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# Aron Broches, Selected Essays: World Bank, ICSID and Other Subjects of Public and Private International Law

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Victor Essien

**Abstract**

This book contains twenty-five essays and is divided into six parts: (1) the International Bank for Reconstruction and Development; (2) Registration of Treaties and International Agreements; (3) the International Center for the Settlement of Investment of Disputes; (4) International Commercial Arbitration; (5) Investment Disputes; and (6) a section devoted to miscellaneous topics.

## COMMENT

# THE TAXATION OF DEFERRED COMPENSATION UNDER I.R.C. § 864(c)(6) AND INCOME TAX TREATIES: A ROSE IS NOT ALWAYS A ROSE

*Meenakshi Ambardar**

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## *INTRODUCTION*

Every year large numbers[1] of employees from abroad come to the United States, intending to work for various periods of

1. Denise S. Freites, *Foreign Recipients of U.S. Income, 1992*, *in* 14 STATISTICS OF INCOME BULLETIN 28, 28 (1995). In 1992, individual residents of all countries filed 1.1 million U.S. returns based on US$3.9 billion of total income and US$314 million in personal services income. *Id.* at 35. The total amount of income earned by non-U.S. persons and corporations was approximately US$77.5 billion. *Id.* at 29.

time.[2] Under the Internal Revenue Code[3] ("I.R.C." or "Code"), these alien[4] employees perform "personal services" by working in the United States.[5] The U.S. tax structure imposes a federal income tax upon earnings for such personal services, regardless of whether aliens receive current or deferred compensation.[6] The rate of taxation and the effective U.S. tax burden for the

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2. *See* John Harllee, Jr., *U.S. Income Taxation of Aliens on Current and Deferred Compensation*, 37 N.Y.U. INST. ON FED. TAX'N 21-1, § 21.01 (1979) (describing U.S. tax rules for workers from other countries).

3. I.R.C. § 871 (1995). The Internal Revenue Code ("I.R.C." or "Code") is the code of federal tax laws. ROBERT SELLERS SMITH, WEST'S TAX LAW DICTIONARY 288 (1992). References to Code sections are to the 1995 Code, unless otherwise indicated. "Internal revenue" refers to the United States' receipt of taxes imposed on domestic transactions, including those involving income, transfers, facilities, products, and sales. SMITH, *supra*, at 288. The Code, thus, determines when and to what extent U.S. tax is imposed. *See id.* (discussing role of Code in U.S. taxation). In addition, the Code applies to all who are under the sovereign power. Webb v. United States, 66 F.3d 691, 697-98 (4th Cir. 1995). Moreover, taxes represent the "lifeblood of government." Bull v. United States, 295 U.S. 247, 259 (1935). "A tax, in the general understanding of the term, and as used in the Constitution, signifies an exaction for the support of the government." United States v. Butler, 297 U.S. 1, 61 (1936). Taxation "is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens." Welch v. Henry, 305 U.S. 134, 146 (1938).

4. *See, e.g.*, Treas. Reg. § 1.1-1(a)(1) (1995) (describing individual as nonresident alien if he is neither citizen nor resident of United States); Treas. Reg. § 301-7701(b)-(1) (using term "alien" to describe taxpayers who are not U.S. citizens). References to Regulations are to the 1995 Regulations, unless otherwise indicated. The U.S. Department of the Treasury ("Treasury" or "Treasury Department"), is the division of the Executive Branch which: "[S]erves as financial agent with the duty of formulating and recommending financial, tax, and fiscal policies. Except as otherwise provided by law, the administration and enforcement of the Code is performed by or under the supervision of the Secretary of the Treasury." SMITH, *supra* note 3, at 590.

The Secretary of the Treasury is authorized to prescribe all needful rules and regulations ("Regulations") for the enforcement of the Code. I.R.C. § 7805(a). The Treasury Secretary's authority extends to enact all rules and regulations that become necessary because of any alternation of law connected to internal revenue. I.R.C. § 7805(a). Regulations under the Code are formal interpretations of the Code provisions covered. SMITH, *supra* note 3, at 590. Furthermore, final regulations are binding on both the Internal Revenue Service ("I.R.S.") and the taxpayer, unless revised or revoked by a court to a change in the law. *Id.* The I.R.S. is the division of the Treasury Department authorized to collect federal taxes and perform other duties as specified in the Code. *Id.* at 290. "After the Internal Revenue Code, the most important primary source of tax law is the Regulations promulgated by the Treasury Department." DOUGLAS A. KAHN, FEDERAL INCOME TAX: A STUDENT'S GUIDE TO THE INTERNAL REVENUE CODE 6 (1994).

5. I.R.C. §§ 61(a)(1), 162(a)(1).

6. Harllee, Jr., *supra* note 2, § 21.05[1]. Deferred compensation refers to earnings withheld by an employer to be paid to the employee at a later date or to be contributed to a pension plan for distribution to the employee in the future. SMITH, *supra* note 3, at 133.

taxable year,[7] however, depends on whether the Code classifies the alien as a resident[8] or a nonresident[9] for tax purposes.[10]

The Tax Reform Act of 1986[11] ("TRA '86") altered the U.S. taxation of aliens by making significant changes to the Code.[12] TRA '86 added I.R.C. § 864(c)(6)[13] ("Section 864(c)(6)") to the Code, now treating the payment of deferred compensation to a nonresident alien as income that is effectively connected[14] to a

7. Muhleman v. Hoey, 124 F.2d 414, 415 (2d Cir. 1942) (defining taxable year as yearly period for which return of income is required).

8. I.R.C. § 7701(b)(1)(A). An alien will be deemed a "resident" if he satisfies any one of the following three tests: (1) lawful permanent residency in the United States at any time; (2) "substantial presence" in the United States; or (3) a first year election to be treated as a U.S. resident. *Id.*; Treas. Reg. § 301.7701(b)-1. "Residence" for this purpose does not mean "domicile." Commissioner v. Nubar, 185 F.2d 584, 586 (4th Cir. 1950), *cert. denied*, 341 U.S. 925 (1951). The term "domicile," in contrast, refers to the "[p]lace where an individual resides and intends to stay indefinitely, permanently or to return to as his permanent residence." SMITH, *supra* note 3, at 156-57. "An individual's intent is an essential ingredient of his domicile." *Id.* at 157.

9. I.R.C. § 7701(b)(1)(B). A nonresident alien is an individual who is neither a U.S. citizen nor a U.S. resident. *Id.*

10. *See* Jon E. Bischel, *Basic Income Tax Treaty Structure*, *in* INCOME TAX TREATIES 1, 11 (Bischel ed., 1978) (stating that United States uses citizenship, rather than residence, as basis for taxing its citizens).

11. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986) (codified as amended in scattered sections of 26 U.S.C.) [hereinafter TRA '86].

12. *See* STAFF OF JOINT COMM. ON TAX'N, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, 99th Cong., 1st Sess. 6 (Comm. Print 1987) [hereinafter 1986 BLUEBOOK]. The Joint Committee on Taxation stated that the Tax Reform Act of 1986 ("TRA '86") embodies one of the "most comprehensive revisions of the Federal income tax system." *Id.* at 6. The Code creates "a joint Congressional committee known as the Joint Committee on Taxation." I.R.C. § 8001. The Joint Committee on Taxation has "broad powers to investigate operation and effects of the Federal system of Internal Revenue taxes." SMITH, *supra* note 3, at 297; *see* I.R.C. §§ 8001-02, 8021 (describing authorization, membership, and powers of Joint Committee of Taxation).

13. I.R.C. § 864(c)(6); TRA '86, Pub. L. No. 99-514, § 1242, 100 Stat. at 2580. I.R.C. § 864(c)(6) states:

> [I]n the case of any income or gain of a nonresident alien individual . . . or a foreign corporation which (A) is taken into account for any taxable year, but (B) is attributable to a sale or exchange of property or the performance of services (or any other transaction) in any other taxable year, the determination of whether such income or gain is taxable under section 871(b) or 882 (as the case may be) shall be made as if such income or gain were taken into account in such other taxable year and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable year referred to in subparagraph (A).

*Id.*

14. I.R.C. § 871(b)(1). "A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable [under the Code] on his taxable income which is effectively connected with the conduct of a trade or

U.S. trade or business.[15] When a nonresident alien receives deferred compensation, even when he is no longer engaged in a U.S. trade or business, the Code defines his U.S. source income[16] as effectively connected and subject to U.S. income tax.[17] The Technical and Miscellaneous Revenue Act of 1988[18] ("TAMRA") subsequently amended provisions of TRA '86, including Section 864(c)(6).[19] TAMRA modified the language of

business within the United States." *Id.* The term "effectively connected income" is used:

> In connection with tax based on income from sources within or without the United States, income, gain, or loss which is treated as effectively connected with the conduct of a trade or business within the United States. The term is used in the case of a non-resident alien individual or a foreign corporation engaged in trade or business within the United States during the taxable year.

SMITH, *supra* note 3, at 164.

15. I.R.C. § 871(b)(1).

16. I.R.C. § 861(a). Generally, compensation for labor or personal services performed in the United States is deemed U.S. source income irrespective of the residence of the payer, the place in which the contract for service income was made, or the place or time of payment. Treas. Reg. § 1.861-4(a)(1); Dillin v. Commissioner, 56 T.C. 228, 244 (1971).

17. I.R.C. § 864(c)(6); *see* 1986 BLUEBOOK, *supra* note 12, at 1047-49 (describing legislative history and rationale of I.R.C. § 864(c)(6)).

18. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (1988) (codified as amended in scattered sections of 26 U.S.C.) [hereinafter TAMRA].

19. TAMRA, Pub. L. No. 100-647, § 1012(r)(2), 102 Stat. at 3525. Prior to the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA"), several bills were proposed in the U.S. Congress ("Congress") to amend certain sections in TRA '86, including I.R.C. § 864(c)(6). *See* STAFF OF JOINT COMM. ON TAX'N, DESCRIPTION OF THE TECHNICAL CORRECTIONS ACT OF 1987 (H.R. 2636 AND S. 1350), 100th Cong., 1st Sess. 221-22 (Comm. Print 1987) [hereinafter TCA '87 DESCRIPTION] (discussing proposed amendment of I.R.C. § 864(c)(6)). This legislation included House Bill 2636 and Senate Bill 1350, the Technical Corrections Act of 1987 ("TCA '87"). Technical Corrections Act of 1987, H.R. 2636, S. 1350, 100th Cong., 1st Sess. § 112(p) (1987) [hereinafter TCA '87]. TCA '87 was never enacted. *See* S. REP. No. 445, 100th Cong., 2d Sess 3 (1988) (providing legislative history of TCA '87). Congress introduced subsequent bills to amend the Code, Senate Bill 2238 and House Bill 4333, on March 31, 1988 as the Technical Corrections Act of 1988 ("TCA '88"). STAFF OF JOINT COMM. ON TAX'N, DESCRIPTION OF THE TECHNICAL CORRECTIONS ACT OF 1988 (H.R. 4333 AND S. 2238), 100th Cong., 2d Sess. (Comm. Print 1988) [hereinafter TCA '88 DESCRIPTION]. After approving Senate Bill 2238, the Senate substituted its text for House Bill 4333 and produced a conference on the bill. *See* H.R. CONF. REP. No. 1104, 100th Cong., 2d Sess. xvii (1988) (describing legislative history of TCA '88). TCA '88 was also not enacted. Morton A. Harris et al., *Owner and Employee Benefits: What's Left*, C583 ALI-ABA 733, 786 (1991). Provisions of TCA '88, however, were enacted as part of TAMRA. *Id.* Congress produced no separate committee reports on TAMRA, but since TCA '88 was incorporated in TAMRA, the legislative history of TCA '88 is referred to when discussing TAMRA. *See* S. REP. No. 445, *supra*, at 2 (containing Senate Finance Committee report on TCA '88). Only the Senate Report on TCA '88 specifically commented on I.R.C. § 864(c)(6), as the Confer-

Section 864(c)(6) by adding references to other Code sections that specifically address effectively connected income.[20]

Moreover, the already complicated system of taxing aliens may become further complicated by provisions of an income tax treaty[21] ("tax treaty" or "tax convention") between the United States and the alien's home country.[22] Tax treaties modify the Code to reduce the amount of U.S. tax liability a resident of another country owes.[23] TAMRA, meanwhile, significantly altered Code sections addressing the relationship between tax treaties and the Code.[24] Specifically, TAMRA amended the Code to incorporate the later-in-time principle.[25]

Since the enactment of TAMRA, the Code no longer automatically defers to tax treaties.[26] Instead, tax treaties and the Code command equal authority.[27] This Comment discusses the language and legislative history of Section 864(c)(6) in relation

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ence Committee did not discuss the provisions that the House and Senate agreed upon explicitly. H.R. REP. No. 1104, *supra*, at 6.

20. TAMRA, Pub. L. No. 100-647, § 1012(r)(2), 102 Stat. at 3525.

21. Robert L. Williams, *Permanent Establishments in the United States*, 29 TAX LAW. 277, 278 (1975). Tax treaties are formally referred to as "tax conventions" since the "subject matter of treaties is less general and the methods of negotiation are less formal than in the case of many other treaties." *Id.* (quoting Blough, *Treaties to Eliminate International Double Taxation and Evasion*, 5 N.Y.U. INST. 208, 209 (1947)). Tax conventions may be accompanied or supplemented by a protocol or supplementary conventions. *Id.*

22. *See* S. REP. No. 445, *supra* note 19, at 326 (noting complexity resulting from interaction of Code, treaties, and non-U.S. laws); Harllee, Jr., *supra* note 2, § 21.01 (describing complications arising from possibility that tax treaty may alter domestic taxation).

23. *See* H. David Rosenbloom, *Tax Treaty Abuse: Policies and Issues*, 15 LAW & POL'Y INT'L BUS. 763, 770 (1983) (describing impact of tax treaties). In 1992, residents of countries with tax treaties with the United States received 87.1%, or US$67.6 billion, of total U.S. source income payments to nonresident aliens. Freites, *supra* note 1, at 29.

24. TAMRA, Pub. L. No. 100-647, § 1012(aa), 102 Stat. at 3531-33. TAMRA amended I.R.C. § 7852(d), for example, to put treaties and statutes on equal footing. TAMRA, Pub. L. No. 100-647, § 1012(aa)(1)(A), 102 Stat. at 3531, I.R.C. § 7852(d). TAMRA also amended I.R.C. § 894(a) by reducing the amount of deference the Code gave to treaties to "due regard." TAMRA, Pub. L. No. 100-647 § 1012(aa)(6), 102 Stat. at 3533. "Due regard" is determined under I.R.C. § 7852(d), and according to the Senate Finance Committee, entails that treaties and statutes are given equal deference. S. REP. No. 445, *supra* note 19, at 321-22.

25. TAMRA, Pub. L. No. 100-647, § 1012(aa), 102 Stat. at 3531-33. *See* Whitney v. Robertson, 124 U.S. 190, 195 (1888). The court explained that the later-in-time rule is the "duty of the courts [ ] to construe and give effect to the latest expression of the sovereign will." *Id.*

26. I.R.C. §§ 894(a), 7852(d).

27. *Id.*

to a recent[28] tax treaty, the U.S.-Netherlands Tax Treaty[29] ("Dutch Treaty"), and an existing[30] tax treaty, the U.S.-Switzerland Tax Treaty[31] ("Swiss Treaty").[32] These treaties classify workers into different categories,[33] including independent contractors[34] and dependent employees.[35] The Dutch Treaty, for exam-

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28. *See* Treaty Developments Status Table, 3 Tax Treaties (CCH) ¶ 25,501, at 46,511, 46,512 to -513 (1995) [hereinafter Treaty Status Table] (listing recent tax treaty developments). "Recent" refers to treaties that were ratified after TRA '86 was enacted. *See id.* (listing treaties in chronological order).

29. Income Tax Convention, Dec. 18, 1992, U.S.-Neth., S. TREATY DOC. No. 6, 103d Cong., 1st Sess. (1993), 32 I.L.M. 462 (1993) [hereinafter Dutch Treaty].

30. *See* Treaty Status Table, *supra* note 28, 3 Tax Treaties (CCH) ¶ 25,501, at 46,512 to -513 (listing bilateral U.S. tax treaties). "Existing" refers to treaties that were ratified before TRA '86 was enacted. *See id.* (providing enactment dates of treaties).

31. Income Tax Convention, May 24, 1951, U.S.-Switz., 2 U.S.T. 1751, T.I.A.S. No. 2316 [hereinafter Swiss Treaty]. The United States is currently negotiating a new tax treaty with Switzerland. Sindhu G. Hirani, *Standstill on Benefits Limitation Provision in U.S.-Swiss Accord Disappoints Treasury*, Daily Rep. for Executives (BNA) No. 192, at D-53 (Oct. 4, 1995).

32. *See* Treaty Status Table, *supra* note 28, 3 Tax Treaties (CCH) ¶ 25,501, at 46,512 to -513 (listing U.S. tax treaties). Other tax treaties include: Income Tax Convention, Sept. 18, 1992, U.S.-Mex., S. TREATY DOC. No. 7, 103d Cong., 1st Sess. (1993), 2 Tax Treaties (CCH) ¶ 5903, at 35,807 (1995) [hereinafter Mexican Treaty]; Income Tax Convention, Feb. 22, 1990, U.S.-Spain, S. TREATY DOC. No. 16, 101st Cong., 2d Sess. (1990), 3 Tax Treaties (CCH) ¶ 8403, at 40,507 (1995) [hereinafter Spanish Treaty]; Income Tax Convention, Sept. 21, 1989, U.S.-Fin., S. TREATY DOC. No. 11, 101st Cong., 2d Sess. (1990), 1 Tax Treaties (CCH) ¶ 2845, at 26,039 (1995) [hereinafter Finnish Treaty]; Income Tax Convention, Aug. 29, 1989, U.S.-F.R.G., S. TREATY DOC. No. 10, 101st Cong., 2d Sess. (1990), 2 Tax Treaties (CCH) ¶ 3249, at 28,151 (1995) [hereinafter German Treaty]; Income Tax Convention, Dec. 31, 1975, U.S.-U.K., 31 U.S.T. 5668, T.I.A.S. No. 9682 [hereinafter U.K. Treaty].

33. Dutch Treaty, *supra* note 29, arts. 15-22, S. TREATY DOC. No. 6, at 38-48, 32 I.L.M. at 477-81; Swiss Treaty, *supra* note 31, arts. 10-13, 2 U.S.T. at 1758-59, T.I.A.S. No. 2316, at 8-9. The Dutch Treaty, for example, contains the following categories of personal service income: independent personal services, dependent personal services, directors' fees, artists and athletes, pensions, annuities and alimonies, government service, professors and teachers, and students and trainees. Dutch Treaty, *supra* note 29, arts. 15-22, S. TREATY DOC. No. 6, at 38-48, 32 I.L.M. at 477-81. The categories in the Swiss Treaty include: compensation for labor and personal services, government service, pensions, professors and teachers, and students and apprentices. Swiss Treaty, *supra* note 31, arts. 10-13, 2 U.S.T. at 1758-59, T.I.A.S. No. 2316, at 8-9.

34. Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. No. 6, at 38-39, 32 I.L.M. at 477-78; Swiss Treaty, *supra* note 31, art. 10, 2 U.S.T. at 1758, T.I.A.S. No. 2316, at 8. An independent contractor is, "in general, one who contracts to perform work according to one's own methods who is not subject to control except as to the product result of the work." SMITH, *supra* note 3, at 275.

35. Dutch Treaty, *supra* note 29, art. 16, S. TREATY DOC. No. 6, at 39-40, 32 I.L.M. at 478; Swiss Treaty, *supra* note 31, art. 10, 2 U.S.T. at 1758, T.I.A.S. No. 2316, at 8. A dependent employee is an individual:

> [W]ho works for an employer. A person who works for salary or wages. An

ple, expressly mitigates the rate of taxation under Section 864(c)(6) for Dutch independent contractors.[36]

This Comment argues that Section 864(c)(6) taxes the deferred income of all nonresident aliens, whether independent contractors or dependent employees, by analyzing the tax treatment of nonresident aliens subject to the Dutch and Swiss Treaties. Part I discusses the general rules for taxing aliens for compensation earned in the United States. Part I also describes the change in the taxation of deferred compensation after TRA '86, the legislative history of Section 864(c)(6), and the tax treaty process. Part II discusses TAMRA's amendments to the Code sections that are relevant to tax treaties. Part II also examines how the Dutch and Swiss Treaties treat deferred compensation payments to individuals who are currently nonresident aliens, but who worked in the United States in previous years. Part III argues that while the language of Section 864(c)(6) is ambiguous, its legislative history and the principles of other Code sections indicate that Section 864(c)(6) provides for a net tax of a nonresident alien's deferred compensation. Part III also illustrates that the Swiss Treaty can be construed as compatible with Section 864(c)(6). Finally, Part III advocates that dependent employees subject to the Dutch Treaty be subject to net tax under Section 864(c)(6). This Comment concludes that the United States should tax deferred compensation of nonresident aliens on a net basis, regardless of whether the taxpayer is an independent contractor or a dependent employee.

## I. *BACKGROUND ON U.S. TAXATION OF ALIENS RECEIVING DEFERRED COMPENSATION*

The U.S. determination of alien tax liability depends on several factors, including the tax status of the alien,[37] the source of

> employee is generally a person who is subject to control and direction of an employer, not only as to [the] result to be accomplished by work but also as to details and means by which the result is accomplished.

SMITH, *supra* note 3, at 166; *see* William Kenny & Myron Hulen, *Determining Employee or Independent Contractor Status*, 20 TAX ADVISER 661, 661 (1989) (discussing determination of employee or independent contractor status for tax purposes).

36. Dutch Treaty, *supra* note 29, art. 24, S. TREATY DOC. NO. 6, at 50-51, 32 I.L.M. at 482-83.

37. *See* I.R.C. § 7701(b)(1) (determining whether alien is resident or nonresident); *see supra* notes 8-10 and accompanying text (defining residence under Code).

his income,[38] and whether his income is effectively connected to a U.S. trade or business.[39] Tax liability also depends on whether nonresident aliens receive deferred compensation for services performed in the United States.[40] Prior to TRA '86, a nonresident alien could reduce his tax liability by deferring compensation from U.S. employment, even if earned while he was a resident alien.[41] Section 864(c)(6) changed completely the tax treatment of deferred compensation for services rendered in the United States by nonresident aliens, mandating that they pay tax at the regular graduated rates.[42] The language of Section 864(c)(6), however, differs from that of other Code sections, I.R.C. § 871(b)[43] ("Section 871(b)") and I.R.C. § 882 ("Section 882") taxing effectively connected income.[44] Sections 871(b) and 882 tax effectively connected income on a net basis.[45] With respect to the difference in terminology between Section 864(c)(6) and Sections 871(b) and 882, a taxpayer advocating net taxation under Section 864(c)(6) could rely on certain pervasive tax principles, including concerns of fairness, equity, and economic reality.[46] An alien who is a resident of a country hav-

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38. *See* I.R.C. §§ 861-65 (providing source rules and other general rules relating to non-U.S. income under Code). "Foreign source" is a U.S. term of art when used in the international tax context to classify income. *See* STAFF OF JOINT COMM. ON TAX'N, EXPLANATION OF PROPOSED INCOME TAX TREATY AND PROPOSED PROTOCOL BETWEEN THE UNITED STATES AND THE KINGDOM OF THE NETHERLANDS, 103d Cong., 1st Sess. 33 (Comm. Print 1993) [hereinafter JOINT COMM. DUTCH EXPLANATION] (stating treatment of U.S. business income depends on whether income is foreign or U.S. source); BORIS I. BITTKER & LAWRENCE LOKKEN, FUNDAMENTALS OF INTERNATIONAL TAXATION ¶ 66.3.4 (1991) (describing source of income as "foreign"); David P. Zaiken et. al., *Revisions to Income — Sourcing Rules Likely to Increase U.S. Tax on Foreign Income*, 69 J. TAX'N 120, 120 (1988) (describing source rules using term "foreign").

39. *See* I.R.C. §§ 871, 881-82 (stating provisions for determining whether income is effectively connected).

40. I.R.C. § 864(c)(6).

41. *See* Robert T. Cole, *Application of Treaty Rules to Income from Services and Licenses*, 5 N.Y.U. INT'L INST. ON TAX & BUS. PLAN., 77, 82-83 (1978) (discussing treatment of deferred compensation in Code before enactment of TRA '86).

42. I.R.C. § 864(c)(6). Prior to TRA '86, the Code taxed a nonresident alien's deferred compensation as income that was not effectively connected to a U.S. trade or business at a flat 30%, or lower tax treaty, rate. Cole, *supra* note 41, at 83.

43. I.R.C. §§ 871(b), 882.

44. *Compare* I.R.C. § 864(c)(6) (taxing deferred "income or gain") *with* I.R.C. § 871(b) (discussing "taxable income" of individuals). *Compare* I.R.C. § 864(c)(6) (addressing taxation of deferred "income or gain") *with* I.R.C. § 882 (providing for tax on "taxable income" of corporations).

45. *See* I.R.C. §§ 871(b), 882 (allowing nonresident aliens to take deductions).

46. *See* Webb v. United States, 66 F.3d 691, 694 (4th Cir. 1995) (discussing limita-

ing a bilateral tax treaty with the United States, moreover, may also be able to rely on a treaty provision to mitigate his U.S. tax liability.[47]

### A. *Determining the Tax Status of the Alien*

An alien's U.S. tax liability depends on whether he is currently a U.S. resident or nonresident.[48] If the taxpayer is a U.S. resident alien, his tax will be similar to the tax imposed on a U.S. citizen.[49] If the taxpayer is a nonresident alien, however, his income will be subject to U.S. tax only if the Code considers such income U.S. source compensation and a Code exemption is not applicable.[50] A tax treaty exemption, in addition, may also reduce an alien's U.S. tax liability.[51] U.S. tax treaties, however, never increase the rate of tax.[52]

### B. *Source Rules for Compensation*

For nonresident aliens, the source rules[53] for characterizing income under the Code aid in determining whether the income

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tions of equitable principles in tax law). Administrative predictability is another consideration in tax law. Oklahoma Tax Comm'n v. Chickasaw Nation, 115 S. Ct. 2214, 2221 (1995). Substance-over-form is another pervasive principle in tax law. KAHN, *supra* note 4, at 31. Substance-over-form describes:

> When a transaction or a series of steps to a transaction have no economic significance and are designed solely to obtain favorable tax consequences, the tax law will recharacterize the transactions (or the steps) so as to reflect the economic substance of what was accomplished without regard to economically meaningless transactions or steps.

*Id.* "The economic substance doctrine dictates that a transaction which has no independent non-tax purpose will be disregarded for tax purposes." *Id.*

47. *See* I.R.C. § 894(a) (stating Code provisions will be applied with due regard to tax treaties); PHILIP BAKER, DOUBLE TAXATION AGREEMENTS AND INTERNATIONAL TAX LAW 6 (1991) (discussing role of tax treaties in mitigating liability resulting from domestic statutory provisions).

48. *See* Harllee, Jr., *supra* note 2, § 21.02[1] (stating that watershed issue in determining whether United States can tax income is tax residence of alien).

49. I.R.C. § 7701(b)(1)(A); Treas. Reg. § 301.7701(b)-1; *see supra* notes 8-10 and accompanying text (discussing definition of residence in Code).

50. I.R.C. §§ 2(d), 871, 877.

51. *See* I.R.C. § 894(a) (stating Code will give due regard to treaty obligations of United States).

52. *See* BAKER, *supra* note 47, at 6 (stating that U.S. view is that treaties can only relieve tax burden; treaties cannot impose higher tax rate).

53. *See* I.R.C. §§ 861-65 (containing source rules). For tax purposes, the Code distinguishes income earned within the United States from income earned outside the United States. *See* SMITH, *supra* note 3, at 217 (defining "foreign income" as income from sources without the United States).

is subject to U.S. taxation.[54] Income, including compensation for personal services, is deemed either U.S. or foreign source gross income.[55] In the absence of an overriding Code section, the situs of the services constitutes the main factor in determining the source of income.[56] When services are performed within the United States, the compensation is accordingly defined as U.S. source gross income.[57] Conversely, when services are rendered outside of the United States, the Code deems such compensation to be foreign source gross income.[58] When a nonresident alien is compensated for services rendered partially within and partially without the United States, he must allocate his income from the two sources.[59] This split source compensation is generally allocated between the U.S. and foreign sources based on the amount of time spent working in each country.[60]

Since the identification of the source of personal services income depends upon the place where services are performed, the nationality of the person performing the services is irrelevant.[61] These source rules apply to nonresident aliens, including independent contractors[62] and employees,[63] earning compensation for personal services, including: wages, salaries, bonuses, commissions, and pensions.[64] The source rules also apply to de-

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54. I.R.C. §§ 861-65.

55. *See* I.R.C. § 861(a)(3) (defining rules relating to U.S. source income from personal services).

56. *Id.*; Rev. Rul. 73-252, 1973-1 C.B. 337. "A revenue ruling represents the view of the Commissioner, not the Treasury Department." Crow v. Commissioner, 85 T.C. 376, 389 (1985). In addition, unless a revenue ruling constitutes a consistent and longstanding administrative position with prior congressional or judicial approval, it is not entitled to any special deference in the tax courts. *Id.*

57. I.R.C. § 861(a)(3).

58. I.R.C. § 862(a)(3).

59. I.R.C. §§ 861(b), 862(b).

60. *See* Mooney v. Commissioner, 9 T.C. 713, 718 (1947) (allocating income based on time taxpayer spent in United States during taxable year); Harllee, Jr., *supra* note 2, § 21.05[1][a] (discussing alternate methods of apportionment).

61. Treas. Reg. § 1.861-4(a)(1); *see supra* note 16 and accompanying text (stating place of service determines source of compensation).

62. *See, e.g.*, Rev. Rul. 73-107, 1973-1 C.B. 376 (finding nonresident alien journalist earned U.S. source income while working in United States).

63. *See* Harllee, Jr., *supra* note 2, § 21.05[1] (discussing source rules for nonresident alien employees).

64. Treas. Reg. § 31.3401(a)-1(a)(2). "The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commission on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his em-

ferred,[65] as well as, current compensation.[66] The Code, however, provides a de minimus exception to the rule that all services rendered in the United States generate U.S. source compensation.[67] The exception is for temporary stays and applies whether the nonresident alien performs the services as an employee or as an independent contractor.[68]

### C. *Determining Whether Compensation Is Effectively Connected*

Because U.S. citizens are subject to U.S. taxation on their worldwide income,[69] the concept of effectively connected income only relates to nonresident aliens.[70] U.S. source income is divided into two categories:[71] the first category includes U.S. source income that is effectively connected with a nonresident alien's U.S. trade or business;[72] the second category defines U.S. source income that is not effectively connected with such a trade or business.[73] Under an applicable tax treaty provision, both

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ployer." *Id.*; *see* I.R.C. § 861(a)(3) (stating compensation is generally U.S. source income if services are performed in United States).

65. *See, e.g.*, Rev. Rul. 72-279, 1972-1 C.B. 218 (sourcing deferred compensation payments from retirement plan).

66. *See* Muhleman v. Hoey, 124 F.2d 414, 415 (2d Cir. 1942) (sourcing compensation based on tax year alien received bonus).

67. I.R.C. § 864(b)(1). When a nonresident alien: (1) receives compensation of not more than US$3000 for that taxable year; (2) is temporarily present in the United States; and (3) for a period not more than 90 days during the taxable year, he is treated as having received foreign source gross income, although his services were rendered in the United States. *Id.* The employee must receive this compensation under a contract with either: (1) a nonresident alien, foreign partnership, or foreign corporation not engaged in a U.S. trade or business or (2) a U.S. citizen or resident, partnership, corporation, if the labor or services are performed for a foreign office or place of business. I.R.C. §§ 861(a)(3)(C), 864(b)(1). Tax treaties expand the Code's exception for commercial travelers. *See, e.g.*, Swiss Treaty, *supra* note 31, art. 10, 2 U.S.T. at 1758, T.I.A.S. No. 2316, at 8 (increasing maximum on temporary stay and compensation to 183 days and US$10,000, respectively).

68. Treas. Reg. § 1.864-2(b)(2)(iii). In order to determine whether the alien meets the exemption requirements, "it is immaterial whether the services performed by the nonresident alien individual are performed as an employee for his employer or under any form of contract with the person for whom the services are performed." *Id.*

69. Treas. Reg. § 1.1-1(b). The United States taxes its citizens "wherever resident, on their worldwide income, solely by reason of their citizenship." *Crow*, 85 T.C. at 380. The source rules for characterizing income, thus, are irrelevant to U.S. citizens. *Id.*; *see supra* notes 8-10 and accompanying text (defining residence).

70. Treas. Reg. § 1.1-1(b).

71. I.R.C. § 864(c)(2)-(3); BITTKER & LOKKEN, *supra* note 38, ¶ 66.3.3.

72. I.R.C. § 864(c)(2). For further discussion of the term "effectively connected," see generally Harvey P. Dale, *Effectively Connected Income*, 42 TAX L. REV. 689 (1987).

73. I.R.C. § 864(c)(3).

types of income may be taxed at reduced rates.[74]

In the case of no exemption, either under the Code or a tax treaty, when gross income[75] is effectively connected the taxpayer is entitled to deductions[76] and his taxable income[77] is taxed on a net basis under the regular graduated rates applicable to individuals.[78] When no exemptions are available to an alien, his compensation income from U.S. sources is effectively connected to a U.S. trade or business if he performed services in the United States during the taxable year in which he received income.[79] Neither the Code nor the U.S. Department of the Treasury Regulations[80] ("Treasury Regulations") explicitly define the term "trade or business."[81] Under the Code, however, the perform-

74. Freites, *supra* note 1, at 28.

75. I.R.C. § 61. Gross income is defined in the Code as including "all income from whatever source derived." *Id.* This includes: compensation for services, dividends, interest and rents, and gains from the sale of investments. *Id.*; *see* MARVIN A. CHIRELSTEIN, FEDERAL INCOME TAXATION 1 (1994) (explaining concept of gross income).

76. I.R.C. § 871(b)(1). "Once gross income has been reduced by allowable deductions . . . the figure that remains is the taxpayer's *taxable income.*" CHIRELSTEIN, *supra* note 75, at 2.

77. CHIRELSTEIN, *supra* note 75, at 2. "Taxable income is the residual or net amount on which the taxpayer's tax liability is based." *Id.*

78. JOINT COMM. DUTCH EXPLANATION, *supra* note 38, at 49. The graduated individual rates apply to all income that is effectively connected with the conduct of a U.S. trade or business. *Id.*; *see* I.R.C. § 1 (providing tax tables); I.R.C. § 63 (defining tax terms). U.S. tax rates are graduated in that as income increases, an individual's tax liability also increases, but at a greater rate. I.R.C. § 1; CHIRELSTEIN, *supra* note 75, at 3. The tax rates for a married couple in 1995 are, for example, 15% on taxable income up to US$39,000, 28% on additional income up to US$94,250, 31% on additional income up to US$143,600, 36% on additional income up to US$256,500, 39.6% on additional income over US$256,500. I.R.C. § 1.

79. I.R.C. § 864(b); Treas. Reg. § 1.864-2(a). The "term 'trade or business within the United States' includes the performance of personal services within the United States at any time within the taxable year." I.R.C. § 864(b). *Cf. supra* note 67 and accompanying text (discussing exception in I.R.C. § 864(b) whereby employee temporarily present in United States is not deemed to be engaged in U.S. trade or business).

80. *See* KAHN, *supra* note 4, at 6 (stating authority of Regulations is second only to Code).

81. BITTKER & LOKKEN, *supra* note 38, ¶ 66.3.2. Generally, profit-oriented activities in the United States will constitute a trade or business if they are "considerable, continuous, and regular." Lewenhaupt v. Commissioner, 20 T.C. 151, 163 (1953), *aff'd*, 221 F.2d 227 (9th Cir. 1955). "Whether the activities of a nonresident alien constitute engaging in a trade or business in the United States, is, in each instance, a question of fact." *Lewenhaupt*, 20 T.C. at 162. *But cf.* Rev. Proc. 89-6, 1989-1 C.B. 776 (stating that I.R.S. will ordinarily not rule on whether nonresident alien is engaged in U.S. trade or business or has permanent establishment). For further discussion of the term "trade or business," see generally David M. Garelik, *What Constitutes Doing Business Within the United States by a Non-resident Alien Individual or a Foreign Corporation*, 18 TAX L. REV. 423

(1963); Joseph Isenbergh, *The "Trade or Business" of Foreign Taxpayers in the United States*, 61 TAXES 972 (1983). A permanent establishment is a tax treaty concept, undefined by the Code. Williams, *supra* note 21, at 279. The existence of a permanent establishment in the United States provides a tax treaty basis for U.S. taxation. *Id.* at 278. The permanent establishment concept is the fundamental method used by treaty countries to limit the taxing jurisdiction of the host country. D. Roy Hershberger & Michael A. Siegel, *Tax Advisors' Forum: PE or no PE—that is the Question*, 9 TAX NOTES INT'L 1993, 1994 (1994). The term "permanent establishment" postulates:

> [T]he existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country into the soil of another country.

BAKER, *supra* note 47, at 89 (citation omitted). A fixed base is an analogous concept to permanent establishment. Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. NO. 6, at 38-39, 32 I.L.M. at 477-78; *see* Rev. Rul. 75-131, 1975-1 C.B. 389 (relying on definition of permanent establishment to clarify definition of fixed base). A fixed base, however, applies only to individuals and triggers taxation in the other treaty country. Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. NO. 6, at 38-39, 32 I.L.M. at 477-78.

The permanent establishment and fixed base concepts are also used by countries belonging to the Organisation for Economic Co-operation and Development ("OECD"). *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, COMM. ON FISCAL AFFAIRS, MODEL DOUBLE TAXATION CONVENTION ON INCOME AND CAPITAL arts. 5, 14, at 26-27, 34 (1977) [hereinafter 1977 OECD MODEL]. OECD members include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Japan, Iceland, Italy, Luxemborg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, COMM. ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND CAPITAL 2 (1992 condensed version) [hereinafter 1992 OECD MODEL]. The OECD recently revised its model tax treaty and commentaries in 1992. *Id.* at 9. Although the treaties discussed in this Comment were negotiated before the 1992 OECD Model was drafted, in references to the OECD model commentaries, only the 1992 OECD Model will be cited. *See, e.g., id.* at 66-79 (discussing permanent establishment concept); *id.* at 153 (discussing fixed base principle). The OECD Committee on Fiscal Affairs has stated:

> Although the Commentaries are not designed to be annexed in any manner to the conventions to be signed by Member countries, which alone constitute legally binding international instruments, they can nevertheless be of great assistance in the application and interpretation of the conventions and, in particular, in the settlement of any disputes.

*Id.* at 14. In addition, the OECD Committee on Fiscal Affairs noted that the amendments made to the 1977 OECD Model articles and commentaries often "are intended to simply clarify, not change, the meaning of the Articles or the Commentaries, such *a contrario* would clearly be wrong in many cases." *Id.* at 15; *see* Hershberger & Siegel, *supra*, at 1994 n.5 (stating that most paragraphs of 1992 OECD Model commentaries remain unchanged from 1977 OECD Model).

The OECD model is the "embodiment of a typical conventional structure providing economically relatively more developed countries with the opportunity of having an instrument available for facilitating negotiations with other such countries." A.H. Figueroa, *Comprehensive Tax Treaties*, *in* DOUBLE TAXATION TREATIES BETWEEN INDUSTRIALISED AND DEVELOPING COUNTRIES - OECD AND UN MODELS, A COMPARISON 9, 11 (44th ance of personal services within the United States at any time during the taxable year constitutes engaging in a U.S. trade or business.[82]

In terms of the second category of U.S. source income, a nonresident alien's U.S. source income that is not effectively connected is taxed at a flat thirty percent,[83] or lower treaty rate, on the gross amount,[84] without deductions.[85] When an alien does not have a U.S. trade or business he is taxed on only "fixed or determinable annual or periodical"[86] ("FDAP") income and certain capital gains.[87] The Code requires the payers of such in-

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International Fiscal Association Cong., seminar proceedings, 1990). "The influence of the OECD Model Double Tax Convention lies in the fact that it provides a framework for negotiation, which already has the broad agreement of most developed countries." ADRIAN OGLEY, THE PRINCIPLES OF INTERNATIONAL TAX—A MULTINATIONAL PERSPECTIVE 36 (1993). The proposed 1981 U.S. Model Income Tax Treaty ("1981 Treasury Model"), for example, is based upon the 1977 OECD Model with modifications necessary to reflect specific U.S. policy concerns. *Treasury Announces Review of Model Income Tax Treaty*, [July-Dec.] Daily Tax Rep. (BNA) No. 139, at G-5 (July 20, 1992); U.S. Treasury Department Proposed Model Income Tax Treaty, 1 Tax Treaties (CCH) ¶ 211, at 10,573 (1981) [hereinafter 1981 TREASURY MODEL]. The Treasury Department, however, is drafting a new model treaty to replace the 1981 Treasury Model. *Id.* The Dutch Treaty was negotiated on the basis of the 1981 Treasury Model and the 1977 OECD Model. Treasury Dept. Technical Explanation, Income Tax Convention, Dec. 18, 1992, U.S.-Neth., 2 Tax Treaties (CCH) ¶ 6121, at 36,447-115 (1993) [hereinafter Dutch Technical Explanation]. The Dutch Technical Explanation, however, incorporates the commentary of the 1992 OECD Model for guidance in interpreting provisions. *Id.*

82. I.R.C. § 864(b).

83. *See* I.R.C. § 871(a) (providing for 30% tax on nonresident alien with income not effectively connected with U.S. trade or business); I.R.C. § 881(a) (providing for 30% tax on non-U.S. corporations with income not connected with U.S. trade or business).

84. *See* Dutch Treaty, *supra* note 29, art. 10, S. TREATY DOC. NO. 6, at 19-23, 32 I.L.M. at 469-70 (reducing tax rate on dividends to 5% for 10% beneficial owners of voting stock and 15% for other Dutch residents); Swiss Treaty, *supra* note 31, art. 7, 2 U.S.T. at 1757, T.I.A.S. No. 2316, at 7 (stating interest income taxed at 5% rate).

85. I.R.C. § 873. Deductions are outlays and expenditures that represent the cost of earning gross income. CHIRELSTEIN, *supra* note 75, at 1.

86. I.R.C. §§ 871(a)(1), 881(a). "Fixed or determinable annual or periodical" ("FDAP") gains, profits or income include items such as interest, dividends, rents, and annuities. *Id.*; Treas. Reg. § 1.871-7(b). Income is fixed when it is paid in predetermined amounts. Treas. Reg. § 1.1441-2(a)(2). Income is determinable whenever there is an ascertainable means for calculating the amount to be paid. *Id.* "The income need not be paid annually if it is paid periodically." *Id.* In other words, income can be considered FDAP income if it is paid from time to time, regardless of regularity of payments. *Id.* Income derived from the sale in the United States of property, either real or personal, is not FDAP income. Treas. Reg. § 1.1441-2(a)(3).

87. I.R.C. § 864(c)(2); Treas. Reg. § 1.864-4(c). An FDAP item is effectively connected with a U.S. trade or business under two principal tests: either an asset-use test or a business activities test. Treas. Reg. § 1.864-4(c); BITTKER & LOKKEN, *supra* note 38, ¶

come to withhold the thirty percent, or lower treaty, U.S. tax liability.[88]

In computing effectively connected taxable income, the Code generally allows a nonresident alien to deduct only business-related expenses[89] from gross income, resulting in adjusted gross income.[90] A nonresident alien's taxable income is his adjusted gross income less only one personal exemption[91] and no

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66.3.3. The asset-use test applies if the income is "derived from assets used in or held for use in the conduct of [a U.S.] trade or business." I.R.C. § 864(c)(2)(A); *see* Treas. Reg. § 1.864-4(c)(2) (discussing application of asset-use test). The business-activities test applies if the activities of the U.S. trade or business were a "material factor in the realization of the income, gain, or loss." I.R.C. § 864(c)(2)(B); *see* Treas. Reg. § 1.864-4(c)(3)(i) (discussing application of business-activities test).

88. *See, e.g.*, I.R.C. § 1441 (addressing withholding for individuals); I.R.C. § 1442 (discussing withholding for corporations). "Without this withholding requirement there would be no way to enforce taxpayer compliance because foreign recipients are not required to file U.S. tax returns to report this income." Freites, *supra* note 1, at 28. FDAP income, thus, is subject to withholding. Treas. Reg. § 1.1441-2(a)(1). Amounts withheld under I.R.C. §§ 1441 and 1442 are included in the recipient's gross income and credited against the tax otherwise due. I.R.C. § 1462; Treas. Reg. § 1.1462-1(a). Moreover, income effectively connected with the U.S. trade or business of the recipient is usually exempt from withholding because tax on such income is determined and collected in the same manner as it is for U.S. persons. BITTKER & LOKKEN, *supra* note 38, ¶ 66.2.12. A nonresident alien's compensation for personal services is exempt from withholding, but only when his compensation is subject to wage withholding. *Id.*

89. I.R.C. § 873(a) (providing that deductions are only allowed to extent "connected with income which is effectively connected" with U.S. trade or business); *see* Harllee, Jr., *supra* note 2, § 21.05[3][c] (discussing deductions when computing effectively connected income). Aliens must file their income tax returns in a timely manner or else deductions may be disallowed. Treas. Reg. § 1.874-1.

90. I.R.C. § 62(a); SMITH, *supra* note 3, at 9. Adjusted gross income is:

> In the case of an individual, gross income minus trade and business deductions, certain trade and business deductions of employers, losses from sale or exchange of property, deductions attributable to rents and royalties, certain deductions of life tenants and income beneficiaries of property, deduction for provision for profit-sharing and annuity plans of self-employed individuals, deduction for retirement savings, deduction for certain portion of lump-sum distributions from pension plans taxed under section 402(e) and other deductions allowed in the Code. The term applies to individuals and affects the extent to which medical expenses, nonbusiness casualty and theft losses, charitable contributions, and other items may be deducted.

*Id.*; *see* BITTKER & LOKKEN, *supra* note 38, ¶ 66.3.1 (discussing deductions available to nonresident aliens).

91. I.R.C. § 873(b)(3). Deductions include personal exemptions. CHIRELSTEIN, *supra* note 75, at 2. A personal exemption is a statutory dollar amount allowed as a deduction from adjusted gross income for each individual taxpayer. SMITH, *supra* note 3, at 406. A nonresident alien residing in Mexico or Canada, or a national of the United States, is entitled to the same exemptions as a U.S. citizen. I.R.C. § 873(b)(3); Treas. Reg. § 1.873-1(b)(2)(iii). The personal exemption amount in 1995 is US$2000,

standard deduction.[92] Nonresident aliens, however, are permitted to take certain limited deductions from adjusted gross income regardless of whether such deductible expenses are related to the effectively connected income.[93] The Code allows two non-business deductions: (1) charitable contributions;[94] and (2) casualty and theft losses of property located in the United States.[95] In addition, a nonresident alien's compensation for a given year may consist of both U.S. source and foreign source income.[96] In such situations, taxpayers allocate deductions between income that is effectively connected and income that is not, with only the expenses associated with the former being deductible.[97]

### D. *Deferred Compensation in the United States*

Deferred compensation represents payment at some later date for present services.[98] Deferred compensation plans[99] are

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but may be reduced if the taxpayer's adjusted gross income exceeds certain threshold amounts. I.R.C. § 151(d). The exemption amount is reduced 2% for each US$2500, or fraction thereof, that the taxpayer's adjusted gross income for the taxable year exceeds the threshold amount. I.R.C. § 151(d)(3)(B). The threshold amount, for example, of a married couple is US$150,000 of adjusted gross income. I.R.C. § 151(d)(3)(C).

92. I.R.C. § 63(c)(6)(B). For a taxpayer who does not itemize deductions, the standard deduction is the sum of the basic standard deduction and any additional standard deduction. I.R.C. § 63(c)(1); SMITH, *supra* note 3, at 531. The basic standard deduction, for instance, for a married couple in 1995 is US$5000. I.R.C. § 63(c)(2). The Code also provides additional standard deductions in 1995 of US$600 each for aged and/or blind taxpayers. I.R.C. § 63(c), (f).

93. I.R.C. § 873(b).

94. I.R.C. §§ 170, 873(b)(2).

95. I.R.C. §§ 165(c)(3), (h), 873(b)(1).

96. I.R.C. § 873(a). The "proper apportionment and allocation of the deductions" will be made under the Regulations. *Id.*; *see* Robert Feinschreiber, *Treaty Provisions for Allocating and Apportioning Deductions*, 4 INT'L TAX J. 995, 997 (1978) (describing apportionment rules in U.S. tax treaties).

97. Treas. Reg. § 1.873-1; *see supra* note 60 and accompanying text (discussing apportionment of income by source).

98. ROBERT J. HANSMAN & JOHN W. LARRABEE, DEFERRED COMPENSATION 1 (1983); STEPHAN R. LEIMBERG & LINDA I. FELDMAN, THE DEFERRED COMPENSATION HANDBOOK 3 (1989).

99. HANSMAN & LARRABEE, *supra* note 98, at 2-3. Deferred compensation plans, similar to other retirement plans, are either "qualified" or "non-qualified" for U.S. tax purposes. LEIMBERG & FELDMAN, *supra* note 98, at 3-4. Under qualified plans, the employer can deduct current plan expenses as contributions are made into it. *Id.* at 3. Plan assets accumulate tax-free and the employee is not currently taxed on the contributions. *Id.* In exchange for these benefits, however, qualified plans have an exacting set of requirements. *Id.* The employer must earmark, for example, beyond its creditors' reach, assets which guarantee the funding of plan payments. *Id.* at 3-4.

arrangements in which an employer promises to compensate the employee in the future with income that replaces, or supplements, current cash or other benefits.[100] Under deferred compensation plans the recipient can sometimes avoid paying current tax on his deferred income.[101] An individual who is currently in a high tax bracket because of his high income[102] can participate in a deferred compensation plan and thereby postpone compensation to later years, when he anticipates being in a lower tax bracket.[103]

The benefit of deferred compensation arrangements can be determined under a present value analysis.[104] If the present value of the income received in later years is greater than the net income received today, then the deferred compensation arrangement benefits the employee.[105] When, in the future, the

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A plan is non-qualified if it is discriminatory and does not qualify for special tax advantages under I.R.C. § 401(a). *Id.*; I.R.C. § 401(a). The employee pays no tax until he receives the payment. I.R.C. §§ 61(a)(1), 451(a). The employer is unable to deduct the expense for a non-qualified plan during the current period, although it may actually incur current expenses. I.R.C. §§ 162(a), 404(a)(5); Treas. Reg. §§ 1.162-7(b)(1), 1.404(a)-1(b). The employer can deduct plan expenses when the recipient actually receives the income as long as the payments are: (1) ordinary and necessary; and (2) reasonable. Treas. Reg. §§ 1.162-7(a), (b)(3), 1.404(a)-1(b).

100. LEIMBERG & FELDMAN, *supra* note 98, at 3; *see* Douglas W. Ell & Brian H. Graff, *Non-qualified Deferred Compensation: Towards "Unfunded" Security*, 51 N.Y.U. INST. ON FED. TAX'N 5-1, § 5.01 (1993) (discussing deferred compensation arrangements).

101. LEIMBERG & FELDMAN, *supra* note 98, at 5.

102. *See id.* at 4-5 (describing possible tax advantages of deferred compensation arrangements); *see supra* note 78 and accompanying text (illustrating graduated tax rates).

103. HANSMAN & LARRABEE, *supra* note 98, at 65.

104. RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE 12-24 (1988). Present value is defined as the discounted value of future cash flows. *Id.* at 23.

> The present value of $400,000 1 year from now must be less than $400,000. After all, *a dollar today is worth more than a dollar tomorrow*, because the dollar today can be invested to start earning interest immediately. . . . [T]he present value of a delayed payoff may be found by multiplying the payoff by a discount factor which is less than 1. . . . If $C_1$ denotes the expected payoff at time period 1 (1 year hence), then Present Value (PV)= discount factor x $C_1$. The discount factor is expressed as the reciprocal of 1 plus a *rate of return*: Discount Factor = $1/1+r$. The rate of return $r$ is the reward investors demand for accepting delayed payment.

*Id.* at 12.

105. *See id.* (describing present value concept). For example, in 1995, for a married couple with over US$256,500 in taxable income, the marginal rate of tax on the next US$20,000 in taxable income is 39.6%. I.R.C. § 1(a). Thus, the couple would receive US$12,080 of the US$20,000 after taxes if they received the income today. *Id.*

taxpayer receives payment, his deferred compensation is taxed as gross income.[106]

The Internal Revenue Service[107] ("I.R.S."), however, may attack deferred compensation plans under the doctrine of constructive receipt.[108] A cash-basis taxpayer[109] constructively receives taxable income when funds are made available to him without substantial restrictions, even if he does not actually receive the funds until a later date.[110] Constructive receipt, therefore, prevents taxpayers from manipulating income in order to avoid tax liability.[111]

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Assuming that the couple arranges to receive deferred compensation in five years, and has total taxable income at that time of less than US$39,000, at 1995 tax rates, the couple would pay a 15% rate of tax on the US$20,000 and receive US$17,000 after taxes. I.R.C. § 1(a). The present value of the deferred compensation, at a discount rate of 5%, is US$13,320. *See* CHIRELSTEIN, *supra* note 75, at 369 (providing discount factors used to calculate present value). Thus, the couple receives US$1240 more under a deferred compensation arrangement. *See* KAHN, *supra* note 4, at 135-38 (explaining present value concept).

106. LEIMBERG & FELDMAN, *supra* note 98, at 9; *see* I.R.C. § 61 (listing wages, salaries, and business profits as types of gross income).

107. SMITH, *supra* note 3, at 290; *see supra* note 4 and accompanying text (describing I.R.S. as division of Treasury Department authorized to collect federal taxes and perform other duties as specified in Code).

108. Treas. Reg. §§ 1.446-1(c)(1)(i), 1.451-2(a). Treasury Regulation § 1.451-2(a) explains:

> Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Treas. Reg. § 1.451-2(a).

109. I.R.C. § 446(c). A cash basis taxpayer reports income as he receives it and deducts expenses when actually paid. SMITH, *supra* note 3, at 531. The other principal method of accounting is accrual basis. I.R.C. § 446; SMITH, *supra* note 3, at 531. An accrual basis taxpayer reports income when he earns it, regardless of actual receipt. SMITH, *supra* note 3, at 4. Similarly, an accrual basis taxpayer deducts expenses when he incurs them, regardless of whether he pays them in the same period. *Id.* at 4.

110. Treas. Reg. §§ 1.446-1(c)(1)(i), 1.451-2(a); *see supra* note 108 and accompanying text (describing constructive receipt concept in Code).

111. *See* Rev. Rul. 71-419, 1971-2 C.B. 220 (holding taxpayer's deferred income pursuant to corporation's unfunded deferred compensation plan should not be included in gross income by taxpayer until actually paid or otherwise made available to him).

### E. *The Taxation of Deferred Compensation Prior to TRA '86*

Prior to TRA '86, the I.R.S. determined whether a taxpayer's income was effectively connected to a U.S. trade or business on an annual basis, looking to the period in which the income was received.[112] Thus, when an alien earned income while engaged in a U.S. trade or business in year one, but received this income in year two when he had no connections to the United States, the alien's U.S. source compensation was not effectively connected.[113] Before the enactment of Section 864(c)(6),[114] consequently, most salaries or wages paid to employees and fees paid to independent contractors were considered FDAP income.[115] Treating the deferred compensation as FDAP income,

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112. Treas. Reg. § 1.864-3(a) (1985). The Regulations provided the following example:

> During the months of June through December 1971, B, a nonresident alien individual . . . is employed in the United States by domestic corporation M for a salary of $2,000 per month, payable semimonthly. During 1971, B receives from M salary payments totaling $13,000, all of which income . . . is effectively connected for 1971 with the conduct of a trade or business in the United States by B. On December 31, 1971, B terminates his employment with M and departs from the United States. At no time during 1972 is B engaged in a trade or business in the United States. In January of 1972, B receives from M salary of $1,000 for the last half of December 1971, and a bonus of $1,000 in consideration of the services B performed in the United States during 1971 for that corporation. . . . [T]he $2,000 received by B during 1972 from sources within the United States is not effectively connected for that year with the conduct of a trade or business in the United States, even though such amount, if it had been received by B during 1971, would have been effectively connected for 1971 with the conduct of a trade or business in the United States by B.

Treas. Reg. § 1.864-3(b), example 3 (1985); *see* DALE, *supra* note 72, at 693 (stating that prior to TRA '86, effectively connected income was determined on annual basis).

113. Treas. Reg. § 1.864-3 (1985); *see* 1986 BLUEBOOK, *supra* note 12, at 1048 (criticizing Code's former treatment of nonresident alien's deferred compensation); *see also* I.R.C. § 864(c)(1)(B) (1985) (providing that if no trade or business is conducted within United States during year income is received, then income cannot be considered effectively connected). Even prior to TRA '86, however, the doctrine of constructive receipt was a check on taxpayer manipulation, so that if the compensation were constructively received in year one, it was "effectively connected." Harllee, Jr., *supra* note 2, § 21.05[3][b] n.50; *see supra* notes 108-11 and accompanying text (stating that constructive receipt acts as check against taxpayers trying to avoid or reduce tax liability).

114. *See* I.R.C. § 871(a)(1)(A) (1985) (providing for 30% tax on income, including compensation that was not connected with U.S. trade or business).

115. I.R.C. § 864(c)(2) (1985); Treas. Reg. § 1.864-4(c) (1985); *see supra* note 86-88 and accompanying text (defining FDAP income as U.S. source income not effectively connected to U.S. trade or business).

the Code taxed it at a flat thirty percent withholding rate[116] and disallowed any deductions.[117] At the time, the FDAP characterization was generally beneficial because the gross thirty percent treaty rate was lower than the net tax under the Code.[118] In addition, many treaties reduced or eliminated the thirty percent withholding tax on FDAP income.[119] Consequently, a nonresident alien eligible for treaty benefits was able to avoid, or significantly decrease, his U.S. tax liability on compensation he had earned previously while in the United States.[120]

In order to prevent a nonresident alien from avoiding taxes on compensation, Revenue Ruling 86-145,[121] which pre-dated TRA '86, found that the term "tax year" in Article 15,[122] Dependent Personal Services, of the United States-United Kingdom Tax Convention[123] ("U.K. Treaty") referred to the tax year in which personal services were performed rather than to the year in which compensation for those services was received.[124] Thus,

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116. I.R.C. § 871(a)(1) (1985); *see* Harllee, Jr., *supra* note 2, § 21.05[4] (describing taxation of deferred compensation prior to TRA '86).

117. I.R.C. § 873(a) (1985). Prior to TRA '86, a nonresident alien with non-effectively connected income could still take deductions for losses, charitable contributions, and personal exemptions. I.R.C. § 873(b) (1985); *see supra* notes 89-97 and accompanying text (noting nonresident aliens are entitled to deductions relating to effectively connected income).

118. *See* I.R.C. § 1 (1985) (listing tax rates prior to TRA '86). *Compare* I.R.C. § 1 (1985) *with* I.R.C. § 1 (illustrating decrease in tax rates after TRA '86).

119. Cole, *supra* note 41, at 83. The exemption or reduced rate of U.S. tax under treaties applied only to income that was not attributable to a trade or business conducted through a permanent establishment or fixed base in the United States. Williams, *supra* note 21, at 279. The U.S. trade or business was needed as a basis for taxing income. Cole, *supra* note 41, at 83.

120. Cole, *supra* note 41, at 83. *But cf.* notes 108-111 (stating checks on taxpayer manipulation include determining whether taxpayer constructively received income in earlier period).

121. Rev. Rul. 86-145, 1986-2 C.B. 297.

122. U.K. Treaty, *supra* note 32, art. 15, 31 U.S.T. at 5682, T.I.A.S. No. 9682, at 15. Article 15 of the U.K. Treaty states:

> [R]enumeration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if: (a) the recipient is present in that other State for a period not exceeding in the aggregate 183 days in the *tax year* concerned; and (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of that other State; and (c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in that other State.

*Id.* (emphasis added).

123. *Id.*

124. Rev. Rul. 86-145, 1986-2 C.B. 297.

if a U.K. treaty resident received income for previous dependent services and the individual was not eligible for any exceptions for temporary stays in the United States, the United States could tax the deferred income, regardless of whether payment for the activities was deferred to years in which the resident had no presence in the United States.[125]

### F. *Legislative History of the Current Treatment of Deferred Compensation*

A tax statute, such as TRA '86 or TAMRA, originates as a bill in the House of Representatives ("House")[126] and, absent a veto, is enacted into law after various stages of congressional and executive approval.[127] In TRA '86, Congress enacted Section 864(c)(6),[128] which completely altered the taxation of deferred income by treating it as effectively connected to a U.S. trade or business.[129] After TRA '86, Congress enacted TAMRA, which amended the wording of Section 864(c)(6) to refer explicitly to other Code sections addressing effectively connected income.[130]

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125. *See id.* (discussing taxation of deferred compensation under dependent personal services article in U.K. Treaty).

126. U.S. CONST. art. 1, § 2. "[A]ll Bills for raising Revenue shall originate in the House of Representatives." *Id.*

127. Richard L. Doernberg, *Overriding Tax Treaties: The U.S. Perspective*, 9 EMORY INT'L L. REV. 71, 75 (1995).

128. TRA '86, Pub. L. No. 99-514, § 1242, 100 Stat. at 2580.

129. I.R.C. § 864(c)(6); 1986 BLUEBOOK, *supra* note 12, at 1047-49.

130. TAMRA, Pub. L. No. 100-647, § 1012(r)(2), 102 Stat. at 3525. Prior to TAMRA, I.R.C. § 864(c)(6) stated:

> [A]ny income or gain of a nonresident alien individual or a foreign corporation for any taxable year which is attributable to a sale or exchange of property or the performance of services (or any other transaction) in any other taxable year *shall be treated as effectively connected with the conduct of a trade or business within the United States* if it would have been so treated if such income or gain were taken into account into such other taxable year.

I.R.C. § 864(c)(6)(1987) (emphasis added). After TAMRA, I.R.C. § 864(c)(6) states that:

> [I]n the case of any income or gain of a nonresident alien individual . . . or a foreign corporation which (A) is taken into account for any taxable year, but (B) is attributable to a sale or exchange of property or the performance of services (or any other transaction) in any other taxable year, *the determination of whether such income or gain is taxable under section 871(b) or 882 (as the case may be)* shall be made as if such income or gain were taken into account in such other taxable year and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable year referred to in subparagraph (A).

### 1. How Tax Statutes, Such as TRA '86 and TAMRA, Are Enacted Into Law

Under the U.S. Constitution, all tax bills must originate in the House.[131] The House Committee on Ways and Means[132] ("House Ways and Means Committee") specifically introduces all domestic tax bills.[133] As in the case of other bills, if a tax bill receives committee and then full House approval,[134] it is sent to the Senate for consideration.[135] The Senate Committee on Finance[136] (the "Senate Finance Committee") first examines the House bill and, if it decides to continue the legislation, generally modifies the tax bill and then refers its version to the entire Senate for a vote.[137] The Senate, after floor debate, generally revises the tax bill.[138] At this point, a Conference Committee,[139] composed of members of the Senate Finance Committee and the House Ways and Means Committee ("the tax-writing commit-

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I.R.C. § 864(c)(6) (emphasis added); *see supra* note 19 and accompanying text (describing TAMRA's amendment to TRA '86).

131. U.S. CONST. art. 1, § 2.

132. Doernberg, *supra* note 127, at 75. The House Committee on Ways and Means ("House Ways and Means Committee") is the House committee that originates domestic tax bills. *Id.*

133. *Id.*

134. *Id.* After hearings and the approval of the House of Ways and Means Committee, the full House debates and votes on the bill. *Id.*

135. *Id.*

136. *Id.* The Senate Committee on Finance ("Senate Finance Committee") examines domestic tax Acts after House approval. *Id.* It is the standing committee of the Senate having jurisdiction over all tax and other revenue legislation. SMITH, *supra* note 3, at 506.

137. Doernberg, *supra* note 127, at 75.

138. *Id.* The staff of the Joint Committee on Taxation assists both the House Ways and Means Committee and Senate Finance Committee with respect to domestic legislation. *Id.* at 77 n.20. Under the Code, the Joint Committee on Taxation is composed of five members of the Senate Finance Committee and five members of the House Ways and Means Committee. I.R.C. § 8002. Membership is bipartisan as both the House and the Senate committees each select three members from the majority party and two members from the minority party. *Id.*

139. Doernberg, *supra* note 127, at 75-76. A conference arises:

> In the practice of legislative bodies, when the two houses cannot agree upon a pending measure, each appoints a committee of "conference," and the committees meet and consult together for the purposes of removing differences, harmonizing conflicting views, and arranging a compromise which will be accepted by both houses.

BLACK'S LAW DICTIONARY 296 (6th ed. 1990). The Conference Committee in tax legislation includes members of the Senate Finance Committee and the House Ways and Means Committee which attempts to reconcile the differences between the House and Senate versions of a bill. Doernberg, *supra* note 127, at 75-76.

tees"),[140] is formed to reconcile the two versions.[141] The Conference Committee's version then must be approved by both the House and Senate.[142] The legislation is next sent to the President and, absent a veto, the bill becomes law with or without his signature.[143]

In 1986, concerned about the numerous loopholes[144] and complexity in the Code, Congress made significant changes to the Code to clarify and simplify the taxing scheme.[145] At that time, along with a general overhaul of the Code, Congress enacted Section 864(c)(6).[146] Section 864(c)(6) provides that the deferral of income to a later year will not change the character of income from effectively connected income to non-effectively connected income even if the taxpayer were not actually engaged in a U.S. trade or business during the year of receipt.[147] Congress also enacted an analogous provision, I.R.C.

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140. Doernberg, *supra* note 127, *Id.* at 77 n.20. The tax-writing committees are the House Ways and Means Committee and Senate Finance Committee. *Id.*

141. *Id.*

142. *Id.* at 76.

143. U.S. CONST. art. I, § 7, cl. 2.

> If any Bill shall not be returned by the President within ten Days (Sundays excepted) after it shall have been presented to him, the Same shall be a Law, in like Manner as if he had signed it, unless the Congress by their Adjournment prevent its Return, in which Case it shall not be a Law.

*Id.*

144. BLACK'S LAW DICTIONARY, *supra* note 139, at 943. In taxation, a loophole is a:

> [P]rovision in the tax code by which a taxpayer may legally avoid or reduce his income taxes. For example, prior to the Tax Reform Act of 1986, a tax shelter was an effective loophole in reducing an individual's taxes; however, with the change in the law, the advantages of such shelters have been substantially been reduced.

*Id.*

145. 1986 BLUEBOOK, *supra* note 12, at 6.

> Congress concluded that only a thorough reform could assure a fairer, more efficient, and simpler tax system. Congress believed that the Act, establishing the Internal Revenue Code of 1986, will restore the trust of the American people in the income tax system and lead the nation's economy into greater productivity.

*Id.*

146. TRA '86, Pub. L. No. 99-514, § 1242, 100 Stat. at 2580; *see* Zaiken, *supra* note 38, at 120 (noting that Code sections governing source laws were significantly changed by TRA '86).

147. I.R.C. § 864(c)(6). The Joint Committee on Taxation estimated that the new treatment of deferred payments would increase tax revenue in 1987 by less than US$5 million per year. 1986 BLUEBOOK, *supra* note 12, at 1049.

§ 864(c)(7)[148] ("Section 864 (c)(7)"), which treats the gain from a sale of assets as effectively connected income after the cessation of the U.S. trade or business of the taxpayer.[149]

### 2. TRA '86 Changed the Treatment of Deferred Compensation

The legislative history of Section 864(c)(6), although not legally controlling,[150] illustrates the impetus behind its enactment.[151] Before TRA '86,[152] a nonresident's salary for services performed in the United States was considered FDAP income when he received compensation, a year in which he was not engaged in a U.S. trade or business.[153] In the legislative history of TRA '86, both the House and Senate tax-writing committees expressed their intent to tax an alien's compensation, regardless of whether receipt of that income was deferred until a later taxable year.[154] Additionally, in its report on TRA '86, the Joint Committee on Taxation[155] explained that Congress wanted to prevent

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148. I.R.C. § 864(c)(7); TRA '86, Pub. L. No. 99-514, § 1242, 100 Stat. at 2580. I.R.C. § 864(c)(7) provides that if:

> (A) any property ceases to be used or held for use in connection with the conduct of a trade or business within the United States, and (B) such property is disposed of within 10 years after such cessation, the determination of whether any income or gain attributable to such disposition is taxable under section 871(b) or 882 (as the case may be) shall be made as if such sale or exchange occurred immediately before such cessation and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable year for which such income or gain is taken into account.

I.R.C. § 864(c)(7).

149. *Id.*

150. Snap-On Tools, Inc. v. United States, 26 Cl. Ct. 1045, 1057 (1992), *aff'd*, 26 F.3d 137 (Fed. Cir. 1994). "Where the language of a statute is clear, the courts should not replace that language with unenacted legislative intent." *Id.* For a further discussion of the limits of legislative history when used to interpret statutes, see Note, *Why Learned Hand Would Never Consult Legislative History Today*, 105 HARV. L. REV. 1005, 1012-24 (1992).

151. *See* 1986 BLUEBOOK, *supra* note 12, at 1048-49 (discussing impetus behind enactment of I.R.C. § 864(c)(6) and (7)).

152. I.R.C. § 864(c)(1)(B) (1985); *see supra* notes 112, 120 and accompanying text (explaining treatment of deferred income before enactment of I.R.C. § 864(c)(6)).

153. I.R.C. § 864(c)(1)(B) (1985).

154. H.R. REP. No. 426, 99th Cong., 1st Sess. 436 (1985); S. REP. No. 313, 99th Cong., 2d Sess. 408 (1986). "[D]eferring the recognition of income until a later taxable year will no longer change the manner in which the U.S. tax system treats the income." *Id.*

155. I.R.C. §§ 8001, 8021; *see supra* note 12 and accompanying text (describing

nonresident aliens from avoiding U.S. tax obligations on their compensation by arranging to receive compensation in a later year.[156]

The congressional discussion of Section 864(c)(6) in TRA '86 focused on the new characterization of deferred compensation as effectively connected income, but did not address the deductibility of deferred expenses.[157] The House,[158] Senate,[159] and Conference Committee[160] reports on TRA '86 only referred to the taxation of deferred "income or gain" that became effectively connected by virtue of Section 864(c)(6).[161] Similarly, the Joint Committee on Taxation limited its discussion of Section 864(c)(6) to the taxation of deferred "income or gain."[162] Fur-

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Joint Committee on Taxation's role); *see supra* note 138 and accompanying text (describing Joint Committee on Taxation's assistance to tax-writing committees in drafting U.S. tax legislation).

156. 1986 BLUEBOOK, *supra* note 12, at 1048. The Joint Committee on Taxation explained:

> Under prior law, foreign taxpayers could avoid U.S. tax by receiving income that was earned by a U.S. trade or business in a year after the trade or business had ceased to exist. For example, the business could sell property and accept an installment obligation as payment. By recognizing the gain on the installment basis, the taxpayer could defer the income to a later taxable year. If the taxpayer had no U.S. trade or business in that year, then the income recognized in that year was not treated as effectively connected with a U.S. trade or business. Congress believed that income earned by a foreign person's U.S. trade or business should be taxed as such, regardless of whether recognition of that income is deferred until a later taxable year. Similarly, *Congress believed that foreign persons should not be able to avoid U.S. tax on their income from the performance of services in the United States where payment of the income is deferred until a subsequent year in which the individual is not present in the United States.*

*Id.* (emphasis added). This provision applies only if both the transaction and the recognition of the income or gain occur in a taxable year after 1986. *Id.* at 1049.

157. *Id.* at 1048; H.R. CONF. REP. NO. 841, 99th Cong., 2d Sess. II-651 (1986); S. REP. NO. 313, *supra* note 154, at 408-09; H.R. REP. NO. 426, *supra* note 154, at 436.

158. H.R. REP. NO. 426, *supra* note 154, at 436.

159. S. REP. NO. 313, *supra* note 154, at 408-09.

160. H.R. CONF. REP. NO. 841, *supra* note 157, at II-651.

161. *See, e.g., id.* The Conference Committee stated that the "House bill provides that *income or gain* is treated as effectively connected with a U.S. trade or business if it is attributable to another taxable year and would have been so treated if it had been taken into account in that other year." *Id.* The Senate amendment agreed with the House treatment for the deferred payment of personal services. *Id.* The Conference agreement followed the Senate treatment. *Id.*

162. 1986 BLUEBOOK, *supra* note 12, at 1048. The Joint Committee on Taxation stated:

> The Act [TRA '86] amends section 864(c) to provide that any income or gain of a foreign person for any taxable year which is attributable to a transaction in any other taxable year will be treated as effectively connected with the con-

thermore, these reports did not distinguish between different classes of personal services.[163]

3. TAMRA Subsequently Amended the Language of Section 864(c)(6)

TAMRA, which amended Section 864(c)(6) in 1988,[164] incorporated provisions of the Technical Corrections Act of 1988[165] ("TCA '88") by adding references to other Code sections addressing effectively connected income.[166] Sections 871(b) and 882 tax effectively connected income on a net basis.[167] Correspondingly, the Senate Finance Committee explained that Section 864(c)(6) was amended to tax deferred compensation on a net basis under the principles of Sections 871(b) and 882.[168] The Senate Finance Committee stated that when determining whether deferred income was taxable on a net basis under Section 864(c)(6), income was to be considered received in the earlier year, without regard to the I.R.C. § 871(b)[169] requirement

> duct of a U.S. trade or business if it would have been so treated had it been taken into account in that other taxable year.

*Id.* at 1048-49.

163. *Id.* at 1048; H.R. CONF. REP. NO. 841, *supra* note 157, at II-651; S. REP. NO. 313, *supra* note 154, at 408-09; H.R. REP. NO. 426, *supra* note 154, at 436.

164. TAMRA, Pub. L. No. 100-647, § 1012(r)(2), 102 Stat. at 3525; *see supra* note 130 and accompanying text (discussing TAMRA's amendment of I.R.C. § 864(c)(6)).

165. *See* TCA '88, S. 2238, 100th Cong., 2d Sess. § 112(r) (1988) (amending language of I.R.C. § 864(c)(6)); *see* H.R. CONF. REP. NO. 1104, *supra* note 19, at xvii (discussing legislative background of TCA '88).

166. I.R.C. §§ 871(b), 882. I.R.C. § 871(b) states: "A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable [under the Code] on his taxable income which is effectively connected with the conduct of a trade or business within the United States." I.R.C. § 871(b). I.R.C. § 882 states: "A foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable . . . on its taxable income which is effectively connected with the conduct of a trade or business within the United States." I.R.C. § 882. "Taxable income" refers to a net tax. CHIRELSTEIN, *supra* note 75, at 2.

167. I.R.C. §§ 871(b), 882.

168. S. REP. NO. 445, *supra* note 19, at 303. The Senate Finance Committee stated:

> In the case of payments for sales or exchanges of property, the performance of services, or any other transaction, that are deferred from one taxable year to a later taxable year, *the determination whether such income or gain is taxable on a net basis (under sec. 871(b) or 882(a))* is to be made as if the income were taken into account in the earlier year and without regard to the requirement of sec. 871(b) or 882(a) that the taxpayer be engaged in a trade or business within the United States during the later taxable year.

*Id.* (emphasis added).

169. I.R.C. § 871(b).

that the taxpayer be engaged in a U.S. trade or business during the year the income was received.[170] Furthermore, in its discussion, the Senate Finance Committee did not distinguish between various types of personal service income.[171]

### G. *The Amended Wording of Section 864(c)(6) Differs from Other Code Sections Taxing Effectively Connected Income*

After TAMRA, Section 864(c)(6) referred explicitly to the other Code sections taxing effectively connected income.[172] The legislative history of Section 864(c)(6), however, does not explain the difference in terminology used in the other Code sections taxing effectively connected income.[173] Under Sections 864(c)(6), 871(b), and 882, effectively connected income is taxed at the regular U.S. graduated rates.[174] The language of Section 864(c)(6), however, differs from that of Sections 871(b)[175] and 882.[176] That is, Section 864(c)(6) uses the term "any income or gain"[177] to describe income that is subject to U.S. tax whereas Sections 871(b) and 882 employ the term "taxable income."[178]

### H. *Tax Principles Mitigating Tax Liability Under the Code*

A taxpayer may seek relief from tax liability[179] under Section

170. S. REP. No. 445, *supra* note 19, at 303.

171. *Id.* at 302-03. As the Supreme Court stated, however, "Congress' silence is just that — silence." Alaska Airlines, Inc. v. Brock, 480 U.S. 678, 686 (1987). Another court, however, stated that "silence in all the relevant negotiation documents, and in the language of the Convention itself . . . cannot be taken lightly or taken as abrogating existing United States law." *Snap-On Tools*, 26 Cl. Ct. at 1063.

172. TAMRA, Pub. L. No. 100-647, § 1012(r)(2), 102 Stat. at 3525.

173. *Compare* I.R.C. § 864(c)(6) (discussing deferred "income or gain") *with* I.R.C. § 871(b) (providing for tax on "taxable income" of individuals). *Compare* I.R.C. § 864(c)(6) (taxing deferred "income or gain") *with* I.R.C. § 882 (referring to "taxable income" of corporations).

174. I.R.C. §§ 864(c)(6), 871(b), 882; *see supra* note 78 and accompanying text (listing graduated tax rates in Code).

175. *Compare* I.R.C. § 864(c)(6) (taxing deferred "income or gain") *with* I.R.C. § 871(b) (referring to "taxable income" of individuals).

176. *Compare* I.R.C. § 864(c)(6) (addressing taxation of deferred "income or gain") *with* I.R.C. § 882 (providing for tax on "taxable income" of corporations).

177. I.R.C. § 864(c)(6); *see* I.R.C. § 61 (defining gross income as income from any source).

178. I.R.C. §§ 871(b), 882; *see supra* notes 76-77 and accompanying text (noting taxable income is gross income after expenses).

179. Doernberg, *supra* note 127, at 119-20. In terms of an alien bringing suit in the United States, it "is theoretically possible to pursue a claim in the U.S. courts, but

864(c)(6) based on the difference in its language when compared to other Code sections taxing effectively connected income, Sections 871(b) and 882.[180] A taxpayer may advance equitable principles to advance his proposition.[181]

Fairness considerations, however, play a limited role in tax cases.[182] As the U.S. Court of Appeals for the Fourth Circuit has stated, the court's task is not to weigh equities, but rather to determine the technical application of the law.[183] The court's view is consistent with the principle that tax laws are technical and are to be interpreted accordingly.[184] As a special rule in tax cases, however, where the text is ambiguous, courts have held that doubt should be resolved in favor of the taxpayer.[185]

In addition to issues of fairness, a taxpayer may argue his position by relying on the principles underpinning the substance-over-form doctrine.[186] The substance-over-form principle is well-settled in tax matters[187] and is invoked to show the eco-

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the likelihood of success is not high. It is clear that international agreements of the United States—including income tax treaties—are the law of the United States and are within the jurisdiction of the federal courts." *Id.*

180. *Compare* I.R.C. § 864(c)(6) (referring to deferred "income or gain") *with* I.R.C. §§ 871(b), 882 (taxing "taxable income" of individuals). *See supra* notes 175-78 and accompanying text (describing difference in terminology among Code sections taxing effectively connected income).

181. *Cf. Webb*, 66 F.3d at 694 (stating equitable principles are generally of limited application in tax cases).

182. *Id.* "The world at large, and the income-tax world in particular, are full of hardship and loss despite which it is deemed sound policy to enforce general rules inflexibly." *Id.* (quoting J.M. Maguire et al., *Section 820 of the Revenue Act of 1938*, 48 YALE L.J. 509, 515 (1939)). Other tax policy goals include administrative predictability. Oklahoma Tax Comm'n v. Chickasaw Nation, 115 S. Ct. 2214, 2221 (1995).

183. *Webb*, 66 F.3d at 694.

184. *Id.* Textual "silence as to matters of taxation will never be sufficient to establish an exemption." Lazore v. Commissioner, 11 F.3d 1180, 1184 (3d Cir. 1993). The tax court has stated that if statutory provisions "are unambiguous, we are not permitted, except in rare and unusual situations, to depart from the statutory language." Vulcan Materials Co. v. Commissioner, 96 T.C. 410, 417 (1991), *aff'd*, 958 F.2d 973 (11th Cir. 1992). "In construing a statute, we must first look to the plain text used by Congress. If the language of the statute is unambiguous, it is conclusive unless there is a 'clearly expressed legislative intent to the contrary.'" United States v. Hurt, 795 F.2d 765, 770 (9th Cir. 1986), *cert. denied*, 484 U.S. 816 (1987) (citations omitted).

185. Hassett v. Welch, 303 U.S. 303, 314 (1938); Xerox Corp. v. United States, 41 F.3d 647, 658 (Fed. Cir. 1994), *cert. denied*, 116 S. Ct. 72 (1995).

186. KAHN, *supra* note 4, at 31; *see supra* note 46 and accompanying text (defining substance-over-form doctrine).

187. United States v. Phellis, 257 U.S. 156, 168 (1921). The Supreme Court stated: "We recognize the importance of regarding matters of substance and disregarding forms in applying the provisions of the Sixteenth Amendment and income tax laws

nomic realities of a transaction.[188] Taxpayers, for example, rely on the substance-over-form doctrine to gain tax relief.[189] The I.R.S. generally uses substance-over-form arguments to recharacterize transactions according to their economic reality, thereby depriving taxpayers of certain tax advantages in labeling a transaction one way over another.[190] Courts, moreover, apply the doctrine in a manner that generally favors the I.R.S.[191]

### I. *Overview of U.S. Tax Treaties*

The general tax treatment of aliens is subject to overriding provisions in tax treaties,[192] which seek to avoid double taxation and fiscal evasion.[193] The United States relies on model treaties as a basis for its negotiation with other countries.[194] Tax treaties are brought into force after negotiations by the Executive Branch[195] and ratification by the Senate.[196] Additionally, tax

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enacted thereunder. In a number of cases . . . we have under varying conditions followed the rule." *Phellis*, 257 U.S. at 168. The Sixteenth Amendment states : "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. CONST. amend. XVI.

188. BORIS I. BITTKER & MARTIN J. MCMAHON, JR., FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 1.3[3] (1995).

189. *See id.* (discussing disavowal of transaction form by taxpayers).

190. *Id.*

191. *Id.* "[T]he substance-over-form doctrine ordinarily is a one-way street reserved for the IRS." *Id.*

192. I.R.C. § 894(a)(1); *see* BAKER, *supra* note 47, at 11-12 (illustrating benefits of tax treaties).

193. *See* 1992 OECD MODEL, *supra* note 81, at 7-10 (explaining that model convention addresses issues of preventing double taxation and tax evasion). Double taxation is "the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods." *Id.* at 7. One commentator has noted that "from the governmental point of view, most comprehensive tax treaties appear to have [the] twin purposes of avoiding double taxation and preventing fiscal evasion." BAKER, *supra* note 47, at 9. As the Supreme Court has stated, the purpose of a double taxation agreement is:

> [N]ot to assure complete and strict equality of treatment—a virtually impossible task in light of the different tax structures of the two nations—but rather . . . to facilitate commercial exchange through elimination of double taxation resulting from both countries levying on the same transaction or profit; an additional purpose was the prevention of fiscal evasion.

Maximov v. United States, 373 U.S. 49, 54 (1963).

194. *Treasury Announces Review of Model Income Tax Treaty*, *supra* note 81, at G-5.

195. BLACK'S LAW DICTIONARY, *supra* note 139, at 569. The executive "as distinguished from the legislative and judicial departments (*i.e.* branches) of government, the executive department is that which is charged with the detail of carrying the laws into effect and securing their due observance." *Id.*

treaties modify tax liability under the Code and, in cases of conflict, a court decides which prevails.[197]

### 1. Rationale for Tax Treaties

Countries enter into tax treaties in order to spur international economic growth[198] and eliminate double taxation[199] of their citizens.[200] Tax treaties also lower withholding tax rates,[201] reduce other taxation in the source country,[202] avoid discriminatory treatment[203] on tax matters, and prevent tax evasion.[204] The United States, for example, has entered into over forty bilateral tax treaties[205] under which the contracting states extend tax concessions to each other's residents.[206] For nonresident aliens, the Code's usual graduated U.S. tax rates that apply to U.S. source

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196. Doernberg, *supra* note 127, at 76-78.

197. I.R.C. § 894(a); *see* Carl Estes, *Tax Treaties*, 14 INT'L LAW. 508, 508 (1980) (discussing interplay between Code and tax treaties).

198. *See* JOINT COMM. DUTCH EXPLANATION, *supra* note 38, at 35 (discussing objectives of U.S. tax treaties); 1992 OECD MODEL, *supra* note 81, at 7 (stating goals of model convention); The principal goal of tax treaties is to remove the negative effects of double taxation on the international movement of goods, technology, capital, and people. *Id.*; *see* BAKER, *supra* note 47, at 5 (stating that treaties further policy of encouraging foreign investment and assisting participation of investors in overseas development or trade).

199. 1992 OECD MODEL, *supra* note 81, at 7.

200. Rosenbloom, *supra* note 23, at 770; *see* OGLEY, *supra* note 81, at 31 (characterizing double taxation as undesirable). "In the absence of any arrangements to prevent or relieve double taxation, the taxpayer would be faced with the dual claims, of his country of residence and the country of source, to tax the same [income]." *Id.*

201. Estes, *supra* note 197, at 508; *see* BAKER, *supra* note 47, at 6 (stating that U.S. view is that treaties can only relieve tax burden; treaties cannot impose higher tax rate).

202. OGLEY, *supra* note 81, at 32. "[D]ouble taxation generally arises out of the competing claims of an [individual's] country of residence to tax his worldwide income and the country of source's assertion of its taxing rights over income arising within it." *Id.*

203. *See* BAKER, *supra* note 47, at 10 (discussing anti-discrimination provisions of treaties); Estes, *supra* note 197, at 511-13 (stating that every tax treaty has non-discrimination clause).

204. *Maximov*, 373 U.S. at 54; *see* 1992 OECD MODEL, *supra* note 81, at 10 (explaining model convention addresses issue of preventing tax evasion); BAKER, *supra* note 47, at 9 (discussing twin purposes of tax treaties as avoiding double taxation and fiscal evasion); *see supra* note 193 and accompanying text (discussing purposes of tax treaties).

205. Treaty Status Table, *supra* note 28, 3 Tax Treaties (CCH) ¶ 25,501, at 46,512 to -513.

206. *See* BITTKER & LOKKEN, *supra* note 38, ¶ 65.7 (discussing effect of treaties on U.S. citizens and residents); Estes, *supra* note 197, at 508 (describing goals of tax treaties).

income may be mitigated by tax treaty reductions or exemptions.[207]

2. Model Tax Treaties Are Used as a Basis of Negotiations

The United States relies on model treaties, such as the proposed 1981 U.S. Model Income Tax Treaty[208] ("1981 Treasury Model"), as starting points for treaty negotiations with other countries.[209] The United States is a member of the Organisation for Economic Co-operation and Development[210] ("OECD") and based its model tax treaty on the 1977 OECD Model.[211] The Netherlands also belongs to the OECD.[212] Accordingly, the Dutch Treaty was based on both the 1977 OECD Model and the 1981 Treasury Model.[213]

On July 17, 1992, the Treasury Department announced that it was conducting a review of the U.S. model tax treaties and intended to draft a new U.S. model.[214] The Treasury Department simultaneously withdrew both the 1981 Treasury Model and the 1977 U.S. Model Income Tax Treaty ("1977 Treasury Model") as bases for negotiations with other countries.[215] The

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207. Freites, *supra* note 1, at 31. In 1992, for example, of the US$77.5 billion of total U.S. source income 77.4%, or US$59.9 billion was exempt from U.S. taxation. *Id.* Because of tax treaties, only US$2.1 billion of the remaining US$17.5 billion of income subject to taxation was taxed at the 30% statutory rate. *Id.* This figure represents just 2.7% of the total U.S. source income in 1992. *Id.*

In addition, in 1992, individual residents of all countries filed 1.1 million U.S. returns based on US$3.9 billion of total income and US$314 million in personal services income. *Id.* at 35. For example, Dutch residents filed 10,854 returns and had US$107 million in income, US$8 million of which was personal services income. *Id.* at 36. Swiss residents filed 15,554 returns and had US$128.2 million in income, US$4.6 million of which was personal services income. *Id.* at 37. Finnish residents filed 1,440 returns and had US$4.2 million in income, US$501,000 of which was personal services income. *Id.* at 35. German residents filed 104,382 returns and had US$297 million in income, US$21 million of which was personal services income. *Id.* Mexican residents filed 81,759 returns and had US$301 million in income, US$5.5 million of which was personal services income. *Id.* at 36. Spanish resident filed 11,282 returns and had U.S. income of US$34 million, US$4.4 million of which was personal services income. *Id.* at 37. U.K. resident filed 87, 209 returns and had U.S. income of US$585 million, US$28.9 million of which was personal services income. *Id.* at 37.

208. 1981 TREASURY MODEL, *supra* note 81, 1 Tax Treaties (CCH) ¶ 211, at 10,573.

209. *Treasury Announces Review of Model Income Tax Treaty*, *supra* note 81, at G-5.

210. 1992 OECD MODEL, *supra* note 81, at 2.

211. *Treasury Announces Review of Model Income Tax Treaty*, *supra* note 81, at G-5.

212. 1992 OECD MODEL, *supra* note 81, at 2.

213. Dutch Technical Explanation, *supra* note 81, at 36,447-115.

214. *Treasury Announces Review of Model Income Tax Treaty*, *supra* note 81, at G-5.

215. *Id.* The United States has a model treaty from 1977 ("1977 Treasury Model").

Treasury Department declared that it was revising the withdrawn model treaties because they were antiquated with respect to both changing tax policies and important changes in statutory international tax law enacted by TRA '86.[216]

3. How Tax Treaties Are Enacted in the United States

Although most tax bills in the United States originate in the House,[217] the House plays no constitutional role in the creation of international tax treaties.[218] Instead, the Executive Branch, through the Treasury Department, first negotiates a tax treaty with another country.[219] The draft then is initialed by the respective delegates, signed by the Executive Branch, and sent to the Senate for its advice and consent to ratification.[220] Once the Senate receives the draft, the Senate Committee on Foreign Relations[221] ("Senate Foreign Relations Committee") considers the proposed treaty for the first time.[222] At this point, the Senate

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U.S. Treasury Department, Model Income Tax Treaty, 1 Tax Treaties (CCH) ¶ 208, at 10,539 (1977) [hereinafter 1977 TREASURY MODEL].

216. *Treasury Announces Review of Model Income Tax Treaty, supra* note 81, at G-5. "There have been important changes in U.S. statutory international tax rules since 1981, include the 1986 Tax Reform Act. Some of these new rules are expected by Congress to be preserved in all U.S. income tax treaties." *Id.*

217. *See* Marshall J. Langer, *The Need for Reform in the Tax Treaty Area, in* INCOME TAX TREATIES 717, 753 (Bischel ed., 1978). As Langer has noted:

> The basic purpose of every bilateral tax treaty is to amend the Internal Revenue Code as it applies to residents of the other country in return for corresponding amendments of the tax laws of the other country as applied to Americans. All other amendments of our tax laws involve public hearings before the House Ways and Means Committee and the Senate Finance Committee . . . .

*Id.* at 751-52; *see supra* notes 131-43 and accompanying text (describing U.S. legislative tax process).

218. Doernberg, *supra* note 127, at 76.

219. U.S. CONST. art. II, § 2, cl. 2. "He [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." *Id.* The Executive Branch is responsible for the negotiation of treaties because it is responsible for conducting foreign relations. Doernberg, *supra* note 127, at 76; *see* Langer, *supra* note 217, at 753 (listing steps that comprise treaty-making process).

220. Langer, *supra* note 217, at 753; *see* Estes, *supra* note 197, at 508 (summarizing creation of tax treaties in United States).

221. Doernberg, *supra* note 127, at 77. The Senate Committee on Foreign Relations ("Senate Foreign Relations Committee") has official jurisdiction over tax treaties. *Id.*

222. Langer, *supra* note 217, at 753; Doernberg, *supra* note 127, at 77. The Senate Finance Committee has no official jurisdiction over tax treaties, as its role is limited to domestic tax legislation. *Id.*

Foreign Relations Committee holds hearings and either approves or rejects the proposed treaty.[223]

Once the Senate Foreign Relations Committee approves a treaty, it is sent out to the full Senate for its advice and consent.[224] The Senate gives its advice and consent to a treaty by a two-thirds vote recommending ratification.[225] The Senate, moreover, may debate provisions of the treaty.[226] In some instances, the Senate may give its advice and consent to a proposed tax treaty while entering a reservation,[227] rendering the tax treaty contingent upon revision or omission.[228] The tax treaty only will come into force if it is modified in accordance with the reservation.[229]

After the Senate approves a tax treaty, the Executive Branch decides when and whether to ratify it.[230] Consequently, the President also has the authority to prevent a proposed treaty from entering into force.[231] Once the President signs a tax treaty, however, the tax treaty becomes law as soon as the instruments of ratification are exchanged.[232] In the United States, tax treaties are self-executing[233] and, therefore, become operative as domestic law upon the Senate's advice and consent and the exchange of instruments of ratification.[234] No further domestic legislation is required to incorporate a tax treaty into domestic

223. Langer, *supra* note 217, at 753; Doernberg, *supra* note 127, at 77.

224. Doernberg, *supra* note 127, at 77.

225. U.S. CONST. art. II, § 2, cl. 2.

226. Doernberg, *supra* note 127, at 77.

227. *Id.* A reservation indicates that the proposed treaty is "conditional upon a particular modification or omission." *Id.*

228. *Id.*

229. *Id.* As Doernberg notes:

> The ability of the Senate to enter a reservation or to refuse to give its advice and consent after the Executive Branch has signed a treaty effectively gives the United States a "second look" at the treaty terms. Treaty partners of the United States have expressed objection to this practice. If the Legislative Branch has the authority effectively to override what the Executive Branch has negotiated, some may consider it a small additional step for Congress to override a treaty that has already entered into effect.

*Id.* at 77-78.

230. *Id.* at 78. The Executive Branch effectively "has a 'third look' by deciding when or if legislation will take place." *Id.*

231. *Id.*

232. U.S. CONST. art. II, § 2, cl. 2.

233. *See* Whitney v. Robertson, 124 U.S. 190, 194 (1888) (defining self-executing treaties as those that require no legislation to carry them into effect).

234. U.S. CONST. art. II, § 2, cl. 2.

law.[235]

Several congressional committees and the Treasury Department issue reports analyzing a tax treaty during its proposed stages.[236] The Senate Foreign Relations Committee, for example, requests the input of the domestic tax-writing committees, the House Ways and Means Committee, and the Senate Finance Committee.[237] The analysis of a tax treaty, however, is done primarily by the staff of the Joint Committee on Taxation.[238] The Joint Committee on Taxation's explanation of the proposed treaty ("Joint Committee Explanation") prepares the Senate Foreign Relations Committee for hearings on the proposed treaty.[239] After hearings, the Senate Foreign Relations Committee issues its report ("Senate Report") while the Treasury Department issues a Technical Explanation ("Technical Explanation").[240]

#### 4. The Relationship Between Tax Treaties and the Code

Tax treaties affect taxation under the Code by reducing or eliminating tax liability.[241] In cases of conflict between the Code and tax treaties, courts give both equal authority under the U.S. Constitution ("Constitution").[242] Courts construe the language

235. Doernberg, *supra* note 127, at 78.

236. *See* Williams, *supra* note 21, at 279 n.3 (describing legislative history of domestic tax treaties).

237. Doernberg, *supra* note 127, at 77.

238. *Id.* at 77 n.20; *see supra* note 138 and accompanying text (stating that Joint Committee on Taxation assists tax-writing committees of Congress in drafting domestic legislation).

239. Doernberg, *supra* note 127, at 77. "The Staff of the Joint Committee on Taxation prepares a pamphlet that reviews the provisions of the treaty and highlights issues to be considered." *Id.*; *see, e.g.*, JOINT COMM. DUTCH EXPLANATION, *supra* note 38, at 1 (describing legislative process preceeding Dutch Treaty).

240. Doernberg, *supra* note 127, at 77. The Technical Explanation, according to the Treasury Department, is the official guide to the tax conventions. Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-115. The Technical Explanation "reflects the policies behind the particular convention provisions, as well as understandings reached with respect to the application and interpretation of the [c]onvention." *Id.*

241. I.R.C. § 894(a); Estes, *supra* note 197, at 508; *see* BAKER, *supra* note 47, at 6 (noting U.S. tax treaties only relieve tax burden and cannot impose higher tax rate).

242. Reid v. Covert, 354 U.S. 1, 18 (1957); *see Whitney*, 124 U.S. at 194 (discussing interplay between treaties and statutes). The Supreme Court stated:

> 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

of the tax treaty so as to make it harmonious with the Code.[243] The possibility of a treaty override, however, occurs when subsequent amendments to the Code cannot be reconciled with existing provisions of a tax treaty.[244]

a. Courts' Interpretation of Conflicts Between Tax Treaties and the Code

In determining the force of treaties in the United States, the Supremacy Clause of the Constitution subjects all treaties and laws to constitutional scrutiny.[245] The U.S. Supreme Court ("Supreme Court") has interpreted the Supremacy Clause as putting statutes and treaties on equal footing[246] because both are part of the domestic law.[247] Accordingly, in trying to interpret the relationship between an earlier treaty provision and a statute enacted after the treaty has been adopted, courts must decide whether the two provisions, both of equal authority, can both be given effect.[248]

As in the case of statutes, courts construe tax treaties by first considering the text of the treaty.[249] Courts begin with a general

> 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.

*Id.*

243. S. Rep. No. 445, *supra* note 19, at 316. "Of those [interpretative] guidelines, one of the most important is the initial presumption of harmony between earlier and later pronouncements." *Id.*; *see* Amaral v. Commissioner, 90 T.C. 802, 813 (1988) (finding that treaties should be construed like contracts); *see also* Estate of Burghardt v. Commissioner, 80 T.C. 705, 713 (1983), *aff'd*, 734 F.2d 3 (3d Cir. 1984) (finding that courts attempt to harmonize treaties and later revenue laws relating to same subject).

244. Baker, *supra* note 47, at 36.

245. U.S. Const. art. VI, cl. 2. "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." *Id.*

246. *Reid*, 354 U.S. at 18; *Whitney*, 124 U.S. at 194; *see supra* note 242 and accompanying text (discussing relationship between Code and tax treaties).

247. I.R.C. § 7852(d)(1); Baker, *supra* note 47, at 37 (stating that federal legislation and treaties carry equal weight).

248. *Whitney*, 124 U.S. at 194; *see* S. Rep. No. 445, *supra* note 19, at 316 (describing courts' interpretation of relationship between treaties and statutes)

249. Bread Political Action Comm. v. Federal Election Comm., 455 U.S. 577, 580 (1982); *Maximov*, 373 U.S. at 51. When the Code taxes income, "[w]hatever basis there may be . . . for relieving the . . . tax must be found in the words or implications of the Convention." *Maximov*, 373 U.S. at 51. Even where identical provisions exist in U.S. tax treaties, however, each tax treaty should be construed individually unless identical sec-

presumption of harmony between treaties and statutes, regardless of which was first enacted.[250] In resolving conflicts, courts may also rely upon the legislative history of a tax treaty when interpreting its provisions.[251] Historically, absent specific legislative history or explicit statutory override, courts have upheld existing treaties that conflict with subsequent revenue laws.[252]

### b. Treaty Overrides by the Code

Treaty overrides occur when subsequent domestic legislation by the source country conflicts with earlier obligations assumed under a binding tax treaty with another country.[253] Treaty overrides are thus linked to the incorporation of tax treaty provisions into domestic law.[254] Tax treaty overrides can be classified into two groups: intentional and unintentional.[255]

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tions in other treaties have received interpretation in a similar situation. David S. Foster, *Treaty Rules Applicable to Engaging in Trade or Business and Direct Investment*, 5 N.Y.U. INT'L INST. ON TAX & BUS. PLAN. 45 n.25 (1978). For example, one commentator has noted that:

> Ideally, the United States would like to have a similar interpretation of the same language under each of its treaties. Each of the United States' treaty partners of course has a similar desire. In addition, each outstanding treaty should be interpreted the same by both parties. It is impossible for all three of these goals to be met unless everyone in the world agrees on the same interpretation.

*Id.*; *see* Estes, *supra* note 197, at 509 (stating that tax treaties are end result of negotiation and compromise).

250. S. REP. NO. 445, *supra* note 19, at 316.; *see supra* note 243 and accompanying text (discussing courts' presumption of harmony between Code and existing tax treaty provisions). Furthermore, the Supreme Court has stated that tax provisions generally should be read to incorporate domestic tax concepts, absent a clear congressional expression that foreign concepts control. United States v. Goodyear Tire & Rubber, 493 U.S. 132, 145 (1989).

251. Xerox Corp. v. United States, 41 F.3d 647, 653 (Fed. Cir. 1994), *cert. denied*, 116 S. Ct. 72 (1995). To determine the intent of the parties, the court in *Xerox* examined the negotiation history of the U.K. Treaty by looking at the Senate report that accompanied the treaty when it was presented for ratification. *Xerox*, 41 F.3d at 653. The court also examined the Technical Explanation accompanying the tax treaty. *Id.* at 655; *see* BAKER, *supra* note 47, at 13 (describing tax treaty process in United States).

252. Cook v. United States, 288 U.S. 102, 120 (1933). According to the Supreme Court, a "*treaty will not be deemed to have been abrogated or modified by a later statute, unless such purpose on the part of Congress has been clearly expressed.*" *Id.* (emphasis added); *see Estate of Burghardt*, 80 T.C. at 717 (finding no congressional intent to abrogate provision of tax treaty).

253. BAKER, *supra* note 47, at 36.

254. *Id.*; *see* OGLEY, *supra* note 81, at 164 (discussing treaty overrides in United States).

255. BAKER, *supra* note 47, at 36.

Intentional tax treaty overrides occur when one country enacts legislation knowing and intending that it will conflict with a tax treaty obligation.[256] An unintentional tax treaty override occurs when the country does not express such intent.[257] In the latter situation, U.S. courts may reconcile the existing tax treaty and the new law.[258] In cases of intentional override, however, the new domestic law prevails over the treaty.[259]

## II. TAX TREATIES: HOW HAS THE TAXATION OF DEFERRED INCOME BEEN INCORPORATED?

Before TAMRA, inconsistent provisions between the Code and tax treaties were resolved in favor of tax treaties.[260] The Code's relationship with tax treaties changed significantly after TAMRA, as the Code no longer deferred to tax treaties.[261] After TAMRA, statutes and treaties are on equal footing.[262] Recent statements by Congress[263] and the Treasury Department indicate

256. *Id.*; *see Crow*, 85 T.C. at 382-83 (discussing congressional override of tax treaties).

257. BAKER, *supra* note 47, at 36.

258. *Id.*

259. *Id.*

260. I.R.C. §§ 894(a), 7852(d) (1985). Before TAMRA, I.R.C. § 894(a) stated: "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 [U.S. income] taxation . . . ." I.R.C. § 894(a) (1985). In addition, prior to amendment, I.R.C. § 7852(d) stated: "No provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title." I.R.C. § 7852(d) (1985).

261. I.R.C. § 894(a); TAMRA, Pub. L. No. 100-647, § 1012(aa)(6), 102 Stat. at 3533. After TAMRA, I.R.C. § 894(a) states: "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." I.R.C. § 894(a).

262. I.R.C. § 7852(d); TAMRA, Pub. L. No. 100-647, § 1012(aa)(1)(A), 102 Stat. at 3531. After TAMRA, I.R.C. § 7852(d) states: "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." I.R.C. § 7852(d); *see* S. REP. No. 445, *supra* note 19, at 318-21 (stating amendments to Code shifted balance between Code and treaties to one of parity).

263. JOINT COMM. DUTCH EXPLANATION, *supra* note 38, at 85 n.43. The Joint Committee on Taxation, in its description of the Dutch Treaty, stated that "[w]ith respect to the language in the proposed treaty that conforms to the U.S. model, it is understood that *no change to the language is necessary* to conform the treatment of income derived from independent personal services with the Code Section 864(c)(6)." *Id.* Moreover, in its Mexican and Finnish Reports, the Joint Committee on Taxation stated that: "[I]t is understood that no change to the model treaty language is necessary to conform the treatment of income derived from independent personal services with Code Section 864(c)(6) . . . ." STAFF OF JOINT COMM. ON TAX'N, EXPLANATION OF PROPOSED INCOME

that Section 864(c)(6) is consistent with the language in existing tax treaties.[264] Additionally, recent treaties, such as the Dutch Treaty, incorporate the treatment of deferred compensation under Section 864(c)(6) specifically for independent contractors and businesses.[265] The Swiss Treaty, enacted before TRA '86, also addresses the taxation of businesses and personal services but does not expressly discuss the taxation of deferred income under the principles of Section 864(c)(6).[266]

### A. *TRA '86 and TAMRA's Relationship with U.S. Tax Treaties*

Although TRA '86 did not address the relationship between tax treaties and statutes, TAMRA amended several Code sections governing the deference due to treaties, including Sections 894(a) and 7852(d).[267] After TAMRA, tax treaties and the Code are accorded equal weight.[268] In addition, TAMRA codified the later-in-time principle[269] enabling the Code to prevail over certain provisions of existing tax treaties.[270] Accordingly, the court

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TAX TREATY (AND PROPOSED PROTOCOL) BETWEEN THE UNITED STATES AND MEXICO, 103d Cong., 1st Sess. 78 (Comm. Print 1993) [hereinafter JOINT COMM. MEXICAN EXPLANATION]; STAFF OF JOINT COMM. ON TAX'N, EXPLANATION OF PROPOSED INCOME TAX TREATY BETWEEN THE UNITED STATES AND THE REPUBLIC OF FINLAND, 101st Cong., 2d Sess. 49 (Comm. Print 1990) [hereinafter JOINT COMM. FINNISH EXPLANATION].

264. *See* Treasury Dept. Technical Explanation, Income Tax Convention, Aug. 29, 1989, U.S.-F.R.G., 2 Tax Treaties (CCH) ¶ 3255, at 28,177, 28,201 (1989) [hereinafter German Technical Explanation] (stating language of independent personal services article in German Treaty incorporates taxation of deferred income).

265. Dutch Treaty, *supra* note 29, art. 24, S. TREATY DOC. No. 6, at 50-51, 32 I.L.M. at 482-83; Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-158.

266. Swiss Treaty, *supra* note 31, art. 3, 2 U.S.T. at 1755-56, T.I.A.S. No. 2316, at 5-6. The Swiss Treaty was brought into force on September 27, 1951. 2 STAFF OF JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS § 22, at 2382 (1962) [hereinafter 2 LEGISLATIVE HISTORY OF U. S. TAX CONVENTIONS].

267. I.R.C. §§ 894(a), 7852(d); TAMRA, Pub. L. No. 100-647, § 1012(aa), 102 Stat. at 3531-33; *see supra* notes 261-62 and accompanying text (discussing TAMRA's amendment of Code sections addressing relationship between tax treaties and Code).

268. I.R.C. § 7852(d).

269. BITTKER & LOKKEN, *supra* note 38, ¶ 66.2.11. The later-in-time rule is the "duty of the courts [ ] to construe and give effect to the latest expression of the sovereign will." *Whitney*, 124 U.S. at 195. As one commentator noted after TAMRA's amendments: "The judicially developed later-in-time rule, like the doctrine of equal status, has been codified." Doernberg, *supra* note 127, at 80.

270. TAMRA, Pub. L. No. 100-647, § 1012(aa)(2), 102 Stat. at 3531.

in *Lindsey v. Commissioner*[271] applied the later-in-time principle enacted by TAMRA and held that the Code overrode the inconsistent provision in the Swiss Treaty.[272] Commentators have criticized the override provisions in TAMRA that allow decisions such as *Lindsey* to abrogate existing tax treaties.[273]

1. After TAMRA, the Code No Longer Defers to Tax Treaties

TRA '86 and its legislative history did not specifically address the interaction of the Code and tax treaties.[274] At that time, the Code continued to defer to inconsistent provisions in tax treaties.[275] Thus, when TRA '86 was enacted, tax treaties prevailed over the Code.[276]

TAMRA subsequently amended several Code sections addressing the relationship between tax treaties and statutes, including Sections 894(a) and 7852(d).[277] Section 894(a), for example, now reduces the amount of deference the Code gives treaties to "due regard."[278] The Conference Committee, in its

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271. Lindsey v. Commissioner, 98 T.C. 672 (1992), *aff'd*, 15 F.3d 1160 (D.C. Cir. 1994).

272. *Lindsey*, 98 T.C. at 676-77.

273. *See, e.g.*, David Sachs, *Is the 19th Century Doctrine of Treaty Override Good Law for Modern Day Tax Treaties?*, 47 TAX LAW. 867, 877 (1994). Sachs described the consequences of TAMRA:

> Despite the almost universal criticism by tax and fiscal experts of the practice of overriding tax-treaty provisions by statutory enactments, Congress has clearly determined to take full advantage of the carte blanche seemingly given it by the Supreme Court to make whatever adjustments in tax treaties it deems necessary to achieve the domestic tax-policy objectives of the moment. Were it not for the outcry, Congress may have gone as far as to seek to reject the Supreme Court's presumption against finding a treaty override unless there is a clear expression of congressional purpose to override.

*Id.*; *see supra* note 252 and accompanying text (stating that explicit congressional intent is required for legislative overrides of existing treaties).

274. S. REP. NO. 445, *supra* note 19, at 317. "In a number of respects, the 1986 Act (and its legislative history) did not specifically address its interactions with U.S. treaties." *Id.*

275. I.R.C. §§ 894(a), 7852(d) (1985); *see supra* note 260 and accompanying text (describing Code's deference to tax treaties prior to TAMRA).

276. I.R.C. §§ 894(a), 7852(d) (1985).

277. I.R.C. §§ 894(a), 7852(d); TAMRA, Pub. L. No. 100-647, § 1012(aa), 102 Stat. at 3531-33; *see* BAKER, *supra* note 47, at 38 (discussing enactment of I.R.C. § 7852(d)); BITTKER & LOKKEN, *supra* note 38, ¶ 66.2.11 (describing relationship between statutory and treaty rules); *see supra* notes 261-62 and accompanying text (describing Code provisions treating statutes and treaties as equally authoritative).

278. *Compare* I.R.C. § 894(a) (eliminating deference to treaties) *with* I.R.C. § 894 (1985) (indicating that treaties prevailed over Code). The U.S. Court of Appeals for

subsequent report on TCA '88, stated that the term "due regard" indicated that neither the treaty nor any relevant law was to have preferential status by reason of its being a treaty or law.[279] Section 7852(d), correspondingly, establishes parity between tax treaties and the Code.[280] The Senate Finance Committee in its report on TCA '88 stated that the amended language of Section 7852(d) merely represented the codification of case law.[281]

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the Third Circuit, for example, has stated that the Code taxes treaty residents with "due regard" to treaty provisions. Lazore v. Commissioner, 11 F.3d 1180, 1183 (3d Cir. 1993). The court, however, did not define due regard. *Lazore*, 11 F.3d at 1183.

279. H.R. CONF. REP. No. 1104, *supra* note 19, at 12. The Conference Committee explained:

> In place of the existing Code provision, which states that a taxpayer can exclude items of income from gross income, and therefore be exempt from income tax on those items, where such treatment is called for by treaty, the agreement provides that the provisions of the Internal Revenue Code are to be applied to any taxpayer with due regard to any treaty obligation of the United States which is applicable to such taxpayer. The agreement further clarifies that in determining what regard is due to a treaty, reference must be made to the principle that neither the treaty nor any relevant law shall have preferential status by reason of its being a treaty or law.
>
> Thus, as is true of current section 894(a), the agreement's provision adds no operative rules to be applied in determining the relationship of the Code (or other tax law) and a treaty, but rather states the constitutional principles that such determinations are relevant in determining tax liabilities. *Where the relationship of treaties and statutes must be determined, the agreement simply provides for giving the treaty that regard which it is due under the ordinary rules of interpreting the interactions of statutes and treaties. For example, . . . where a treaty obligation has been superseded for internal U.S. law purposes, no effect need be given to the treaty under the agreement's provisions.*

*Id.* at 12-13 (emphasis added); *see* I.R.C. § 894(a)(1) (stating that Code should be applied with due regard to treaty obligations).

280. I.R.C. § 7852(d); *see supra* note 262 and accompanying text (quoting language of I.R.C. § 7852(d)).

281. S. REP. No. 445, *supra* note 19, at 326. The Senate Finance Committee stated:

> [T]he 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. Thus, for example, the bill continues to allow an earlier ratified treaty provision to continue in effect where there is not an actual conflict between that treaty provision and a subsequent revenue statute (i.e., where it is consistent with the intent of each provision to interpret them in a way that gives effect to both).

*Id.* at 321-22.

### 2. TAMRA Codified the Later-in-Time Rule

TRA' 86 contained a number of provisions that conflicted, or appeared to conflict, with existing U.S. treaty obligations.[282] TAMRA's amendment of Sections 894(a) and 7852(d) addressed this issue by codifying the later-in-time rule.[283] The later-in-time rule, originally formulated for conflicts between statutes, establishes that the law last adopted controls.[284] To this end, TAMRA specified that certain provisions of TRA '86 overrode earlier tax treaty provisions that were inconsistent with the Code, including the alternative minimum tax[285] ("AMT") provisions.[286] Despite the lack of a "residual" later-in-time rule[287] in TCA '88,[288] the

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282. *See* BAKER, *supra* note 47, at 38 (discussing possible congressional overrides enacted by TRA '86 and explicit override provisions in TAMRA).

283. BITTKER & LOKKEN, *supra* note 38, ¶ 66.2.11. The Senate Finance Committee added: "Nor does the committee intend that this codification [of the later-in-time rule] blunt in any way the superiority of the latest expression of the sovereign will in cases involving actual conflicts, whether that expression appears in a treaty or a statute." S. REP. No. 445, *supra* note 19, at 322.

284. *Whitney*, 124 U.S. at 195; BITTKER & LOKKEN, *supra* note 38, ¶ 66.2.11.

285. I.R.C. § 55. Alternative minimum tax ("AMT") refers to an:

> [A]lternative income tax imposed by the Code to ensure that taxpayers who enjoy tax preference income must pay at least a minimum of taxes. The [AMT] tax . . . reduces the tax advantage of certain benefits known as tax preference items. The tax is imposed at a flat rate on the taxpayer's alternative minimum taxable income that exceeds certain specified exemption amounts. If the taxpayer's liability for the minimum tax exceeds his regular tax liability, the excess amount is payable in addition to the regular tax.

SMITH, *supra* note 3, at 21.

286. TAMRA, Pub. L. No. 100-647, § 1012(aa)(2), 102 Stat. at 3531.

287. *See* S. REP. No. 445, *supra* note 19, at 326. The Senate Finance Committee stated that a "residual" later-in-time rule meant that the TRA '86 overrode all inconsistent provisions in existing tax treaties. *Id.* The Senate Finance Committee explained that:

> If any case actually arises in which proper application of the canons of construction ultimately reveals an actual conflict, the committee expects the full legislative consideration of that conflict will take place to determine whether application of the general later-in-time rule is consistent with the spirit of the treaty (namely, to prevent double taxation by an agreed division of taxing jurisdiction, and to prevent fiscal evasion) and the proper expectations of the treaty partners . . . .
>
> It is noted that a "residual" later-in-time rule was a part of the introduced technical corrections bill in each House of Congress (H.R. 2636, S.1350) [TCA '87], and that during the legislative process considering this bill [TCA '88], a number of previously unknown treaty conflicts became known. The committee believes that the residual later-in-time rule of the introduced bill may have encouraged taxpayers to raise potential conflicts that might have violated the spirit of U.S. treaty obligations. *In any event, in each case where a*

Senate Finance Committee concluded that, in the case of a future conflict between a tax treaty and TRA '86's amendments to the Code, the amendments would prevail over any existing tax treaty provision.[289] TAMRA, like TCA '88, also did not contain a residual override provision.[290]

TAMRA, in contrast, made explicit exceptions to the later-in-time rule for certain provisions in existing treaties.[291] TAMRA stated that several new Code sections added by TRA '86 would not apply to the extent that their application would be contrary

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> *conflict became known after original introduction of the bill, the bill provides that the treaty is to prevail.*

*Id.* (emphasis added).

288. TCA '88, S. 2238, 100th Cong., 2d Sess. § 112(aa)(2) (1988). Unlike TCA '87, an earlier bill to amend TRA '86, TCA '88 did not state that TRA '86 overrode all inconsistent provisions. *Compare* TCA '87, H.R. 2636 and S. 1350, 100th Cong., 1st Sess. § 112(y)(2) (1987) (providing that TRA '86 prevailed over treaties) *with* TCA '88, § 112(aa)(2) (eliminating residual override provision). TCA '87 stated:

> The following amendments made by the Reform Act shall apply notwithstanding any treaty obligation of the United States in effect on the date of the enactment of the Reform Act: (A) The amendments made by section 1201 of the Reform Act; (B) The amendments made by title VII of the Reform Act to the extent such amendments relate to the alternative minimum foreign tax credit; (C) *Except as provided in the Reform Act or in paragraph (3) of this subsection, any other amendment made by the Reform Act.*

TCA '87, § 112(y)(2) (emphasis added). TCA '88 incorporated the first two provisions of § 112(y)(2) in TCA '87, but deleted § 112(y)(2)(C), the residual later-in-time rule. TCA '88, § 112(aa)(2). Regarding the residual override provisions in TCA '87, the Senate Finance Committee commented that:

> [T]he committee is concerned that the introduced bill [TCA '87] would have changed the rules by which the United States adheres to its international agreements. The committee believes that it is in everyone's best interest that this concern be alleviated, so long as the Congress and the Executive branch can be assured that treaty claims affecting later-enacted statutes can be promptly brought to the attention of both branches of government.

S. REP. NO. 445, *supra* note 19, at 327.

289. *Id.* at 319. The Senate Finance Committee explained that "the committee believes it would be erroneous to assert that an income tax statute . . . prevails over treaties only if treaty interactions are mentioned in the statute or legislative history." *Id.* at 325. In terms of TRA '86, the Senate Finance Committee added: "If, in any of the cases . . . where conflicts are understood not to exist, any treaty is somehow read so that it would bar operation of the Act, *the committee intends that the Act is to be effective notwithstanding the treaty.*" *Id.* at 321 (emphasis added).

290. TAMRA, Pub. L. No. 100-647, § 1012(aa)(2), 102 Stat. at 3531. *Compare* TCA '87, § 112(y)(2) (allowing TRA '86 to prevail over existing treaties) *with* TAMRA, Pub. L. No. 100-647, § 1012(aa)(2), 102 Stat. at 3531 (showing TAMRA did not incorporate residual later-in-time rule of TCA '87).

291. TAMRA, Pub. L. No. 100-647, § 1012(aa)(3), 102 Stat. at 3531-32.

to existing U.S. tax treaty obligations.[292] These exceptions include Section 864(c)(7), which, in certain cases, treats the gain from a sale of assets used in a U.S. trade or business as effectively connected income after cessation of the trade or business.[293] TAMRA also made limited exceptions to the later-in-time rule for tax treaties enacted before the 1954 Code that conflicted with 1954 Code provisions.[294] These provisions, however, do not apply to amendments of the Code after 1954.[295]

### 3. *Lindsey v. Commissioner*: Application of TAMRA's Later-in-Time Rule

In a recent case involving the Swiss Treaty, *Lindsey v. Commissioner*,[296] the court applied TAMRA's later-in-time rule for U.S. AMT[297] provisions.[298] In *Lindsey*, the taxpayer was a U.S. citizen residing in Switzerland.[299] For the taxable year, the tax-

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292. *Id.*

293. I.R.C. § 864(c)(7); TAMRA, Pub. L. No. 100-647, § 1012(aa)(3)(H), 102 Stat. at 3532; *see* S. REP. No. 445, *supra* note 19, at 319 (noting that certain provisions of TRA '86 would not apply to extent they were inconsistent with existing treaties, including I.R.C. § 864(c)(7)). *But cf.* S. REP. No. 445, *supra* note 19, at 320. The Senate Finance Committee indicated that "the Act's [TRA '86's] imposition of tax on installment gains received after a foreign person ceases a U.S. trade or business . . . is fully consistent with existing U.S. treaty obligations." *Id.*

294. I.R.C. § 7852(d). "No provisions of this title (as in effect without regard to any amendment thereto enacted after August 16, 1954) shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on August 16, 1954." *Id.*; *see supra* note 145 and accompanying text (discussing TRA '86 amendment of Code changing title from 1954 Code to 1986 Code).

295. I.R.C. § 7852(d). The Senate Finance Committee explained the provision:

> The bill modifies the 1954 transition rule (embodied in sec. 7852(d)) governing the relationship between treaties and the Code to clarify that it does not prevent application of the general rule providing that the later in time of a statute or a treaty controls (sec. 7852(d)). The bill provides that no provision of the Internal Revenue title that was in effect on August 16, 1954, shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of the 1954 Code (August 16, 1954). *This provision makes it clear that treaty provisions that were in effect in 1954 and that conflict with the 1954 Code as originally enacted are to prevail over then-existing Code provisions but not over later amendments to the Code.*

S. REP. No. 445, *supra* note 19, at 318 (emphasis added).

296. Lindsey v. Commissioner, 98 T.C. 672 (1992), *aff'd*, 15 F.3d 1160 (D.C. Cir. 1994).

297. I.R.C. § 55; *see supra* notes 285-86 and accompanying text (describing TAMRA's express override of AMT tax provisions in existing tax treaties).

298. *Lindsey*, 98 T.C. at 677.

299. *Id.* at 673; *see supra* note 69 and accompanying text (stating that Code taxes U.S. citizens on their worldwide income).

payer's gross income was completely foreign source and fully taxable in Switzerland.[300] The taxpayer's Swiss tax liability was far greater[301] than his estimated U.S. tax liability on the same income.[302] The taxpayer thus claimed that he did not owe any U.S. tax based on the provisions of the Swiss Treaty.[303]

Noting that the Swiss Treaty prohibits double taxation and provides for full credit for Swiss taxes paid against a taxpayer's U.S. tax liability,[304] the taxpayer claimed the foreign tax credit completely offset his U.S. AMT liability.[305] In response, the I.R.S. claimed that under the Code only ninety percent of the taxpayer's U.S. AMT tax liability could be offset.[306] The court thus faced a direct conflict between the Code's AMT provisions, enacted by TRA '86, and those existing in the Swiss Treaty.[307] After reviewing the legislative history and text of TAMRA,[308] the court found that Congress specifically intended the ninety percent limitation to supersede all inconsistent AMT treaty provisions.[309] Accordingly, the court held that the provisions in TAMRA overrode the treaty.[310]

### 4. Commentators' Reactions to TAMRA

According to several commentators, TAMRA's amendments to Sections 894(a) and 7852(d) reflect Congress' trend in recent years of decreased deference to tax treaties.[311] Commentators'

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300. *Lindsey*, 98 T.C. at 674.

301. *Id.* at 674. The taxpayer's Swiss tax liability was US$14,732 and his U.S. AMT liability was US$9156. *Id.*

302. *Id.*

303. *Id.*

304. *Id.*

305. *Id.*

306. *Id.* at 674-75.

307. *Id.*

308. TAMRA, Pub. L. No. 100-647, § 1012(aa)(2)(B), 102 Stat. at 3531.

309. *Lindsey*, 98 T.C. at 675-77.

310. *Id.* at 676-77.

311. BAKER, *supra* note 47, at 37-38; BITTKER & LOKKEN, *supra* note 38, ¶ 66.2.11; OGLEY, *supra* note 81, at 164-65. "[I]n recent years Congress has demonstrated an increasing willingness to override treaty obligations." OGLEY, *supra* note 81, at 164. On several occasions, Congress has intentionally overridden tax treaty provisions by statute. *See* S. REP. NO. 445, *supra* note 19, at 317-18 (discussing instances of intentional congressional override); BAKER, *supra* note 47, at 37 (discussing § 1125(c) of Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), which expressly provided that after five years, FIRPTA would apply without regard to any relief granted by tax treaty); OGLEY, *supra* note 81, at 164-65 (listing introduction of FIRPTA and branch profits tax among examples of Congress' willingness to override tax treaties).

criticism focuses on the explicit, as well as the implicit, override of tax treaty provisions in TAMRA.[312] Section 894(a), in particular, reflects congressional desire to override tax treaties.[313] Some commentators conclude these statutory provisions for potential tax treaty overrides may cause treaty partners of the United States to become wary of the U.S. habit of overriding existing tax treaties by subsequent amendments to the Code.[314] Another commentator added that tax treaty overrides by the

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"More generally, Congress has found that income tax treaties are often an inconvenient restraint on the development of U.S. international tax policy." BITTKER & LOKKEN, *supra* note 38, ¶ 66.2.11. Responding to criticism that the amendments were unfair, the Senate Finance Committee stated:

> [W]hen a treaty partner's internal tax laws and policies change, treaty provisions designed and bargained to coordinate the predecessor laws and policies must be reviewed for purposes of determining how those provisions apply under the changed circumstances .... In some cases the continued effect of the existing treaty provision would be to give an unbargained-for benefit to taxpayers or one of the treaty partners. At that point, the treaty provision in question may no longer eliminate double taxation or prevent fiscal evasion; if not, its intended purpose would no longer be served.
>
> The committee recognizes that some would prefer that existing treaties be conformed to changing U.S. tax policy solely by treaty renegotiation. However, the committee notes that in recent years, U.S. tax laws have been constantly changing. Moreover, once U.S. tax policy has changed, the existence of an unbargained-for benefit created by the change would have the effect of making renegotiation to reflect current U.S. tax policy extremely difficult, because the other country may have little or no incentive to remove an unbargained-for benefit whose cost is borne by the United States.

S. REP. No. 445, *supra* note 19, at 323.

312. *See* Sachs, *supra* note 273, at 877 (commenting that TAMRA's incorporation of later-in-time rule met with universal criticism). "The US constitutional position is that a treaty is on a par with domestic legislation and, as a consequence, subsequently enacted legislation will have the effect of overriding a provision of a treaty where there is a conflict." OGLEY, *supra* note 81, at 164.

313. Doernberg, *supra* note 127, at 81. As Doernberg notes:

> While Code section 7852(d) codifies existing law, the history of another Code provision perhaps offers some insight into a changed mood in Congress. . . . Since Congress was concerned about section 894(a) rendering tax treaties superior to domestic legislation, it amended the provision in 1988 . . . The change to the "due regard" language serves as a warning by Congress that the existence of a treaty obligation exempting an item from income may be given due regard but that it nevertheless will give way to subsequent legislation.

*Id.* at 81.

314. BAKER, *supra* note 47, at 39. Regarding treaty overrides:

> Tax treaties are an extension of the policy of encouraging overseas investment. It would be an overstatement to suggest that even the deliberate overriding of a tax treaty by subsequent domestic legislation undermines the entire legal standing in the international community of the state concerned. Nevertheless, it is true that other potential treaty partners may become wary of a

United States undermine the value of those treaties.[315] The prevailing view among tax experts is that tax treaties serve no purpose when one of the parties does not regard itself as being bound by its terms.[316]

### B. *The Interpretation of Section 864(c)(6) in Congressional and Treasury Department Reports on Recent Treaties*

Congressional reports on recent tax treaties have generally interpreted Section 864(c)(6) as compatible with the independent personal services article[317] of the 1981 Treasury Model.[318]

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> state which frequently and intentionally overrides treaties by domestic legislation.

*Id.* "Helpless frustration over the U.S. policy of overriding its bilateral income tax treaties through domestic legislation has created some bitter feelings among our [U.S.] trading partners." Doernberg, *supra* note 127, at 115.

315. OGLEY, *supra* note 81, at 165. As one commentator warned: "The US position on treaty override threatens to undermine the value of treaties. In developing countries treaty obligations tend to be 'more honoured in the breach than in the observance' and the US now appears to be condoning this practice." *Id.*

316. *Id.*

317. 1981 TREASURY MODEL, *supra* note 81, art. 14, 1 Tax Treaties (CCH) ¶ 211, at 10,579. The independent personal services article in the 1981 Treasury Model states:

> Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall be taxable only in that State, unless such services are performed in the other Contracting State and the income is attributable to a fixed base regularly available to the individual in that other State for the purpose of performing his activities.

*Id.*; *see* 1977 OECD MODEL, *supra* note 81, art. 14, at 34 (addressing independent personal services). Independent contractors are discussed in the independent personal services article which is concerned with professional services and other activities of an independent character. 1992 OECD MODEL, *supra* note 81, at 153. These professional services include examples of typical liberal professions such as medicine and law. *See id.* at 153 n.2 (stating that OECD list of examples are explanatory and not exhaustive); *see supra* note 81 (explaining that 1981 Treasury Model is based on 1977 OECD Model).

318. JOINT COMM. MEXICAN EXPLANATION, *supra* note 263, at 78. The Joint Committee stated: "[I]t is understood that no change to the model treaty language is necessary to conform the treatment of income derived from independent personal services with Code Section 864(c)(6)." *Id. But cf. id.* at 5. The Joint Committee also stated that:

> *Unlike the U.S. model*, the proposed [Mexican] treaty provides that a country could tax the business profits of an enterprise of the other country where those profits are attributable to a permanent establishment that the enterprise formerly had in the first country. This provision reflects the policy underlying Code section 864(c)(6) which . . . permits the United States to tax certain deferred payments received by a foreign person without regard to whether the person is engaged in a U.S. trade or business in the taxable year of receipt of the payments.

*Id.* at 5 (emphasis added).

The Joint Committee on Taxation, for example, stated that the principles of Section 864(c)(6) were harmonious with the 1981 Treasury Model and thus did not need to be discussed explicitly.[319] Furthermore, the Senate Foreign Relations Committee agreed that the language of the 1981 Treasury Model incorporated the principles of Section 864(c)(6).[320] The Senate Finance Committee commented that Sections 864(c)(6) and (c)(7) were fully consistent with existing U.S. treaty obligations.[321] The Joint Committee on Taxation and Senate Foreign Relations Committee also cited the treatment in Revenue Ruling 86-145,[322] predating TRA '86, as a basis for finding deferred compensation taxable under the language of the tax treaty.[323]

In the 1989 Technical Explanation of the U.S.-German tax

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319. JOINT COMM. MEXICAN EXPLANATION, *supra* note 263, at 78; JOINT COMM. DUTCH EXPLANATION, *supra* note 38, at 85 n.43.; JOINT COMM. FINNISH EXPLANATION, *supra* note 263, at 49; *see supra* note 263 and accompanying text (describing Joint Committee on Taxation's view that no change is necessary to incorporate I.R.C. § 864(c)(6) under 1981 Treasury Model).

320. SENATE FOREIGN RELATIONS COMM., REPORT ON TAX CONVENTION (AND PROTOCOL) WITH THE KINGDOM OF THE NETHERLANDS, S. EXEC. REP. NO. 19, 103d Cong., 1st Sess. 92 n.40 (1993) [hereinafter SENATE DUTCH REPORT]. "With respect to the language in the proposed treaty that conforms to the U.S. model, it is understood that no change to that language is necessary to conform the treatment of income derived from independent personal services with Code Section 864(c)(6)." *Id.* Moreover, in the Spanish Treaty, the Senate Foreign Relations Committee stated that the Spanish Treaty did not "override" Section 864(c)(6). SENATE FOREIGN RELATIONS COMM., REPORT ON INCOME TAX CONVENTION WITH THE KINGDOM OF SPAIN, S. EXEC. REP. NO. 29, 101st Cong., 2d Sess. 4 (1990) [hereinafter SENATE SPANISH REPORT].

321. S. REP. NO. 445, *supra* note 19, at 320. The Senate Finance Committee explained that:

> Some treaties prevent imposition of U.S. tax on business profits of a foreign person unless those profits are attributable to a permanent establishment through which the foreign person carries on business in the United States. The committee believes that these treaties do not prevent imposition of U.S. tax on income that was, when realized, attributable to a permanent establishment, even though that income is recognized after the permanent establishment no longer exists . . . . *The committee understands that the Act [TRA '86] creates no conflict with treaties in taxing amounts earned for personal services in the United States which are paid after the person earning the income no longer maintains a U.S. presence.*

*Id.* (emphasis added).

322. Rev. Rul. 86-145, 1986-2 C.B. 297; *see supra* notes 121-25 and accompanying text (describing taxation of deferred income under Revenue Ruling 86-145).

323. SENATE DUTCH REPORT, *supra* note 320, at 92 n.40; JOINT COMM. DUTCH EXPLANATION, *supra* note 38, at 85 n.43; SENATE FOREIGN RELATIONS COMM., REPORT ON TAX CONVENTION WITH THE FEDERAL REPUBLIC OF GERMANY, S. EXEC. REP. NO. 27, 101st Cong., 2d Sess. 59 n.12 (1990) [hereinafter SENATE GERMAN REPORT].

treaty[324] ("German Treaty"), the Treasury Department found that the rule allowing taxation of deferred income under Section 864(c)(6) did not need to be explicitly stated.[325] The language of the German Treaty's independent personal services article[326] did not address deferred compensation.[327] According to the Treasury Department, therefore, the language of the independent personal services article did not require that the performance of services and the receipt of income occur in the same time period.[328]

324. German Treaty, *supra* note 32, art. 14, S. TREATY DOC. NO. 10, at 49, 2 Tax Treaties (CCH) ¶ 3249.27, at 28,158.

325. German Technical Explanation, *supra* note 264, 2 Tax Treaties (CCH) ¶ 3255, at 28,201.

326. German Treaty, *supra* note 32, art. 14, S. TREATY DOC. NO. 10, at 49, 2 Tax Treaties (CCH) ¶ 3249.27, at 28,158. Article 14 of the German Treaty states:

> (1) Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall be taxable only in that State, unless such services are performed in the other Contracting State and the income is attributable to a fixed base regularly available to the individual in that other State for the purpose of performing his activities. (2) The term "personal services in an independent capacity" includes but is not limited to independent scientific, literary, artistic, educational, or teaching activities as well as the independent activities of physicians, lawyers, engineers, economists, architects, dentists, and accountants.

*Id.*

327. *Id.*

328. German Technical Explanation, *supra* note 264, 2 Tax Treaties (CCH) ¶ 3255, at 28,201. The Treasury Department stated:

> There is no special rule in the Protocol with respect to this article comparable to Paragraph 4 of the Protocol which is applicable to Articles 7 (Business Profits) and 13 (Gains). That rule clarifies that income which is attributable to a permanent establishment, but is deferred and received after the permanent establishment no longer exists, may nevertheless be taxed by the State in which the permanent establishment was located. An analogous rule applies with respect to Article 14, under which income derived by an individual resident of a Contracting State from services performed in the other Contracting State and attributable to a fixed base there may be taxed by that other State even if the income is deferred and received after there is no longer a fixed base there available to the resident. *It was not considered necessary to specify this rule in the Protocol with respect to Article 14 because there is nothing in the text of the Article which requires that the performance of services and the receipt of income be in the same time frame.*

*Id.* (emphasis added). The Protocol to the German Treaty expressly provided for a net tax under I.R.C. § 864(c)(6) for income attributable to a permanent establishment and certain gains. Protocol Amending Income Tax Convention, Aug. 21, 1989, U.S.-F.R.G., S. TREATY DOC. NO. 10, 101st Cong., 2d Sess. 84, 86 (1990), 2 Tax Treaties (CCH) ¶ 3250, at 28,170 [hereinafter German Protocol].

### C. *Independent Contractors and Dependent Employees Under U.S. Law*

Model treaties and U.S. tax treaties[329] distinguish independent contractors from dependent employees when taxing income.[330] Under the Code, independent contractors are also distinguished from employees.[331] The I.R.S. has listed factors, such as the amount of control a taxpayer has while working, which indicate independent contractor or dependent employee status.[332] Like the I.R.S., courts in the United States have also listed factors to aid in distinguishing between the two classes of personal service.[333]

#### 1. Model and U.S. Treaties Categorize Personal Services Income

The Treasury[334] and OECD[335] model treaties and most recent U.S. bilateral treaties,[336] including the Dutch Treaty,[337] di-

329. *See, e.g.*, Dutch Treaty, *supra* note 29, arts. 15-16, S. TREATY DOC. NO. 6, at 38-41, 32 I.L.M. at 477-78 (discussing independent contractors and dependent employees in separate treaty articles).

330. 1981 TREASURY MODEL, *supra* note 81, arts. 14-15, 1 Tax Treaties (CCH) ¶ 211, at 10,579 to -580; 1977 OECD MODEL, *supra* note 81, arts. 14-15, at 34-35; SENATE GERMAN REPORT, *supra* note 323, at 58.

331. Treas. Reg. § 31.3401(c)-1(c).

332. Rev. Rul. 87-41, 1987-1 C.B. 296. The I.R.S. stated:

> As an aid to determining whether an individual is an employee under the common law rules, twenty factors or elements have been identified as indicating whether sufficient control is present to establish an employer-employee relationship. The twenty factors have been developed based on an examination of cases and rulings considering whether an individual is an employee. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed.

*Id.*

333. *See, e.g.*, United States v. Silk, 331 U.S. 704, 717-19 (1947) (discussing difference between independent contractors and employees); Mares v. Marsh, 777 F.2d 1066, 1067 (5th Cir. 1985) (describing tests that aid in distinguishing between employees and independent contractors).

334. *See* 1981 TREASURY MODEL, *supra* note 81, arts. 14-15, 17-20, 1 Tax Treaties (CCH) ¶ 211, at 10,579 to -581. The 1981 Treasury Model separate personal services income into the following categories: independent personal services, dependent personal services, artists and athletes, pensions, government service, and students and trainees. *Id.*

335. 1977 OECD MODEL, *supra* note 81, arts. 14-20, at 34-37. The 1977 OECD Model separated personal services income into the following categories: independent personal services, dependent personal services, directors' fees, artists and athletes, pensions, government service, and students. *Id.*

336. SENATE GERMAN REPORT, *supra* note 323, at 58.

vide income derived from personal services into separate categories.[338] These categories, which are discussed in separate treaty articles, may include: independent personal services, dependent personal services, income from government service, and pensions.[339] Independent personal services articles[340] concern the taxation of independent contractors, whereas dependent personal services articles concern the taxation of dependent employees.[341] The Swiss Treaty also divides employees into categories.[342] The Swiss Treaty discusses independent contractors and dependent employees in the same tax treaty article, Compensation for Labor or Personal Services.[343]

### 2. U.S. Law Distinguishes Between Independent Contractors and Employees

Under the Code, independent contractors are distinguished from employees.[344] According to the I.R.S., the principal considerations in determining whether a taxpayer is an employee or independent contractor are whether services performed by a taxpayer are for his own account and whether the taxpayer receives the income and bears the losses arising from such services.[345] An employee is considered dependent under the Code[346] because

337. Dutch Treaty, *supra* note 29, arts. 15-22, S. TREATY DOC. No. 6, at 38-48, 32 I.L.M. at 477-81; *see supra* note 33 and accompanying text (listing categories of personal service income in Dutch Treaty).

338. SENATE GERMAN REPORT, *supra* note 323, at 58.

339. Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-148; *see supra* note 33 and accompanying text (listing classes of income from personal services in Dutch Treaty).

340. Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. No. 6, at 38-39, 32 I.L.M. at 477-78.

341. *Id.* art. 16, S. TREATY DOC. No. 6, at 39-40, 32 I.L.M. at 478.

342. Swiss Treaty, *supra* note 31, arts. 10-13, 2 U.S.T. at 1758-59, T.I.A.S. No. 2316, at 8-9; *see supra* note 33 and accompanying text (listing classes of income from personal services in Swiss Treaty).

343. Swiss Treaty, *supra* note 31, arts. 10-11, 2 U.S.T. at 1758-59, T.I.A.S. No. 2316, at 8-9.

344. Treas. Reg. § 31.3401(c)-1(c).

345. Priv. Ltr. Rul. 81-51-117 (Sept. 28, 1981) (finding that nonresident freelance lighting camera man was independent contractor under U.K. Treaty). Article 14 of the U.K. Treaty states: "Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity may be taxed in that state." U.K. Treaty, *supra* note 32, art. 14, 31 U.S.T. at 5682, T.I.A.S. No. 9682, at 15.

346. Treas. Reg. § 1.864-7(e).

his employer may control his work in detail.[347] In addition, the I.R.S. has issued a revenue ruling that lists twenty factors distinguishing independent contractors from employees.[348] These factors focus on an individual's amount of control and flexibility when performing a personal service.[349]

Like the I.R.S., courts in the United States have also listed factors that aid in distinguishing independent contractors from employees.[350] These factors are similar to the I.R.S. factors and include: the risk undertaken,[351] the degree of control,[352] opportunity for profit or loss,[353] investment in facilities,[354] and respon-

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347. Treas. Reg. § 31.3401(c)-1(b). Treas. Reg. § 31.3401(c)-1(b) states:

> Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.

*Id.*; *see* Lawrence Lokken, *The Sources of Income from International Uses and Dispositions of Intellectual Property*, 36 TAX L. REV. 233, 312 (1981) (discussing definition of employee under Code).

348. Rev. Rul. 87-41, 1987-1 C.B. 296.

349. *Id.* The I.R.S. factors include: (1) instructions; (2) training; (3) integration; (4) services rendered personally; (5) hiring, supervising, and paying assistants; (6) continuing relationship; (7) set hours of work; (8) full time required; (9) doing work on employer's premises; (10) order or sequence of work set; (11) oral or written report; (12) payment by hour, week, or month; (13) payment of business and/or traveling expenses; (14) furnishing of tools and materials; (15) significant investment; (16) realization of profit or loss; (17) working for more than one firm at a time; (18) making service available to general public; (19) right to discharge; and (20) right to terminate. *Id.*

350. *See Silk*, 331 U.S. at 717-19 (finding that workers hired to unload railway coal cars were employees while drivers making retail deliveries were independent contractors); *Mares*, 777 F.2d at 1067 (discussing methods of distinguishing independent contractors from dependent employees).

351. *Silk*, 331 U.S. at 719. Greater risk assumed in the employment context indicates independent contractor status. *Id.*

352. *Id.* A greater amount of control over one's work indicates independent contractor status. *Id.*

353. *Id.* The opportunity for profit or loss marks an individual as an independent contractor. *Id.*

354. Aimable v. Long and Scott Farms, 20 F.3d 434, 443 (11th Cir. 1994), *cert. denied*, 115 S. Ct. 351. The court concluded that: "It is apparent that appellants indeed were employees, not independent contractors; they have little or no investment in any equipment." *Aimable*, 20 F.3d at 434.

sibility for investment and management.[355] Relying on these factors, courts have developed tests to distinguish between the two classes of services.[356]

According to the factors used by the I.R.S. and courts, therefore, workers who must rely solely on their own initiative in order to earn income are generally considered independent contractors.[357] As an example of an activity requiring initiative, independent contractors must invest funds to conduct their businesses.[358] A physician, for instance, may need capital to rent an office, hire office staff, and lease medical equipment.[359] As

355. *Silk*, 331 U.S. at 719. The responsibility for investment and management indicates independent contractor status. *Id.*

356. *Mares*, 777 F.2d at 1067. As the U.S. Court of Appeals for the Fifth Circuit has explained:

> Three tests have been devised by the courts to unravel the employee/independent contractor conundrum. The first is the traditional common law test of agency, turning on the employer's right to control. This test was replaced in Fair Labor Standards Act cases by an economic realities test under which persons are considered employees if they, as a matter of economic reality, are dependent upon the business to which they render service. The third test is a hybrid which considers the economic realities of the work relationship as an important factor in the calculus, but which focuses more on the extent of employer's right to control the means and manner of the worker's performance.

*Id.* (quotation marks and citations omitted). The U.S. Court of Appeals for the Second Circuit, commenting on the various tests used to determine employee or independent contractor status, noted that:

> [I]n practice there is little discernible difference between the hybrid test and the common law agency test. Both place their greatest emphasis on the hiring party's right to control the manner and means by which the work is accomplished and consider a non-exhaustive list of factors as part of a flexible analysis of the 'totality of the circumstances.'

Frankel v. Bally, 987 F.2d 86, 90 (2d Cir. 1993).

357. Rutherford Food Corp. v. McComb, 331 U.S. 722, 730 (1947). One factor that distinguishes employees from independent contractors is that "while profits to the [employees] depended on the efficiency of their work, it was more like piecework than an enterprise that actually depended for success upon the initiative, judgment or foresight of the typical independent contractor." *Id.*

358. *See, e.g.*, Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. NO. 6, at 38-39, 32 I.L.M. at 477-78 (stating Dutch independent contractor is subject to U.S. taxation when he establishes fixed base in United States).

359. *See* 1992 OECD MODEL, *supra* note 81, at 153 (discussing medical office as example of fixed base); *see also* MARC LINDER, THE EMPLOYMENT RELATIONSHIP IN ANGLO-AMERICAN LAW, A HISTORICAL PERSPECTIVE 13-14 (1989) (discussing distinction between wage workers and skilled service providers). "Where, as in the case of the plumber or mechanic, the worker owns and understands the equipment and is skilled at using them while his contractee is not, the latter is a customer (not an employer) and the former an independent contractor (not a wage worker)." *Id.* at 14.

one commentator notes, independent contractors frequently view themselves as entrepreneurs rather than employees.[360]

In contrast, according to the I.R.S. and courts, employees are those who rely on their employer to run the business.[361] An employee is considered dependent when his employer incurs the operating expenses of the business and furnishes the materials necessary for the employee to earn income.[362] The employee may incur "ordinary and necessary" business expenses,[363] but, generally, such expenses are lower than the expenses incurred by independent contractors.[364]

The distinction between independent contractors and dependent employees is historical and based in common law.[365] Consequently, both U.S. courts and commentators note the diffi-

360. *See* Breen Creighton, *Employment Security and Atypical Work in Australia*, 16 COMP. LAB. L.J. 285, 290 (1995) (describing ideological differences between independent contractors and workers towards trade unions).

361. *See, e.g.*, *Silk*, 331 U.S. at 719 (listing factors that indicate status as either employee or independent employee); Rev. Rul. 87-41, 1987-1 C.B. 296 (discussing I.R.S. view of distinction between independent contractors and employees).

362. Treas. Reg. § 31.3401(c)-1. "Other factors characteristic of an employer, but not necessarily present in every case, are the furnishings of tools and the furnishing of a place to work to the individual who performs the services." *Id.* The "essence of the employment relationship lies in the employee's relinquishing to the employer complete disposition over his activities subject to agreed-upon limitations." LINDER, *supra* note 359, at 12.

363. I.R.C. § 162(a). Business expenses are the costs incurred by the taxpayer in earning gross income. CHIRELSTEIN, *supra* note 75, at 90. These include meals and travel expenses. I.R.C. § 162(a). One commentator has noted, however, that:

> Employees are not shielded from the risks inherent in the markets for the commodities they produce for their employers; rather, through the latter such risks are mediated — with a time lag. Thus, for example, the workers who produced Edsels presumably lost their jobs rather than invested capital.

LINDER, *supra* note 359, at 25-26 n.23.

364. *See Aimable*, 20 F.3d at 443 (listing investment in equipment and facilities as factors indicating independent contractor, not employee, status).

365. *See* Henderson v. Inter-Chem Coal Co., 41 F.3d 567, 570 (10th Cir. 1994) (describing terms "employee" and "independent contractor" as traditional common law concepts). The Anglo-American judicial distinction between independent contractors and dependent employees traces its origins from fourteenth century English statutes. LINDER, *supra* note 359, at 46. At that time, the aftermath of the Black Plague reduced the supply of labor so as to increase wages significantly. *Id.* at 45-46. In order to counteract market forces to the advantage of employers, several laws were promulgated to restrict the wages of those who were not economically independent. *Id.* at 46-47. The basic principles of the 1349 Ordinance of Labourers, for example, were "compulsory service [of employees] at pre-plague wages and criminalization of the failure to comply with these conditions. *Id.*

culty in distinguishing between the two.[366] Because few job categories are covered in the statutory definitions of "employee," the status of most workers is determined according to the common law.[367] Accordingly, the U.S. Supreme Court relies on common law agency principles[368] when determining whether a hired party is an employee or an independent contractor.[369]

D. *Application of Section 864(c)(6) to the Dutch and Swiss Treaties*

Two examples of tax treaties affected by Section 864(c)(6) include a recent treaty, the Dutch Treaty, and an existing treaty, the Swiss Treaty.[370] The Dutch Treaty expressly mitigates the tax rate on deferred compensation under Section 864(c)(6) for independent contractors and businesses.[371] The Swiss Treaty, in contrast, was enacted before TRA '86 and TAMRA[372] and, thus, makes no reference to Section 864(c)(6).[373] The language of

366. *Silk*, 331 U.S. at 713; *Mares*, 777 F.2d at 1067. *See Silk*, 331 U.S. at 713 (noting difficulty in distinguishing between employees and independent contractors); BAKER, *supra* note 47, at 229 (describing complications in distinguishing between independent contractors and dependent employees). Another commentator has stated that independent contractors, who sell services, are often hard to distinguish from dependent employees, who sell labor power. LINDER, *supra* note 359, at 32 n.70.

367. Kenny & Hulen, *supra* note 35, at 661-62.

368. Community for Creative Non-Violence v. Reid, 490 U.S. 730, 752 n.31 (1989); *see* RESTATEMENT (SECOND) OF AGENCY § 220(2) (1957) (listing factors relevant in determining whether hired party is employee or independent contractor). The term "agency" describes:

> A relationship between two persons, by agreement or otherwise, where one (the agent) may act on behalf of the other (the principal) and bind the principal by words and actions. Relation in which one person acts for or represents another by latter's authority, either in the relationship of principal and agent, master and servant, or employer or proprietor and independent contractor. . . . The consentual relationship existing between two persons by virtue of which one is subject to other's control. . . . Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control and consent by the other so to act.

BLACK'S LAW DICTIONARY, *supra* note 139, at 62 (citations omitted).

369. *Community for Creative Non-Violence*, 490 U.S. at 752 n.31.

370. Dutch Treaty, *supra* note 29, S. TREATY DOC. NO. 6, 32 I.L.M. at 462; Swiss Treaty, *supra* note 31, 2 U.S.T. 1751, T.I.A.S. No. 2316.

371. *See* Dutch Treaty, *supra* note 29, art. 24, S. TREATY DOC. NO. 6, at 50-51, 32 I.L.M. at 482-83 (permitting net taxation of deferred compensation earned by independent contractors but not making express provisions for dependent employees).

372. 2 LEGISLATIVE HISTORY OF U. S. TAX CONVENTIONS, *supra* note 266, § 22, at 2382.

373. Swiss Treaty, *supra* note 31, arts. 3, 10, 2 U.S.T. at 1755-56, 1758, T.I.A.S. No. 2316, at 5-6, 8.

the Swiss Treaty does not address the taxation of deferred income.[374]

1. The Dutch Treaty Expressly Incorporates Section 864(c)(6)

The Dutch Treaty was signed on December 18, 1992,[375] and entered into force on January 1, 1994.[376] The Dutch Treaty allows the United States to tax Dutch taxpayers' business profits and compensation from U.S. sources.[377] Under Article 7[378] of the Dutch Treaty, for example, the United States may tax the business profits of a Dutch resident only if profits are attributable to[379] a permanent establishment[380] in the United States.[381] Article 5[382] of the Dutch Treaty defines a permanent establishment as a fixed place of business through which the business of an enterprise is wholly or partly transacted.[383] Moreover, the

374. *Id.*

375. Dutch Treaty, *supra* note 29, S. TREATY DOC. NO. 6, at v, 32 I.L.M. at 457.

376. I.R.S. Notice 94-1, 1994-1 C.B. 322. This new treaty became effective subject to the provisions of an explanatory protocol ("Dutch Protocol"). Protocol Amending Income Tax Convention, Oct. 13, 1993, U.S.-Neth., S. TREATY DOC. NO. 19, 103d Cong., 1st Sess. (1993), 33 I.L.M. 160 (1994) [hereinafter Dutch Protocol].

377. *See* Dutch Treaty, *supra* note 29, art. 7, S. TREATY DOC. NO. 6, at 15-17, 32 I.L.M. at 467-68 (taxing business profits); *id.* art. 15, S. TREATY DOC. NO. 6, at 38-39, 32 I.L.M. at 477-78 (taxing independent contractors).

378. *Id.* art. 7, S. TREATY DOC. NO. 6, at 15-17, 32 I.L.M. at 467-68.

379. Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-125. The concept of "attributable to" is narrower than the concept of "effectively connected" in the Code. *Id.* Under the Code, all that is necessary for effectively connected business profits to be taxed is that a trade or business be conducted in the United States. I.R.C. §§ 864(c), 871(b), 882; SENATE DUTCH REPORT, *supra* note 320, at 54. Under the Dutch Treaty, in contrast, a fixed place of business must be present and the business profits must be attributable to that fixed place of business. SENATE DUTCH REPORT, *supra* note 320, at 54.

380. Dutch Treaty, *supra* note 29, art. 5, S. TREATY DOC. NO. 6, at 10, 32 I.L.M. at 465; *see* BAKER, *supra* note 47, at 89 (stating that concept of permanent establishment is largely creature of tax treaties); *see supra* note 81 and accompanying text (describing permanent establishment as tax treaty concept enabling United States to tax non-U.S. businesses with U.S. source income).

381. Dutch Treaty, *supra* note 29, art. 7, S. TREATY DOC. NO. 6, at 15-17, 32 I.L.M. at 467-68; *see* Hershberger & Siegel, *supra* note 81, at 1994 (discussing permanent establishment concept).

382. Dutch Treaty, *supra* note 29, art. 5, S. TREATY DOC. NO. 6, at 10, 32 I.L.M. at 465.

383. *Id.* The term "permanent establishment" includes: (1) a place of management; (2) a branch; an office; a factory; (3) a workshop; and (4) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources. *Id.*; *see supra* note 81 and accompanying text (discussing permanent establishment concept). Article 7 of the Dutch Treaty, Business Profits, also refers to a permanent establishment. Dutch

U.S. source business profits are exempt from U.S. taxation when the business activities of a Dutch resident in the United States are purely temporary because a permanent establishment has not been constructed.[384] The existence of a Dutch permanent establishment in the United States, therefore, provides a nexus for U.S. taxation of a Dutch resident's taxable business profits.[385]

Article 15[386] of the Dutch Treaty, Independent Personal Services, meanwhile, addresses the taxation of professional services and other activities of an independent character.[387] Independent personal services include: independent scientific, literary, artistic, educational, and teaching activities and the independent activities of physicians, lawyers, engineers, architects, dentists, and accountants.[388] Article 15 addresses all personal services performed by an individual for his own benefit where he receives income and bears the risk of loss arising from his services.[389]

Article 15's taxation of independent contractors is analogous to Article 7's taxation of businesses.[390] For example, if an

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Treaty, *supra* note 29, art. 7, S. TREATY DOC. NO. 6, at 15-17, 32 I.L.M. at 467-68. Article 7 states:

> The profits of an enterprise of one of the States shall be taxable only in that State unless the enterprise carries on business in the other State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

*Id.*

384. 1992 OECD MODEL, *supra* note 81, at 67. "Since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, i.e. if it is not of a purely temporary nature." *Id.*; *see* BAKER, *supra* note 47, at 89 (discussing permanent establishment in tax treaties).

385. Williams, *supra* note 21, at 278.

386. Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. NO. 6, at 39, 32 I.L.M. at 478.

387. *Id.*; *see supra* notes 344-64 (listing factors which indicate independent contractor, as opposed to employee, status in United States).

388. Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. NO. 6, at 39, 32 I.L.M. at 478; Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 35,829-148; *see* BAKER, *supra* note 47, at 222 (discussing independent personal services article in 1977 OECD Model).

389. Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-149.

390. *Id.* at 36,447-148. The Dutch Technical Explanation states:

> The term "fixed base" is not defined in the Convention, but its meaning is understood to be analogous to that of the term "permanent establishment," as defined in Article 5 (Permanent Establishment). Similarly, some rules of Arti-

independent contractor has a fixed base,[391] certain rules of Article 7 for attributing income and expense to a permanent establishment are relevant for attributing income to a fixed base.[392] Only the income attributable to the fixed base of the contractor is taxable.[393] Thus, a Dutch resident with U.S. income from professional services may be taxed only in the Netherlands, unless the resident has a fixed base regularly available to him in the United States.[394]

Articles 7 and 15, in addition, specifically provide for taxation of deferred income under the principles of Section 864(c)(6).[395] Both Articles refer to Article 24,[396] Basis of Taxation, whose precise counterpart is not found in any other tax treaty.[397] Under Article 24, any income, gain, or expense that is attributable to a permanent establishment or fixed base, but is deferred until after the permanent establishment or fixed base is no longer available to the performer of the services may be taxed or deducted in the nation in which the permanent establish-

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> cle 7 (Business Profits) for attributing income and expenses to a permanent establishment are relevant for attributing income to a fixed base.

*Id.*

391. *See, e.g.*, Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. NO. 6, at 38-39, 32 I.L.M. at 477-78 (stating fixed base provides basis for U.S. taxation of Dutch independent contractors); *see supra* 81 and accompanying text (describing fixed base concept in tax treaties).

392. Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-148; *see* BAKER, *supra* note 47, at 222 (discussing treatment of independent contractors in 1977 OECD Model). Other recent treaties also construe the term "fixed base" as analogous to the term "permanent establishment." Protocol Amending Income Tax Convention, Feb. 22, 1990, U.S.-Spain, S. TREATY DOC. NO. 16, 101st Cong., 2d Sess. 25 (1990), 3 Tax Treaties (CCH) ¶ 8404, at 40,523 [hereinafter Spanish Protocol]; German Technical Explanation, *supra* note 264, 2 Tax Treaties (CCH) ¶ 3255, at 28,185.

393. Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. NO. 6, at 39, 32 I.L.M. at 478; *see* BAKER, *supra* note 47, at 222 (stating that if taxpayer does not have fixed base in contracting country, his income is exempt from tax in that country).

394. Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. NO. 6, at 38-39, 32 I.L.M. at 477-78; Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-148.

395. Dutch Treaty, *supra* note 29, arts. 7, 15, S. TREATY DOC. NO. 6, at 15-17, 38-39, 32 I.L.M. at 467-68, 477-78.

396. *Id.* art. 24, S. TREATY DOC. NO. 6, at 50-51, 32 I.L.M. at 482-83.

397. *Id.*; Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-158. "There is no precise counterpart to Article 24 in other U.S. treaties." 2 Tax Treaties (CCH) ¶ 6121, at 36,447-158.

ment or fixed base was located.[398] Article 24, therefore, clarifies that a Dutch taxpayer may deduct expenses attributable to a permanent establishment or fixed base from his deferred income when that income is taxed.[399]

Furthermore, Article 16[400] of the Dutch Treaty, Dependent Personal Services, discusses the taxation of income earned by dependent employees in the other contracting country.[401] Consis-

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398. Dutch Treaty, *supra* note 29, art. 24, S. TREATY DOC. NO. 6, at 50-51, 32 I.L.M. at 482-83. Article 24, Basis of Taxation, provides that:

> For the implementation of paragraphs 1 and 2 of Article 7 (Business Profits), . . . paragraph 1 of Article 15, (Independent Personal Services) . . . *any income, gain or expense* attributable to a permanent establishment or fixed base during its existence is taxable or deductible in the State where such permanent establishment or fixed base is situated even if the payments are deferred until such permanent establishment or fixed base has ceased to exist.

*Id.* (emphasis added). The Treasury Department has stated that Article 24 "incorporates the rule of Code Section 864(c)(6) into the Convention." Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-160. The Joint Committee on Taxation and Senate Foreign Relations Committee agreed that the Dutch Treaty permitted the United States to apply the principles of I.R.C. § 864(c)(6) to deferred profits attributable to either a permanent establishment or a fixed base. SENATE DUTCH REPORT, *supra* note 320, at 91; JOINT COMM. DUTCH EXPLANATION, *supra* note 38, at 85.

Moreover, other recent tax treaties have also specifically incorporated I.R.C. § 864(c)(6). *See* SENATE FOREIGN RELATIONS COMM., REPORT ON TAX CONVENTION WITH THE REPUBLIC OF FINLAND, S. EXEC. REP. NO. 28, 101st Cong., 2d Sess. 43 (1990) [hereinafter SENATE FINNISH REPORT]. "The Committee understands that the proposed treaty's language conforms the treatment of income derived from independent personal services with Code § 864(c)(6)." *Id.*; *see also* Treasury Dept. Technical Explanation, Income Tax Convention and Protocol, Sept. 18, 1992, U.S.-Mex., 2 Tax Treaties (CCH) ¶ 5943, at 35,829-13 to -14 (1992) [hereinafter Mexican Technical Explanation] (stating that business profits article incorporated I.R.C. § 864(c)(6) with respect to deferred payments); German Protocol, *supra* note 328, S. TREATY DOC. No. 10, at 86, 2 Tax Treaties (CCH) ¶ 3250, at 28,170 (noting that I.R.C. § 864(c)(6) was incorporated into German Treaty).

399. Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-160. Other tax treaties follow the treatment in the Dutch Treaty by allowing net taxation of deferred income earned by a business or independent contractor. Mexican Technical Explanation, *supra* note 398, 2 Tax Treaties (CCH) ¶ 5943, at 35,829-14; German Protocol, *supra* note 328, S. TREATY DOC. No. 10, at 86, 2 Tax Treaties (CCH) ¶ 3250, at 28,170. As explained in the Treasury Department Explanation of the Spanish Treaty, independent personal services are to be taxed on a net, rather than gross, basis under principles analogous to those applicable to Article 7, Business Profits. Treasury Dept. Technical Explanation, Income Tax Convention, Feb. 22, 1990, U.S.-Spain, 3 Tax Treaties (CCH) ¶ 8425, at 40,548 (1990) [hereinafter Spanish Technical Explanation].

400. Dutch Treaty, *supra* note 29, art. 16, S. TREATY DOC. No. 6, at 39-40, 32 I.L.M. at 478.

401. *Id.* Provisions of Article 16 of the Dutch Treaty, however, are overridden by the provisions in other articles specifically concerning artists and entertainers, government employees, and pensions. *Id.*

tent with the general rule of construction mandating that the more specific rule takes precedence over the general,[402] income addressed by other articles is governed by provisions in those articles rather than Article 16.[403] Article 16 provides that salaries, wages, and other similar remuneration received by a Dutch resident, for example, will be taxable only in the Netherlands unless the services are performed in the United States.[404] The Dutch Treaty, its congressional reports, and the Treasury Department do not discuss deferred payments received by employees under Article 16.[405]

### 2. The Swiss Treaty Does Not Discuss the Taxation of Deferred Income

The Swiss Treaty was signed on May 24, 1951,[406] and entered into force on September 27, 1951.[407] To aid in the interpretation of the Swiss Treaty, the Treasury Department enacted

402. Morales v. Trans World Airlines, 504 U.S. 374, 384-85 (1992).

403. Dutch Treaty, *supra* note 29, art. 16, S. TREATY DOC. NO. 6, at 39-40, 32 I.L.M. at 478; Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-149.

404. Dutch Treaty, *supra* note 29, art. 16, S. TREATY DOC. NO. 6, at 39-40, 32 I.L.M. at 478. Article 16 contains a temporary stay exception if: (a) the recipient is present in the other State for less than the aggregate 183 days in a taxable year; (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and (c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State. *Id.* The twelve month period must include the period in which the income was earned. Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-149 to -150. Additionally, all three conditions must be satisfied for the remuneration to be exempt from tax in the source state. *Id.*

405. Dutch Treaty, *supra* note 29, art. 16, S. TREATY DOC. NO. 6, at 39-40, 32 I.L.M. at 478; SENATE DUTCH REPORT, *supra* note 320, at 84; Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-149; JOINT COMM. DUTCH EXPLANATION, *supra* note 38, at 76. The discussion of dependent employees in other reports on recent treaties resembles those of the Dutch Treaty by not addressing deferred compensation and related expenses under I.R.C. § 864(c)(6). *See, e.g.*, Mexican Technical Explanation, *supra* note 398, 2 Tax Treaties (CCH) ¶ 5943, at 35,829-25 to -26 (stating no guidelines for taxing deferred income); German Technical Explanation, *supra* note 264, 2 Tax Treaties (CCH) ¶ 3255, at 28,201 to -202 (providing no discussion of deferred income).

406. 2 LEGISLATIVE HISTORY OF U. S. TAX CONVENTIONS, *supra* note 266, § 22, at 2382.

407. *Id.* The Swiss Treaty became effective subject to the provisions of an explanatory protocol ("Swiss Protocol"). Protocol Amending Income Tax Convention, May 24, 1951, U.S.-Switz., 2 U.S.T. at 1782-83, T.I.A.S. No. 2316, at 32-33 [hereinafter Swiss Protocol].

regulations ("Swiss Treaty Regulations").[408] Article 3[409] of the Swiss Treaty allows the United States to tax a Swiss resident's business profits attributable to a U.S. permanent establishment on a net basis.[410] The language of Article 3, unlike Article 24 of the Dutch Treaty, does not expressly discuss taxation of deferred business profits attributable to a former U.S. permanent establishment.[411]

The Swiss Treaty Regulations define a permanent establishment as a fixed place of business where a business enterprise is actively conducted.[412] The term "enterprise" is defined as any commercial or industrial enterprise or undertaking carried on by any person, including individuals, partnerships, and corporations.[413] Both the Senate Foreign Relations Committee and the Swiss Treaty Regulations state that a Swiss enterprise must have a U.S. permanent establishment during the taxable year in order for it to be subject to U.S. tax on the business profits attributable

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408. T.D. 6149, 1955-2 C.B. 815. Treasury Decision 6149 contains Regulations clarifying the Swiss Treaty ("Swiss Treaty Regulations"). *Id.*

409. Swiss Treaty, *supra* note 31, art. 3, 2 U.S.T. at 1755-56, T.I.A.S. No. 2316, at 5-6.

410. *Id.*

411. *Compare* Swiss Treaty, *supra* note 31, art. 3, 2 U.S.T. at 1755-56, T.I.A.S. No. 2316, at 5-6 *with* Dutch Treaty, *supra* note 29, art. 24, S. TREATY DOC. NO. 6, at 50-51, 32 I.L.M. at 482-83. Article 3 of the Swiss Treaty states:

> A Swiss enterprise shall not be subject to taxation by the United States in respect of its industrial and commercial profits unless it is engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged the United States may impose its tax upon the entire income of such enterprise from sources within the Untied States.

Swiss Treaty, *supra* note 31, art. 3, 2 U.S.T. at 1755-56, T.I.A.S. No. 2316, at 5-6. Article 24 of the Dutch Treaty provides that:

> For the implementation of paragraphs 1 and 2 of Article 7 (Business Profits), . . . paragraph 1 of Article 15, (Independent Personal Services) . . . any income, gain or expense attributable to a permanent establishment or fixed base during its existence is taxable or deductible in the State where such permanent establishment or fixed base is situated *even if the payments are deferred until such permanent establishment or fixed base has ceased to exist.*

Dutch Treaty, *supra* note 29, art. 24, S. TREATY DOC. NO. 6, at 50-51, 32 I.L.M. at 482-83 (emphasis added).

412. T.D. 6149, 1955-2 C.B. 815, § 509.104(b)(5). According to the Swiss Treaty Regulations: "The term 'permanent establishment' means an office, factory, workshop, warehouse, branch, or other fixed place of business, but does not include the casual and temporary use of merely storage facilities. It implies the active conduct of a business enterprise." *Id.*

413. *Id.* § 509.104(b)(6).

to that income.[414] Neither the Senate Foreign Relations Committee nor the Swiss Treaty Regulations, however, addressed the taxation of deferred business profits.[415]

The Swiss Treaty, unlike the Dutch Treaty,[416] does not expressly refer to the tax treatment of businesses when addressing the taxation of independent contractors.[417] As defined by the Swiss Treaty Regulations the term enterprise does not include the rendition of personal services.[418] Thus, Article 10[419] of the Swiss Treaty does not rely on Article 3 to guide its taxation of personal services compensation.[420] Article 10 discusses the compensation of both independent contractors and dependent employees,[421] including compensation, profits, and emoluments.[422]

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414. *Id.* § 509.105. The Swiss Treaty Regulations explain that:

> Article III of the convention adopts the principle that an enterprise of one of the contracting States shall not be taxable by the other contracting State upon its industrial and commercial profits unless it is engaged in trade or business in the latter State through a permanent establishment situated therein. Accordingly, *a Swiss enterprise is subject to United States tax upon its industrial and commercial profits, to the extent of such profits from sources within the Untied States, only if it is engaged in trade or business in the United States at some time during the taxable year through a permanent establishment situated therein.*

*Id.* (emphasis added); *see* S. EXEC. REP. 1, 82d Cong., 1st Sess. 1, 13, (1951) [hereinafter SENATE SWISS REPORT] (stating Swiss enterprise must have U.S. permanent establishment in order for it to be subject to U.S. taxation).

415. T.D. 6149, 1955-2 C.B. 815; SENATE SWISS REPORT, *supra* note 414, at 13.

416. Dutch Treaty, *supra* note 29, art. 15, S. TREATY DOC. No. 6, at 39, 32 I.L.M. at 478; Dutch Technical Explanation, *supra* note 81, 2 Tax Treaties (CCH) ¶ 6121, at 36,447-148.

417. *See* Swiss Treaty, *supra* note 31, art. 10, 2 U.S.T. at 1758, T.I.A.S. No. 2316, at 8 (making no reference to fixed base); T.D. 6149, 1955-2 C.B. 815, § 509.103 (addressing scope of Swiss Treaty and concluding that permanent establishment concept applies only to businesses).

418. T.D. 6149, 1955-2 C.B. 815, § 509.104. The Swiss Treaty Regulations state:

> [A] nonresident alien individual who is a resident of Switzerland and who performs personal services is not, merely by reason of such services, engaged in a Swiss enterprise within the meaning of the convention; consequently, his liability to United States tax is not determined under Article III of the convention, if he has not otherwise carried on a Swiss enterprise.

*Id.*

419. Swiss Treaty, *supra* note 31, art. 10, 2 U.S.T. at 1758, T.I.A.S. No. 2316, at 8.

420. *Id.*

421. *Id.* Article 10 of the Swiss Treaty states:

> (1) An individual resident of Switzerland shall be exempt from United States tax upon compensation for labor or personal services performed in the United States (including the practice of the liberal professions and rendition of services as director) if he is temporarily present in the United States for a period or periods not exceeding a total of 183 days during the taxable year and either of the following conditions is met: (a) his compensation is received

Similar to the case of deferred business profits, the Swiss Treaty, Senate Foreign Relations Committee, and Swiss Treaty Regulations are silent regarding the taxation of deferred compensation for personal services.[423]

## III. *SECTION 864(c)(6) SHOULD BE CONSTRUED TO ALLOW NET TAXATION OF DEFERRED COMPENSATION*

Section 864(c)(6) should be interpreted to allow net taxation of both independent contractors and dependent employees under the Dutch and Swiss Treaties.[424] Its ambiguous language regarding a net or gross tax[425] and most relevant legislative history support the proposition that deferred income should be taxed on a net basis.[426] Furthermore, the language of the Swiss Treaty indicates that the Treaty is harmonious with Section 864(c)(6).[427] Section 864(c)(6) should, therefore, be applied consistently for all employees, regardless of whether they are classified as independent contractors or dependent employees.[428]

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> for such labor or personal services performed as an employee of, or under contract with, a resident or corporation or the entity of Switzerland, or (b) his compensation received for such labor or personal services does not exceed $10,000.

*Id.*

422. T.D. 6149, 1955-2 C.B. 815, § 509.112(b).

423. Swiss Treaty, *supra* note 31, art. 10, 2 U.S.T. at 1758, T.I.A.S. No. 2316, at 8; T.D. 6149, 1955-2 C.B. 815, § 509; SENATE SWISS REPORT, *supra* note 414, at 16.

424. I.R.C. § 864(c)(6); Dutch Treaty, *supra* note 29, arts. 15-16, S. TREATY DOC. No. 6, at 38-40, 32 I.L.M. at 477-78; Swiss Treaty, *supra* note 31, art. 10, 2 U.S.T. at 1758, T.I.A.S. No. 2316, at 8.

425. *Compare, e.g.*, I.R.C. § 864(c)(6) (taxing deferred "income or gain") *with* I.R.C. § 871(b) (referring to "taxable income" of individuals); *see supra* notes 175-78 and accompanying text (discussing differences in wording among Code sections addressing effectively connected income).

426. *See supra* notes 164-71 and accompanying text (illustrating Congress' intent to provide for net tax by amending I.R.C. § 864(c)(6) in TAMRA); *see also supra* notes 150-63 and accompanying text (describing enactment of I.R.C. § 864(c)(6) in TRA '86); *see supra* notes 395-99 and accompanying text (discussing explicit language in Dutch Treaty and other recent treaties mitigating tax under I.R.C. § 864(c)(6)).

427. *See supra* notes 409-11 and accompanying text (discussing taxation of business profits under Swiss Treaty); *see supra* notes 421-23 and accompanying text (describing taxation of personal services under Swiss Treaty).

428. *See supra* notes 172-78 and accompanying text (showing language of I.R.C. § 864(c)(6) is ambiguous); *see supra* note 179-91 and accompanying text (discussing tax policy goals of fairness, administrative convenience, and economic reality).

### A. *The Language of Section 864(c)(6) is Ambiguous but Should be Interpreted as a Net Tax*

Section 864(c)(6) contains language different from the other Code sections addressing effectively connected income, Sections 871(b)[429] and 882.[430] Section 864(c)(6) refers to the taxation of "any income or gain" while other Code sections refer to "taxable income."[431] One distinction between the terms "any income or gain" and "taxable income" is that the former indicates a gross tax while the latter provides for a net tax.[432] A nonresident alien with deferred income deemed effectively connected by virtue of Section 864(c)(6) would, therefore, either pay tax on the entire gross amount under Section 864(c)(6) or pay tax on the net amount under Section 871(b).[433] The difference in the terminology suggests that Section 864(c)(6) imposes a gross tax on deferred compensation.[434]

Section 864(c)(6), however, may be interpreted as a net tax because of its cross-reference to the principles of Sections 871(b) and 882.[435] TAMRA amended Section 864(c)(6) by re-

429. *Compare* I.R.C. § 864(c)(6) (taxing deferred "income or gain") *with* I.R.C. § 871(b) (referring to "taxable income" of individuals); *see supra* notes 176-78 and accompanying text (indicating differences in wording among Code sections concerning effectively connected income).

430. *Compare* I.R.C. § 864(c)(6) (addressing taxation of deferred "income or gain") *with* I.R.C. § 882 (providing for tax on "taxable income" of corporations); *see supra* notes 176-78 and accompanying text (illustrating difference in terms used by I.R.C. §§ 864(c)(6), 871(b), and 882 when taxing effectively connected income).

431. I.R.C. §§ 864(c)(6), 871(b), 882.

432. *Compare* § 864(c)(6) (utilizing term "any income or gain" when referring to effectively connected income) *with* I.R.C. §§ 871(b), 882 (employing term "taxable income" in connection with taxation of effectively connected income). *See supra* note 166 and accompanying text (stating taxable income is gross income less deductions); *see supra* notes 182-84 and accompanying text (describing technical meaning of tax statute as controlling).

433. *See supra* notes 429-32 and accompanying text (noting differences in language among Code sections addressing effectively connected income).

434. *See* I.R.C. § 864(c)(6) (providing for taxation of deferred "income or gain").

435. I.R.C. § 864(c)(6). I.R.C. § 864(c)(6) states:

> [I]n the case of any income or gain of a nonresident alien individual . . . or a foreign corporation which (A) is taken into account for any taxable year, but (B) is attributable to a sale or exchange of property or the performance of services (or any other transaction) in any other taxable year, *the determination of whether such income or gain is taxable under section 871(b) or 882 (as the case may be)* shall be made as if such income or gain were taken into account in such other taxable year and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the taxable year referred to in subparagraph (A).

ferring explicitly to the tax treatment of Sections 871(b) and 882.[436] These two latter sections provide for net taxation of effectively connected income.[437] The revision of Section 864(c)(6) changed the language stating deferred income or gain was effectively connected income to the language indicating that deferred income or gain was taxable under the principles of Sections 871(b) and 882.[438] Before TAMRA, Section 864(c)(6) taxed deferred income as effectively connected income.[439] Consequently, the amended language of Section 864(c)(6) can logically be interpreted as enabling taxation of deferred income on a net basis.[440]

Furthermore, the Supreme Court has stated that in cases of ambiguous taxing statutes, the doubt should be resolved in favor of the taxpayer.[441] Thus, the ambiguous text in Section 864(c)(6) should be interpreted as taxing deferred compensation on a net basis.[442] Section 864(c)(6), a provision that specifically addresses deferred income, however, will prevail over the treatment of effectively connected income in Section 871(b), a more general Code section.[443]

### B. *The Legislative History of Section 864(c)(6) Reveals Inconsistent Congressional Intent Regarding a Net or Gross Tax*

Congress intended a gross tax on deferred income in TRA

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*Id.* (emphasis added).

436. *See supra* note 130 and accompanying text (discussing how TAMRA's amendment of I.R.C. § 864(c)(6) made explicit references to I.R.C. §§ 871(b) and 882).

437. I.R.C. §§ 871(b), 882; *see supra* note 166 and accompanying text (discussing net taxation of effectively connected income under I.R.C. §§ 871(b) and 882).

438. I.R.C. §§ 864(c)(6) (1987), 864(c)(6) (1995). Prior to amendment, I.R.C. § 864(c)(6) stated in part: "[A]ny income or gain . . . shall be treated as effectively connected with the conduct of a trade or business within the United States." I.R.C. § 864(c)(6) (1987). After TAMRA, I.R.C. § 864(c)(6) substituted this phrase with the following: "[T]he determination of whether such income or gain is taxable under section 871(b) or 882 (as the case may be)." I.R.C. § 864(c)(6) (1995); *see supra* note 130 and accompanying text (discussing TAMRA's amendment of I.R.C. § 864(c)(6)).

439. I.R.C. § 864(c)(6) (1987).

440. I.R.C. § 864(c)(6); *see supra* note 130 and accompanying text (comparing language of I.R.C. § 864(c)(6) before and after TAMRA's amendment).

441. *See supra* note 185 and accompanying text (explaining in case of unclear tax statutes, ambiguity resolved in favor of taxpayer).

442. *See supra* notes 431-41 and accompanying text (showing that text of I.R.C. § 864(c)(6) indicates net tax).

443. *See supra* note 402 and accompanying text (indicating rule of statutory interpretation is that more specific provision supersedes general rule).

'86.[444] The legislative history of Section 864(c)(6) in TAMRA,[445] however, indicates a net tax.[446] TAMRA's interpretation is inconsistent, however, with subsequent congressional statements in recent treaties construing Section 864(c)(6) as a gross tax.[447] The ambiguous wording of Section 864(c)(6)[448] and legislative history of TAMRA,[449] as well as the treatment of effectively connected income under other Code sections[450] nevertheless demonstrates that Section 864(c)(6) provides for a net tax.[451]

### 1. The Legislative History of TRA '86 Indicates a Gross Tax

Although legislative history is not legally controlling,[452] given the ambiguous language of Section 864(c)(6), its legislative history is probative.[453] The legislative history of Section 864(c)(6) in TRA '86 suggests that Section 864(c)(6) was intended as a gross tax on deferred income.[454] By enacting Section 864(c)(6), Congress intended to close the loophole in the Code that allowed nonresident aliens to avoid tax liability through the mechanism of deferred compensation.[455] Accordingly, the House, Senate, and Conference Committee reports on TRA '86 refer only to the taxation of deferred "income or gain"

444. *See supra* notes 154-63 and accompanying text (discussing congressional impetus behind I.R.C. § 864(c)(6) to close loophole).

445. *See supra* notes 164-71 and accompanying text (providing legislative history of I.R.C. § 864(c)(6) and TAMRA).

446. *See supra* notes 164-71 and accompanying text (showing that legislative history of TAMRA supports finding of net tax under I.R.C. § 864(c)(6)).

447. *See supra* notes 395-99 and accompanying text (indicating that recent treaties construed I.R.C. § 864(c)(6) as applying gross tax).

448. *See supra* notes 429-43 and accompanying text (showing language of I.R.C. § 864(c)(6) can be construed as either net or gross tax).

449. *See supra* notes 164-71 and accompanying text (discussing TAMRA's amendment of I.R.C. § 864(c)(6)).

450. I.R.C. §§ 871(b), 881(a).

451. *See supra* notes 448-50 and accompanying text (arguing I.R.C. § 864(c)(6) taxes deferred income on net basis).

452. *See supra* note 150 and accompanying text (stating legislative history is not legally controlling); *see supra* note 184 and accompanying text (noting when text is unambiguous, plain meaning of language is conclusive).

453. *See supra* notes 171, 184 and accompanying text (discussing importance of legislative history when language of statute is unclear or silent).

454. *See supra* notes 157-62 and accompanying text (illustrating legislative impetus behind I.R.C. § 864(c)(6) in TRA '86 was to tax deferred income of nonresident aliens).

455. *See supra* notes 152-56 and accompanying text (discussing congressional impetus behind I.R.C. § 864(c)(6) was to close loophole).

under Section 864(c)6).[456] The Joint Committee on Taxation reports also refer only to Section 864(c)(6) in terms of taxation of deferred "income and gain."[457] Under a textual analysis, the use of the term "income or gain" indicates a gross tax.[458] None of these various committee reports on TRA '86 discussed whether deferred expenses were deductible when deferred income or gain was taxed.[459]

2. TAMRA's Subsequent Legislative History Indicates Congress Amended Section 864(c)(6) to Provide for a Net Tax

The legislative history of TAMRA,[460] which amended TRA '86, indicates that Section 864(c)(6) was intended to tax deferred compensation on a net basis.[461] TAMRA amended Section 864(c)(6) by referring to the taxation of effectively connected income under other sections of the Code.[462] The congressional discussion of these revisions indicates that the impetus was to provide for a net tax.[463] In addition, since Section 864(c)(6) already taxed deferred compensation, its amendment only served to provide for a net tax.[464]

3. Reports on Recent Treaties Indicate an Understanding That Section 864(c)(6) Is a Gross Tax

While the Dutch Treaty was ratified several years after TRA

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456. *See supra* notes 157-61 and accompanying text (examining Congress' discussion of I.R.C. § 864(c)(6) in TRA '86).

457. *See supra* note 162 and accompanying text (noting that 1986 Bluebook did not address deductibility of deferred expenses under I.R.C. § 864(c)(6)).

458. *See supra* note 432 and accompanying text (stating that technical meaning of "income or gain" indicates gross tax).

459. *See supra* notes 157-62 and accompanying text (providing legislative history of I.R.C. § 864(c)(6) in TRA '86).

460. *See supra* note 19 and accompanying text (discussing legislative background of TAMRA).

461. *See supra* notes 164-70 and accompanying text (presenting Congress' reasons for amending I.R.C. § 864(c)(6)).

462. *See supra* notes 164-66 and accompanying text (discussing amended language of I.R.C. § 864(c)(6) after TAMRA); *see supra* notes 435-43 and accompanying text (showing that change in language of I.R.C. § 864(c)(6) indicates net tax).

463. *See supra* notes 168-70 and accompanying text (showing that legislative history of I.R.C. § 864(c)(6) in TAMRA indicates net tax).

464. *See supra* notes 164-71 and accompanying text (illustrating amendments to I.R.C. § 864(c)(6)); *see supra* notes 435-40 and accompanying text (stating TAMRA amended I.R.C. § 864(c)(6) to provide for net tax).

'86 and TAMRA[465] had modified and amended the Code, the congressional and Treasury Department reports of the Dutch Treaty and other recent treaties nevertheless continued to construe Section 864(c)(6), on its face, as permitting taxation of deferred compensation on a gross basis.[466] These reports acknowledged that recent treaties, such as the Dutch Treaty, incorporated the rule of Section 864(c)(6).[467] These reports, moreover, also made explicit provisions for a net tax of deferred compensation.[468] The Dutch Treaty thus expressly mitigates taxation under Section 864(c)(6) by permitting net taxation of deferred income attributable to a permanent establishment or fixed base.[469] Treaty countries such as the Netherlands would insist upon an explicit provision for a net tax under Section 864(c)(6), however, only if they interpreted Section 864(c)(6) as applying a gross tax.[470] Despite subsequent congressional statements interpreting Section 864(c)6) as a gross tax, however, the original intent of the drafters in TAMRA, taxing deferred income on a net basis, is more probative.[471]

### C. *Section 864(c)(6) is Harmonious with the Swiss Treaty*

The language of the Swiss Treaty can be construed as allowing the taxation of deferred income under Section 864(c)(6).[472] If a court finds the Swiss Treaty and Section 864(c)(6) are inconsistent, however, the Swiss Treaty should pre-

465. *See supra* notes 375-76 and accompanying text (providing dates of Dutch Treaty ratification and entry into force).

466. *See supra* notes 395-99 and accompanying text (describing interpretation in Dutch Treaty and other recent treaties of I.R.C. § 864(c)(6) as providing gross tax).

467. *See supra* notes 398-99 and accompanying text (describing application of I.R.C. § 864(c)(6) in recent treaties).

468. *See supra* notes 398-99 and accompanying text (citing language in Dutch Treaty and other recent treaties allowing net tax under I.R.C. § 864(c)(6)).

469. *See supra* note 398 and accompanying text (describing Dutch Treaty's explicit provision for net taxation of income attributable to former permanent establishment or fixed base under I.R.C. § 864(c)(6)).

470. *See supra* notes 465-69 and accompanying text (discussing Dutch Treaty's interpretation of I.R.C. § 864(c)(6) as gross tax).

471. *See supra* notes 164-71 and accompanying text (discussing TAMRA's drafters intended net tax of deferred income).

472. Swiss Treaty, *supra* note 31, arts. 3, 10, 2 U.S.T. at 1755-56, 1758, T.I.A.S. No. 2316, at 5-6, 8; *see supra* notes 121-25 and accompanying text (finding term "taxable year" in U.K. Treaty, existing tax treaty, was year in which income was earned); *see supra* notes 324-28 and accompanying text (noting language in independent personal services article of German Treaty implicitly allowed taxation of deferred income).

vail given the lack of an explicit override provision in TAMRA.[473] Consequently, the *Lindsey* case, applying TAMRA's explicit later-in-time provision for AMT tax does not bear on the relationship between Section 864(c)(6) and the Swiss Treaty.[474]

1. The Language of the Swiss Treaty is Consistent with Section 864(c)(6)

Under the Swiss Treaty, the Code can tax the business profits of a Swiss enterprise only if it has a U.S. permanent establishment.[475] The Swiss Treaty, however, does not discuss the taxation of deferred income.[476] In the case of the independent personal services article of the German Treaty, whose language, like that in the Swiss Treaty, did not explicitly refer to the taxation of deferred income, the Treasury Department noted that the language did not preclude the taxation of deferred income.[477] Furthermore, the I.R.S., like the Treasury Department, has defined the term "tax year" in existing treaties as the year in which income was earned.[478] The Treasury Department and Congress have, therefore, interpreted Section 864(c)(6) as being harmonious with the language of existing treaties.[479]

The language of the Swiss Treaty can be construed as allowing the taxation of deferred income under Section 864(c)(6).[480] Article 3 of the Swiss Treaty simply states that a

473. *See supra* note 252 and accompanying text (stating explicit congressional intent necessary to court's finding that Code overrides existing tax treaty provisions); *see supra* notes 285-86 (discussing explicit provisions in TAMRA for override of existing treaty provisions, including AMT tax).

474. *See supra* notes 296-310 and accompanying text (discussing holding in *Lindsey*, 98 T.C. at 676-77 overriding provisions in Swiss Treaty).

475. *See supra* notes 409-10 and accompanying text (stating permanent establishment in United States triggers U.S. taxation of Swiss enterprise).

476. *See supra* notes 411, 423 and accompanying text (indicating text of business profits and personal services articles in Swiss Treaty do not address deferred profits).

477. *See supra* notes 324-28 and accompanying text (commenting that text of independent personal services article of German Treaty implicitly incorporates I.R.C. § 864(c)(6)).

478. *See supra* notes 121-25 and accompanying text (according to I.R.S., taxable year in dependent services article of U.K. Treaty was year in which income was earned).

479. *See supra* notes 317-28 and accompanying text (stating that tax imposed by I.R.C. § 864(c)(6) on deferred personal service income was fully consistent with existing U.S. tax treaty obligations).

480. *See supra* notes 121-25 and accompanying text (finding term "tax year" in U.K. Treaty was year in which income was earned); *see supra* notes 324-28 and accompanying text (noting language in independent personal services article of German Treaty implicitly allowed taxation of deferred income).

Swiss enterprise must have a permanent establishment in the United States in order for it to be subject to U.S. tax.[481] Similar to the articles in the U.K. Treaty,[482] 1981 Treasury Model,[483] and the German Treaty,[484] Article 3 does not refer to the time period involved.[485] The provisions in these tax treaties implicitly incorporate the taxation of deferred income.[486] Article 3, accordingly, can also be interpreted to permit the U.S. taxation of deferred profits attributable to a former permanent establishment.[487] Consequently, Article 3 and Section 864(c)(6) should be construed as compatible.[488]

In terms of personal services, neither the Swiss Treaty nor the Swiss Treaty Regulations explicitly discuss the treatment of deferred compensation.[489] The language of Article 10, however,

481. Swiss Treaty, *supra* note 31, art. 3, 2 U.S.T. at 1755-56, T.I.A.S. No. 2316, at 5-6. Article 3 of the Swiss Treaty states:

> A Swiss enterprise shall not be subject to taxation by the United States in respect of its industrial and commercial profits unless it is engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged the United States may impose its tax upon the entire income of such enterprise from sources within the Untied States.

*Id.*

482. *See supra* notes 121-25 and accompanying text (finding deferred income implicitly taxable under language of U.K. Treaty).

483. *See supra* notes 317-21 and accompanying text (discussing Congress' opinion that language of 1981 Treasury Model and existing treaties were consistent with I.R.C. § 864(c)(6)).

484. *See supra* note 328 and accompanying text (explaining that language of independent personal services article in German Treaty does not explicitly discuss taxation of deferred income).

485. *See supra* note 481 and accompanying text (indicating that language of Article 3 of Swiss Treaty does not refer to period in which income must be earned and recognized).

486. *See supra* notes 482-84 and accompanying text (showing deferred income is implicitly taxable under tax treaty language).

487. *See supra* note 481 and accompanying text (showing that Article 3 of Swiss Treaty only requires that Swiss enterprise have U.S. permanent establishment in order for United States to tax profits attributable to that permanent establishment).

488. *See supra* notes 243, 250 and accompanying text (discussing presumption that earlier treaty and later statute can be construed harmoniously); *see supra* notes 480-87 and accompanying text (showing Swiss Treaty can be construed as harmonious with I.R.C. § 864(c)(6)).

489. Swiss Treaty, *supra* note 31, art. 10, 2 U.S.T. at 1758, T.I.A.S. No. 2316, at 8. Article 10 of the Swiss Treaty states:

> (1) An individual resident of Switzerland shall be exempt from United States tax upon compensation for labor or personal services performed in the United States (including the practice of the liberal professions and rendition of services as director) if he is temporarily present in the United States for a period or periods not exceeding a total of 183 days during the *taxable year* and

allows for the application of Section 864(c)(6).[490] The term "taxable year" as used in Article 10 can be construed to indicate the year income is recognized, not the year personal services were performed.[491] Consequently, Article 10 should also be interpreted as consistent with Section 864(c)(6).[492] The United States should be able, therefore, to tax Swiss nonresident aliens on U.S. source deferred compensation.[493]

2. Despite TAMRA's Amendments to the Code, Section 864(c)(6) Does Not Override the Swiss Treaty

Under current law, U.S. courts invalidate tax treaties when Congress explicitly states an override provision in the statute or its legislative history.[494] To this end, TAMRA stated that certain provisions of TRA '86 prevailed over tax treaties.[495] Congress, however, adamantly expressed the view that TRA '86 overrode existing tax treaties, under the later-in-time rule.[496] Congress made these sweeping statements despite the lack of a residual override provision.[497]

TAMRA did not state an explicit override provision for Sec-

> either of the following conditions is met: (a) his compensation is received for such labor or personal services performed as an employee of, or under contract with, a resident or corporation or the entity of Switzerland, or (b) his compensation received for such labor or personal services does not exceed $10,000.

*Id.* (emphasis added).

490. *See supra* notes 481, 489 and accompanying text (quoting language of Articles 3 and 10).

491. *See* Swiss Treaty, *supra* note 31, art. 10, 2 U.S.T. at 1758, T.I.A.S. No. 2316, at 8 (discussing term "taxable year"); *see supra* notes 121-25 and accompanying text (showing Revenue Ruling 86-145 interpreted taxable year as year income was received); *see supra* notes 317-23 and accompanying text (discussing Treasury Department and Congress' view that language in existing treaties and 1981 Treaty Model incorporated I.R.C. § 864(c)(6)).

492. *See supra* notes 489-90 and accompanying text (indicating language of Article 10 and I.R.C. § 864(c)(6) can be harmonized).

493. *See supra* note 492 and accompanying text (interpreting Swiss Treaty and I.R.C. § 864(c)(6) as compatible).

494. *See supra* note 252 and accompanying text (stating explicit congressional intent necessary to override existing tax treaty provisions inconsistent with Code).

495. *See supra* notes 285-86 and accompanying text (discussing explicit override provisions in TAMRA).

496. *See supra* notes 279, 282-90 and accompanying text (showing Congress' view that TRA '86 prevailed over inconsistent provisions in existing tax treaties under later-in-time rule).

497. *See supra* notes 279, 287-89 and accompanying text (illustrating TAMRA did not incorporate residual later-in-time rule).

tion 864(c)(6).[498] Yet, if Section 864(c)(6) is incompatible with the Swiss Treaty, under Congress' view, the Code would prevail under the later-in-time rule.[499] After TAMRA, therefore, the relationship between Section 864(c)(6) and the Swiss Treaty, without an explicit override provision, is unclear given Congress' overall intent favoring treaty overrides.[500]

Sections 894(a) and 7852(d), codified as the later-in-time rule in TAMRA, should only apply to those Code provisions explicitly enumerated in TAMRA as overriding inconsistent treaty provisions.[501] If a court decides that the Swiss Treaty cannot be harmonized with Section 864(c)(6), it should find that the Swiss Treaty prevails over the Code.[502] Although the later-in-time rule mandates that courts support the latest expression of legislative will, courts should not abrogate existing treaty provisions without explicit congressional intent or statutory provision.[503] To do so would violate the constitutional principle of separation of powers which mandates that it is the duty of the court, not Congress, to interpret the relationship between tax treaties and the Code.[504] Thus, to preserve confidence in the U.S. commitment to honor its treaties[505] and the ability of the Treasury Department to negotiate future tax treaties,[506] existing treaties such as the Swiss Treaty should prevail over Section 864(c)(6) to the ex-

498. TAMRA, Pub. L. No. 100-647, § 1012(aa)(2), 102 Stat. at 3531-32; *see supra* notes 285-86 (describing explicit provisions in TAMRA for congressional override of existing treaty obligations).

499. *See supra* notes 279, 282-90 and accompanying text (indicating that Congress intended the Code to override inconsistent provisions in existing tax treaties).

500. *See supra* notes 498-97 and accompanying text (describing Congress' position on tax treaty overrides).

501. *See supra* notes 285-86 and accompanying text (describing express override provisions in TAMRA under later-in-time rule).

502. *See supra* note 252 and accompanying text (stating court will not invalidate tax treaty provision without explicit congressional override provision).

503. *See supra* notes 311-16 and accompanying text (discussing criticism of TAMRA's amendments altering relationship between tax treaties and Code).

504. *See supra* notes 245-52 and accompanying text (showing court's role is to interpret relationship between Code and tax treaties); *see supra* note 195 and accompanying text (discussing three branches of government in United States).

505. *See supra* notes 311-16 and accompanying text (describing criticism that United States violates tax treaty provisions).

506. *See supra* notes 217-20 and accompanying text (stating that Treasury Department first negotiates tax treaties with representatives of other countries); *see supra* notes 314-16 and accompanying text (noting that value of tax treaties decreases if other countries perceive that United States will not honor its commitments).

tent that conflicting provisions cannot be harmonized.[507]

Under TAMRA, therefore, Section 864(c)(6) should not supersede the Swiss Treaty.[508] Currently, TAMRA provides relief from U.S. taxation by explicitly stating that Section 864(c)(7),[509] a corollary of Section 864(c)(6), does not apply when its application would be inconsistent with existing treaty obligations.[510] TAMRA's treatment of Section 864(c)(7), a provision taxing deferred installment gains, supports the argument that the taxation of deferred income under Section 864(c)(6) does not supersede existing treaty provisions.[511]

### 3. Section 864(c)(6) Remains Harmonious with the Swiss Treaty After *Lindsey*

Section 864(c)(6), after TAMRA, is consistent with the Swiss Treaty, despite the holding in *Lindsey*.[512] *Lindsey* straightforwardly applied TAMRA's explicit provision for override of the AMT provisions of existing treaties.[513] Thus, the *Lindsey* court simply followed existing U.S. law by recognizing that the AMT provisions enacted by TRA '86 overrode clearly inconsistent provisions in the Swiss Treaty.[514]

The *Lindsey* decision, however, does not control the relationship between the Swiss Treaty and Section 864(c)(6).[515] First, Congress did not use language explicitly calling for Section 864(c)(6) to override conflicting provisions in existing tax treaties or specify a provision in TAMRA indicating a treaty over-

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507. *See supra* notes 503-06 and accompanying text (showing Swiss Treaty should not be abrogated by I.R.C. § 864(c)(6) if two are inconsistent).

508. *See supra* notes 503-06 and accompanying text (showing Swiss Treaty prevails over I.R.C. § 864(c)(6)).

509. *See* I.R.C. § 864(c)(7) (treating deferred gains from asset sales as effectively connected income).

510. *See supra* notes 291-93 and accompanying text (listing Code sections not enforceable under existing tax treaties despite later-in-time rule in TRA '86 and TAMRA).

511. *See supra* notes 291-93 and accompanying text (illustrating TAMRA's explicit rule that tax treaties prevail over I.R.C. § 864(c)(7)).

512. *See supra* notes 296-310 and accompanying text (discussing holding in *Lindsey*, 98 T.C. at 676-77 abrogating Swiss Treaty).

513. *See supra* notes 296-310 and accompanying text (illustrating straight-forward application of later-in-time rule in *Lindsey*, 98 T.C. at 672).

514. *See supra* notes 285-86 and accompanying text (showing TAMRA provided for explicit override of AMT provisions of existing tax treaties).

515. *See supra* notes 304-10 and accompanying text (holding in *Lindsey*, 98 T.C. at 676-77 was predicated on explicit congressional intent in TAMRA and inconsistent AMT provisions in Swiss Treaty).

ride.[516] The courts could not, therefore, automatically invalidate the provisions of the Swiss Treaty that were found to conflict with Section 864(c)(6).[517] In the absence of an intent to override, Section 864(c)(6) should yield to the Swiss Treaty provisions in the case of an irreconcilable conflict.[518] Second, the language of the Swiss Treaty can be construed as harmonious with Section 864(c)(6).[519] Unlike the AMT provisions at issue in *Lindsey*, Code provisions for taxing deferred income can be applied without abrogating the Swiss Treaty.[520]

### D. *Both Independent Contractors and Dependent Employees Should be Taxed on a Net Basis Under Section 864(c)(6)*

The Dutch Treaty explicitly provides for a net tax of the deferred income earned by an independent contractor.[521] The Dutch Treaty, moreover, should be interpreted to provide for a net tax under Section 864(c)(6) of both independent contractors and dependent employees.[522] The substantive economic distinctions between independent contractors and dependent employees do not support discriminatory treatment of dependent employees.[523] In addition, other tax policy considerations of fairness and administrative convenience support a uniform net tax of deferred compensation.[524] Finally, the language and legislative history of Section 864(c)(6) shows that it applies to all

516. *See supra* notes 286, 290 and accompanying text (indicating no explicit override provision in TAMRA for I.R.C. § 864(c)(6)).

517. *See supra* note 252 and accompanying text (requiring explicit Congressional intent under U.S. law to override tax treaties); *see supra* note 286 and accompanying text (stating TAMRA did not explicitly override I.R.C. § 864(c)(6)).

518. *See supra* notes 516-17 and accompanying text (stating Swiss Treaty prevails over I.R.C. § 864(c)(6) in case of irreconcilable conflict).

519. *See supra* notes 475-93 and accompanying text (demonstrating how language of Swiss Treaty is consistent with I.R.C. § 864(c)(6)).

520. *See supra* notes 475-93 and accompanying text (demonstrating how I.R.C. § 864(c)(6) and Swiss Treaty are harmonious).

521. *See supra* notes 390-99 and accompanying text (discussing provisions for net taxation under I.R.C. § 864(c)(6) in Dutch Treaty).

522. *See supra* notes 386-405 and accompanying text (discussing independent personal services and dependent personal services articles in Dutch Treaty).

523. *See supra* notes 344-69 and accompanying text (discussing factors distinguishing dependent employees from independent employees); *see supra* notes 186-91 and accompanying text (discussing how substance-over-form principle analyzes economic reality).

524. *See supra* notes 145, 182 and accompanying text (discussing tax policy goals of fairness and administrative convenience).

employees and is not overridden by the Dutch Treaty under the later-in-time rule.[525]

### 1. The Explicit Language of the Dutch Treaty Provides for a Net Tax of Independent Contractors

The Dutch Treaty provides for net taxation under Section 864(c)(6) by analogizing the taxation of deferred income in the independent personal services article to that in the business profits article.[526] Dutch independent contractors with fixed bases in the United States are taxed in a similar manner as Dutch businesses earning business profits attributable to permanent establishments.[527] Consequently, under the Dutch Treaty, nonresident aliens who are independent contractors with fixed bases may deduct related expenses when they receive deferred income.[528]

### 2. The Economic Reality of Deferred Compensation is the Same for Independent Contractors and Dependent Employees

In contrast to the independent personal services article, the dependent personal services article in the Dutch Treaty does not address the taxation of deferred compensation.[529] Under Section 864(c)(6), however, this income is considered effectively connected and subject to taxation.[530] This tax, moreover, should be computed on a net basis under the principles of the substance-over-form doctrine,[531] which evaluates a tax transac-

525. *See supra* notes 13, 163, 171 and accompanying text (showing that language and legislative history of I.R.C. § 864(c)(6) make no distinction between independent contractors and dependent employees); *see supra* notes 121-25 and accompanying text (taxing deferred compensation of nonresident alien who was dependent employee under Revenue Ruling 86-145).

526. *See supra* notes 390-94 and accompanying text (describing provisions for net taxation of deferred compensation in Dutch Treaty).

527. *See supra* notes 395-99 and accompanying text (discussing provisions in Article 24 of Dutch Treaty for net taxation of deferred compensation).

528. *See supra* notes 395-99 and accompanying text (discussing explicit provisions in Dutch Treaty for net taxation under I.R.C. § 864(c)(6)).

529. *See supra* note 405 and accompanying text (describing lack of discussion in Dutch Treaty concerning taxation of deferred income earned by dependent employees).

530. I.R.C. § 864(c)(6); *see supra* notes 121-25 and accompanying text (defining taxable year in existing treaty as year in which income was earned).

531. *See supra* notes 186-91 and accompanying text (describing substance-over-form principle in tax law).

tion in terms of the economic substance of what was accomplished.[532]

In substance, both dependent employees and independent contractors are in similar economic positions when they receive deferred compensation.[533] Although dependent employees can rely on their employers to incur the business expenses connected to running the enterprise,[534] independent contractors generally supply the materials needed to operate their businesses.[535] Thus, a nonresident alien who performed dependent personal services in the United States probably incurred fewer operating expenses than he would have had he been an independent contractor.[536] Economically, both independent contractors and dependent employees, however, have received compensation for services that were performed earlier in the United States and both probably incurred business expenses in connection with earning that income.[537]

The Dutch Treaty, however, only blunts the effect of Section 864(c)(6) for independent contractors.[538] Presumably, the Dutch Treaty's provision serves to prevent an independent contractor from paying taxes on artificially high gross income, which would not reflect his true economic gain.[539] Yet, the same ra-

532. *See supra* notes 187-88 and accompanying text (explaining that substance-over-form principle analyzes economic realities of transaction).

533. *See supra* notes 186-91 and accompanying text (discussing substance-over-form principle); *see supra* notes 344-69 and accompanying text (distinguishing independent contractors from dependent employees under U.S. law).

534. *See supra* notes 362-64 and accompanying text (explaining employer pays operating expenses of business for dependent employees).

535. *See supra* notes 357-60 (discussing investment in business as one factor typifying independent contractor status).

536. *See supra* notes 357-64 and accompanying text (stating independent contractors pay their own operating expenses while dependent employees do not incur such costs).

537. *See supra* notes 89-97 and accompanying text (discussing deductions available to nonresident aliens).

538. *See supra* notes 394-99 and accompanying text (demonstrating that Dutch Treaty allows independent contractors, under I.R.C. § 864(c)(6), to be taxed on net basis).

539. *See* I.R.C. § 61(a) (defining gross income); Dutch Treaty, *supra* note 29, art. 24, S. TREATY DOC. No. 6, at 50-51, 32 I.L.M. at 482-83 (providing for net taxation of deferred income attributable to permanent establishments and fixed bases); *see supra* notes 89-97 and accompanying text (discussing expenses nonresident aliens can deduct under Code).

tionale holds for dependent employees.[540] They, too, incur expenses related to their employment.[541] Moreover, under Section 871(b), such an employee would have been entitled to business deductions had he received current compensation.[542] The distinction between independent contractors and dependent employees should not require dependent employees to pay tax at a gross rate under Section 864(c)(6).[543] Additionally, U.S. law recognizes that distinguishing between the two types of workers is problematic.[544] A dependent employee should not be deprived of the deductibility of business-related deductions simply by deferring income.[545]

### 3. Tax Policy Considerations Promote a Net Tax of Deferred Income

Equitable principles call for net taxation under Section 864(c)(6)[546] because taxing dependent employees receiving deferred income differently from independent contractors is inconsistent and unfair.[547] Section 871(b) allows aliens with current compensation to deduct business-related expenses.[548] Were Section 864(c)(6) interpreted as a gross tax, therefore, the Code would penalize nonresident dependent employees receiving deferred compensation by preventing them from taking deductions related to that compensation.[549] Unfortunately, fairness

540. *See supra* note 363 and accompanying text (stating that dependent employees incur business expenses in connection with their employment).

541. *See supra* note 363 and accompanying text (stating that dependent employees can deduct ordinary and necessary business expenses).

542. I.R.C. § 871(b); *see supra* notes 89-97 and accompanying text (describing net tax of effectively connected income under I.R.C. § 871(b)).

543. *See supra* notes 344-69 and accompanying text (discussing independent contractors and employees under U.S. law).

544. *See supra* note 250 and accompanying text (stating that tax provisions generally incorporate domestic tax concepts without clear congressional intent to the contrary); *see supra* notes 365-69 and accompanying text (illustrating difficulty of distinguishing independent contractors from dependent employees).

545. *See supra* notes 186-91 and accompanying text (noting that under substance-over-form principle, economic reality of transaction should prevail).

546. *Cf. supra* notes 181-85 (discussing how equitable principles are generally of limited application in tax cases).

547. *See supra* notes 399, 405 and accompanying text (demonstrating that Dutch Treaty permits independent contractors to deduct deferred expenses under I.R.C. § 864(c)(6), but makes no such provision for dependent employees).

548. *See supra* notes 89-97 and accompanying text (describing deductions available to nonresident aliens).

549. *See supra* note 405 and accompanying text (indicating that no specific provi-

considerations, although acknowledged, usually play a very limited role in tax cases.[550]

Considerations of efficiency, in terms of administrative convenience, also mandate a uniform net tax under Section 864(c)(6).[551] The Treasury Department should not waste resources distinguishing between independent contractors and dependent employees.[552] Furthermore, concerns of administrative convenience should encourage the Treasury Department to allow dependent employees to deduct their deferred expenses.[553] The amount of lost revenue would be negligible; the Joint Committee on Taxation calculated that the new treatment of deferred compensation and gain under Sections 864(c)(6) and (7) would only generate US$5 million in 1987.[554] Greater efficiency would result from consistent taxation of deferred income as taxpayers would not attempt to characterize their employment in the more favorable category and the I.R.S. would not be obliged to expend resources to investigate their claims.[555] Therefore, the dependent services article in the Dutch Treaty and other recent treaties with similar language should be construed as entitling an individual to deduct related expenses when he receives deferred compensation.[556]

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sion was made for net taxation of Dutch dependent employees under I.R.C. § 864(c)(6)).

550. *See supra* notes 181-85 and accompanying text (indicating that under U.S. tax law fairness considerations are of limited application).

551. *See supra* notes 145, 182 and accompanying text (describing efficiency and administrative convenience as tax policy goals).

552. *See supra* note 4 and accompanying text (noting that Treasury Department is responsible for administering and enforcing Code); *see supra* notes 365-66 and accompanying text (describing difficulty of distinguishing between independent contractors and dependent employees under U.S. law).

553. *See supra* note 182 and accompanying text (indicating administrative convenience is consideration in tax law).

554. *See supra* note 147 and accompanying text (projecting combined revenues in 1987 from I.R.C. §§ 864(c)(6) and (7) at US$5 million); *see supra* note 207 and accompanying text (illustrating that personal services income is small percentage of total U.S. source income earned by aliens).

555. *See supra* note 182 and accompanying text (stating that tax policy goals include administrative convenience).

556. *See supra* notes 551-55 and accompanying text (illustrating dependent employees should be taxed on net basis).

### 4. The Language and Legislative History of Section 864(c)(6) Indicate a Net Tax

Dependent employees should be permitted to take deferred deductions based on the ambiguous language of Section 864(c)(6)[557] and the clear legislative intent in TAMRA.[558] Most other forms of effectively connected income are taxed on a net basis either under the Code or tax treaties.[559] The legislative history of both TRA '86 and TAMRA makes no distinction between the two types of employees.[560] In addition, independent contractors and dependent employees are treated similarly in other sections of the Code.[561] Finally, the Supreme Court has stated that ambiguous statutes must be decided in favor of the taxpayer.[562]

### 5. The Later-in-Time Rule Does Not Enable Dutch Dependent Employees to Seek a Treaty Exemption

Arguably, the Dutch Treaty, ratified after TRA '86 and TAMRA, overrides Section 864(c)(6) under the later-in-time rule.[563] Under this interpretation, Section 864(c)(6) would not apply to dependent employees because no specific provision was made in the Dutch Treaty for taxation of deferred compensation.[564] Textual silence in the Dutch Treaty, however, does not exempt dependent employees from paying tax under Section

557. *See supra* notes 429-43 and accompanying text (discussing unclear language of I.R.C. § 864(c)(6)).

558. *See supra* notes 460-64 and accompanying text (showing how TAMRA's amendment of I.R.C. § 864(c)(6) indicates net tax).

559. I.R.C. §§ 871(b), 882(a); *see supra* notes 395-99 (describing Dutch Treaty's mitigation of liability under I.R.C. § 864(c)(6) for independent contractors).

560. *See supra* notes 163, 171 and accompanying text (illustrating legislative history of TAMRA and TRA '86 did not limit I.R.C. § 864(c)(6)'s applicability).

561. *See supra* notes 67-68 and accompanying text (discussing how temporary stay exception in source rules applies to both independent contractors and employees under Treas. Reg. § 1.864-2(b)(2)(iii)).

562. *See supra* note 185 and accompanying text (discussing interpretation of ambiguous tax statutes).

563. *See supra* note 284 and accompanying text (stating how later-in-time rule provides that law last enacted prevails).

564. *See supra* note 405 and accompanying text (noting absence of specific provision for taxation of dependent employees under I.R.C. § 864(c)(6)). *But cf. supra* note 184 and accompanying text (stating textual silence in tax cases will never be sufficient to establish an exemption).

864(c)(6).[565] To the contrary, under U.S. law the Dutch Treaty must explicitly state that Section 864(c)(6) does not apply to dependent employees.[566]

Furthermore, Revenue Ruling 86-145 indicates Section 864(c)(6) applies to all employees.[567] The dependent personal services article of the U.K. Treaty, for example, does not address deferred income.[568] Nevertheless, under Revenue Ruling 86-145, a nonresident alien employee's deferred income was taxed under the language of the U.K. Treaty.[569] Revenue Ruling 86-145, codified in Section 864(c)(6), indicates that dependent employees are subject to tax on their U.S. source deferred compensation.[570] The interpretation of the term "taxable year" in the dependent personal services article of the Dutch Treaty can also be construed as the year in which income is received.[571] The Senate Foreign Relations Committee also did not distinguish between independent contractors and dependent employees when it relied on the treatment of dependent employees under Revenue Ruling 86-145 to support the taxation of independent contractors under Section 864(c)(6).[572]

In addition to the taxation of deferred income under Revenue Ruling 86-145, congressional committees have interpreted the language of the 1981 Treasury Model, which contains no express provisions for taxation of deferred compensation, as compatible with Section 864(c)(6).[573] The Joint Committee on Tax-

565. *See supra* notes 171, 184 and accompanying text (stating silence does not indicate anything more than silence).

566. *See supra* notes 171, 184 and accompanying text (discussing necessity of explicit language in tax treaty exempting income from tax imposed by Code).

567. *See supra* notes 121-25 and accompanying text (discussing Revenue Ruling 86-145's taxation of deferred income).

568. *See supra* notes 121-25 and accompanying text (indicating language of dependent personal services article in U.K. Treaty is silent regarding U.S. taxation of deferred income).

569. *See supra* notes 121-25 and accompanying text (taxing deferred compensation of nonresident alien under dependent personal services article in U.K. Treaty).

570. *See supra* notes 121-25 and accompanying text (discussing definition of term "taxable year" in existing treaty as permitting taxation of deferred compensation).

571. *See* Dutch Treaty, *supra* note 29, art. 16, S. TREATY DOC. NO. 6, at 39-40, 32 I.L.M. at 478 (using the term "taxable year"); *see supra* notes 121-25 and accompanying text (defining tax year as year income is received, not earned).

572. *See supra* note 323 and accompanying text (presenting Senate reports on recent treaties discussing I.R.C. § 864(c)(6) that relied on Revenue Ruling 86-145).

573. *See supra* notes 317-23 and accompanying text (noting that language in 1981 Treasury Model is consistent with I.R.C. § 864(c)(6)).

ation, for example, stated that the principles of Section 864(c)(6) were harmonious with the model treaties and did not need to be discussed explicitly.[574] The Dutch Treaty was based on the 1981 Treasury Model and the 1977 OECD Model.[575] Accordingly, dependent employees are taxed under Section 864(c)(6) because explicit treaty provisions for taxation are unnecessary for this Code section.[576]

## *CONCLUSION*

The language and legislative history of Section 864(c)(6) demonstrate a net, not gross, tax on deferred income. Accordingly, Section 864(c)(6) should be interpreted to tax deferred income on a net basis under the Dutch and Swiss Treaties. Considerations of fairness and efficiency also mandate that dependent employees be taxed on a net basis under Section 864(c)(6). Consequently, the Treasury Department should incorporate the net tax of deferred income in its new model tax treaty. Uniform and consistent treatment of Section 864(c)(6) will provide clearer guidelines for nonresident aliens and facilitate future treaty negotiations with other countries.

574. *See supra* note 319 and accompanying text (discussing Joint Committee on Taxation's opinion that I.R.C. § 864(c)(6) was harmonious with model treaties and existing treaties).

575. *See supra* note 81 and accompanying text (indicating that Dutch Treaty was based on 1977 OECD Model and 1981 Treasury Model).

576. *See supra* notes 567-75 and accompanying text (demonstrating that I.R.C. § 864(c)(6) applies to dependent employees under Dutch Treaty).