totalization agreements, which allocate social security taxes and benefits among two countries. There, the relevant language is found in the Social Security Act, 42 U.S.C. section 433, and it includes similarly clear language about the content of these authorized agreements.

Pre-authorization does not ensure that every agreement signed by the president is rubber-stamped by the legislature, suggesting that the president does not act alone, even under statutory pre-authorization. For example, in 2004, the U.S. signed a social security totalization agreement with Mexico under the legislative authority granted under the Social Security Act. However, the State Department never submitted the agreement to Congress because several lawmakers opposed its terms, making it likely that the agreement would be rejected if submitted. The resolution was referred to the House Subcommittee on Social Security on July 19, 2004, and no further action has been taken — in other words, the agreement died in committee even after being preapproved by Congress. Thus, while pre-authorization seems to lend legal status to these agreements from a constitutional law perspective, it does not allow the president to bind the U.S. internationally, on tax matters at least, without legislative approval.

Since there is no statutory pre-authorization for Treasury to enter into them, IGAs are clearly not congressional-executive agreements. Again, this is not necessarily fatal to their status as legal instruments in the U.S., but it does rule them out of the category of the most commonly recognized treaty alternatives.

Not Treaty-Based Agreements

A second well-accepted alternative to a treaty is an agreement entered into under the authority of an existing treaty. That is, if a president enters into a treaty that includes within its terms a right to enter into derivative agreements, and the Senate advises and consents to the ratification of that treaty, then agreements entered into under those express terms are viewed as duly authorized. The scope and breadth of authority given must be clearly delineated, because the effect of the executive branch granting itself broad authority could produce agreements well beyond the scope of the initial treaty. That would make any treaty a potential doorway for sole executive action without Senate oversight, which plainly contradicts the constitutional framework. Accordingly, treaty-based agreements are typically interpretive in nature. They are meant to allow the treaty partners to agree on how the treaty will be interpreted and applied in practice.

The U.S. Treasury is taking the position that the IGAs ''interpret'' existing information exchange provisions, which are currently found in existing U.S. tax treaties and tax information exchange agreements. This position is dubious on the merits. While Treasury has authorized itself to enter into interpretive agreements under existing tax treaties and information sharing agreements, casting IGAs in this role creates an uncomfortable fit.

All tax treaties give express authority to a designated bureaucrat — the competent authority — to engage in direct efforts to resolve treaty interpretation problems on behalf of their respective governments. The product of competent authority resolution may take one of two forms: a taxpayer-specific competent authority agreement and a non-taxpayer-specific, or ''generalized,'' competent authority agreement. A specialized competent authority agreement typically makes a tax allocation decision on an individual case, applies only to the individual taxpayer, and remains unpublished. A generalized competent authority agreement is typically characterized as procedural, which is meant to ''clarify or interpret treaty provisions.'' It is in this category that the IGAs are meant to fit. Indeed, if Treasury is successful in its goals for FATCA compliance, the IGAs will swamp the existing body of generalized competent authority agreements: With only 33 such agreements currently published, generalized competent authority agreements comprise a tiny minority of all competent authority agreements in the U.S. (and globally).

But it is not at all clear that these IGAs are in fact competent authority agreements. First, if they were competent authority agreements, they could be entered into by the competent authorities of the treaty signatories without any ratification procedures by either side. Hundreds or perhaps thousands of specialized competent authority agreements, as well as a few generalized competent authority agreements, are entered into every year on that basis. Instead, FATCA partner countries (with the exception of Mexico) are treating the IGAs as they must certainly be — international agreements that override the current tax treaty arrangement and therefore must be subject to internal ratification procedures in order to come into force as legal instruments.

Second, even if the FATCA partners were willing to forgo internal ratification procedures, as Mexico appears willing to do, it is difficult to see how the IGAs could be said to be in the nature of clarity or interpretation, since their purpose is to incorporate a newly enacted U.S. law. The IGAs in effect impose a new condition on existing treaty-based withholding tax rates, namely, the fulfillment of FATCA information gathering and reporting requirements. While all existing treaties have information exchange provisions, none has ever made information exchange a condition for receiving treaty benefits. It is difficult to see how imposing a new condition on an article of the treaty that deals with how one country will tax investors from the other can be seen as an interpretation of another, unrelated article of the treaty that lays out how the countries will exchange information.

Moreover, even if the new contingency was not at odds with all established practices, it seems problematic to suggest that an agreement could interpret an existing treaty to implement a law that postdates and apparently overrides it by more than doubling the typical rate of tax called for under the treaty unless the new information gathering and reporting regimes are adopted and implemented. This seems especially unlikely when it is clear that many or most treaty partner countries will have to enact comprehensive domestic legislation to fulfill the new reporting requirements required under the IGAs mainly to override existing privacy and confidentiality laws.

Finally, as a technical matter, it is difficult to see how the IGAs could be competent authority agreements when in at least one case an IGA was apparently signed by a member of an embassy staff rather than a competent authority. Perhaps that is not fatal, but it certainly calls into question the idea that these agreements are being negotiated by competent authorities as a matter of treaty interpretation, similar to the hundreds and thousands of other treaty interpretation negotiations that take place every year, mostly out of the public eye.

Since they are not expressly authorized by the treaty and they cannot be said to interpret existing treaty provisions, IGAs are not treaty-based agreements.

This leaves IGAs in an uncertain place in terms of their legal pedigree. They are not treaties. They are not congressional-executive agreements, that most viable of treaty alternatives. And they are not interpretive agreements authorized by existing treaties.

Therefore: Sole Executive Agreements

This leaves only one possible characterization for IGAs: They must be ''sole'' executive agreements — agreements undertaken by the president without congressional authorization of any kind. This is a tenuous status in U.S. treaty-making that raises serious doubt about whether IGAs in fact bind the U.S. as a matter of law.

Sole executive agreements are extremely controversial in U.S. law. Constitutional scholars either reject them outright as a viable alternative to treaties and congressional-executive agreements, or begrudgingly allow that they might be viable for administrative or routine matters. Louis Henkin, a leading U.S. scholar of international law and foreign policy, characterized sole executive agreements as constitutionally suspect. Other constitutional scholars agree, stating that the Framers of the constitution did not grant the president exclusive power to make treaties committing the nation internationally, and if the president was to exercise such authority, it would have to be only for minor, short-term agreements. The consensus is that short of those that deal with minor, routine, and noncontroversial matters, international obligations undertaken by the president without any congressional oversight lack the status of law in the U.S.

Using a sole executive agreement to serve as an alternative to direct FATCA implementation thus creates a tremendous amount of uncertainty, and unnecessarily so when it is clear that other, more viable alternatives exist in law, namely, treaties and congressional-executive agreements. This puts the IGAs, and therefore Treasury and the IRS, in a precarious position.

Why This Uncertainty Matters

The dubious legal status of the IGA means that even as due ratification of such agreements makes them good law in partner countries, the agreements might not actually be good law in the U.S. And if they do not constitute good law in the U.S., the existing domestic U.S. law they are meant to override — that is, FATCA itself — would necessarily be in full force and effect. That would impose penalties of 30 percent on any U.S.-source payment passing through virtually any financial institution outside the U.S. As a matter of law, none could escape penalty because it would not be compliant with FATCA's terms even if its government was compliant with those of the IGA. One might anticipate leniency on the part of the IRS in such a case, but speculation does not bind the rule of law.

This raises the question of why the U.S. chose this route. Why jeopardize the important and complex project of global tax compliance with such a legally dubious procedure? The obvious straightforward approach to overriding FATCA bilaterally is to do what treaty partners are doing: following normal treaty-making procedure. This would require either achieving Senate advice and consent to each IGA or enacting the proper congressional authority as was done for TIEAs and social security totalization agreements. Either approach will take more time and create more delay in an already-postponed regime. But in marrying itself to a dubious treaty alternative in haste, Treasury may well find itself repenting at leisure.

Clearly the U.S. and its partners have good reason to seek bilateral cooperation in the fight against tax evasion. Reining in tax evasion is important, perhaps even critical, to the future of the income tax and the welfare state it supports. But it is difficult to see how the U.S. can sign the IGAs in good faith when Treasury is exposing itself to constitutional challenge, especially when this risk is so unnecessary to undertake. Ensuring that the IGAs will have the force of law as any other treaty seems critical to ensuring that the override they provide for the FATCA regime will not fail, with global consequences. ◆