Office of Chief Counsel
Internal Revenue Service

memorandum

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to: Chief, Examination Division, New Jersey District

from: District Counsel, New Jersey District, Newark

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subject: **A.M.T. Foreign Tax Credit Limitation**
U.I.L. Nos. 7852.01-00; 59.01-00
This advisory replaces the advisory issued on August 11, 2000. Footnote 2 was added on page 6. The analysis and conclusion reached in the previous advisory are unchanged.

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ISSUE

Whether the Third Protocol to the U.S.-Canada Tax Treaty overrides the 90% limitation on alternative minimum tax foreign tax credits pursuant to section 59(a)(2)?
Conclusion: No.

FACTS

[redacted] ("taxpayer") reported a tax

liability of $[redacted] on its [redacted] tax return. Taxpayer's alternative minimum taxable income was approximately $[redacted] for the [redacted] taxable year resulting in an alternative minimum tax of $[redacted]. Taxpayer reported deemed paid foreign tax credits in excess of its alternative minimum tax liability. Section 59(a)(2) imposes a 90% limitation on alternative minimum tax foreign tax credits. Application of the 90% limitation would result in a tentative minimum tax of $[redacted].

ANALYSIS

A taxpayer is entitled to claim an "alternative minimum tax foreign tax credit" against its alternative minimum tax liability. The computation of the "alternative minimum tax foreign tax credit" differs from the regular foreign tax credit in two ways:

1) Under section 59 the "tax against which such credit is taken" equals the tentative minimum tax before reduction by the alternative minimum tax foreign tax credit. See section 59(a)(1)(A). In addition, section 904 applies based on "alternative minimum taxable income". See section 59(a)(1)(B).

2) The alternative minimum tax foreign tax credit shall not exceed the excess of the pre-credit tentative minimum tax over 10 percent of the tentative minimum tax before reduction by the alternative minimum tax foreign tax credit ("90% cap"). See section 59(a)(2)(A).

The purpose of the section 59(a)(2) 90% limitation is to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions and credits. See Lindsey v. Commissioner, 98 T.C. 672 (1992) citing S. Rept. 99-313, at 518 (1986), 1986-3 C.B. (Vol. 3) 518. The Senate Report provides,

> "A further change that the committee believes is necessary relates to the use of foreign tax credits by U.S. taxpayers to avoid all U.S. tax liability. Absent a special rule, a U.S. taxpayer with substantial economic income would be able to avoid all U.S. tax liability so long as all of its income was foreign source income and it paid foreign tax at the U.S. rate or above. While allowance of the foreign tax credit for minimum tax purposes generally is appropriate, the committee believes that taxpayers should not be permitted to use the credit to avoid all minimum tax liability. U.S. taxpayers generally derive benefits from the protection and applicability of U.S. law, and in some cases from

> services (such as defense) provided by the U.S. Government, even if all of such taxpayers' income is earned abroad. Thus, it is fair to request at least a nominal tax contribution from all U.S. taxpayers with substantial economic incomes." S. Rept. 99-313, at 520 (1986), 1986-3 C.B. (Vol. 3) 520.

Conflict Between I.R.C. and Treaty Provisions

The Supremacy Clause of the Constitution, Article VI, Section 2 provides, "this constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the authority of the United States, shall be the Supreme Law of the Land". When an act of Congress and a treaty relate to the same subject, the courts attempt to construe the provisions so as to give effect to both, without violating the language of each. It has been acknowledged that "the courts do not favor repudiation of an earlier treaty by implication and require clear indications that Congress, in enacting subsequent inconsistent legislation, meant to supercede the earlier treaty". See Rev. Rul. 80-223, 1980-2 C.B. 217 (Jan. 1, 1980). However, where a conflict is found to exist, it is well established that "the last expression of the sovereign will must control". See Chae Chan Ping v. United States, 130 U.S. 581, 600 (1889); Whitney v. Robertson, 124 U.S. 190, 194 (1888); United States v. Felter, 546 F.Supp. 1002 (D. Utah 1982), aff'd. 752 F.2d 1505 (10th Cir. 1985).

Section 7852(d) reiterates the principle of the Supremacy Clause by providing,

> "(1)[f]or 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. (2) No provision 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."

Section 7852(d)(2) was enacted by section 1012(aa)(1)(A) of the Technical and Miscellaneous Revenue Act of 1988. The legislative history of section 7852(d)(2) provides 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. Rept. 100-445 at 318 (1988). Congress specifically addressed in the legislative history of section 7852(d)(2)the conflict between

the 90% limitation on the alternative minimum tax foreign tax credit and prior treaties. Congress provided,

> "The bill codifies application of the later-in-time rule with respect to the following provisions of the 1986 Act, notwithstanding any treaty provision in effect on the date of enactment of the 1986 Act: section 1201 of the Act, amending the foreign tax credit limitation, and section 701 of the Act (as it relates to the limitation on the use of foreign tax credits against minimum tax liability)." S. Rept. 100-445 at 319.

Therefore, Congress intended that the 90% limitation imposed under section 59(a)(2) would prevail over an inconsistent Treaty provision enacted prior to section 59(a)(2).

In our facts, taxpayer argues that Article XXIX of the U.S.-Canada Treaty (as amended by the Third Protocol signed in August 1994) overrides section 59(a)(2). We need to address: 1) whether the U.S.-Canada Treaty provision is inconsistent with section 59(a)(2) and 2) if an inconsistency exists, which provision prevails under the later in time rule.

1) Whether an inconsistency exists.

Article XXIX(2) of the U.S.-Canada Tax Treaty (as amended by the third protocol) is commonly referred to as a "savings clause". The provision preserves for the United States the right to tax its residents and citizens on their world-wide income. See Tech. Explanation of U.S.-Canada Tax Treaty, Article XXIX(2). Article XXIX(3)(a) lists exceptions to the savings clause. Article XXIV (Elimination of Double Taxation) is one of the enumerated exceptions.[1] Therefore, the right of the U.S. to tax

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[1]Article XXIX of the U.S.-Canada Treaty (as amended by third protocol) provides, in part,

> 2. Except as provided in paragraph 3, nothing in the convention shall be construed as preventing a Contracting State from taxing its residents (as determined under Article IV (Residence)) and, in the case of the United States, its citizens...and companies electing to be treated as domestic corporations, as if there were no convention between the United States and Canada with respect to taxes on income and on capital.
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> 3. The provisions of paragraph 2 shall not affect the obligation undertaken by a Contracting State:

its citizens and residents is subject to the provisions of Article XXIV.

Taxpayer argues that the cross reference to Article XXIV in Article XXIX(3)(a) overrides the 90% limitation of section 59(a)(2). Article XXIV of the U.S.-Canada Treaty provides, in part,

> 1. In the case of the United States, subject to the provisions of paragraphs 4, 5 and 6, double taxation shall be avoided as follows: In accordance with the provisions and **subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof)**, the United States shall allow to a citizen or resident...as a credit against the United States tax on income the appropriate amount of income tax paid or accrued to Canada..." (emphasis added).

Article XXIV(1) incorporates the direct and deemed paid foreign tax credit provided by sections 901 and 902 of the I.R.C. In addition, the provision incorporates the limitations on foreign tax credits imposed by the I.R.C. (as they may be amended from time to time). The Technical Explanation of the U.S.-Canada Tax Treaty, Article XXIV(1) provides, in part, "thus, as is generally the case under U.S. income tax provisions, provisions such as Code sections 901(c), 904, 905, 907, 908, and 911 apply for purposes of computing the allowable credit under paragraph 1."

Limitations imposed on foreign tax credits pursuant to U.S. law are not inconsistent with treaties that contain the provision that foreign tax credits are subject to the limitations of U.S. law as may be amended from time to time. See Rev. Rul. 80-223, 1980-2 C.B. 217. Section 59(a)(2) is a limitation imposed by U.S. law on foreign tax credits. See Pekar v. Commissioner, 113 T.C., No. 12 (1999). Therefore, Article XXIV(1) incorporates the limitations of section 59(a)(2). As such, there is no inconsistency between section 59(a)(2) and Article XXIV of the U.S.-Canada Tax Treaty.

Taxpayer cites Jamieson v. Commissioner, 70 TCM 1372 (1995) as support for its position that the Third Protocol to the U.S.-Canada Tax Treaty conflicts with and overrides section 59(a)(2).

(a) Under...Article XXIV (Elimination of Double Taxation)...

Petitioners in Jamieson, nonresident U.S. citizens, earned income in Canada and paid Canadian taxes during the 1987 taxable year. Petitioners had an alternative minimum tax liability in the U.S. Respondent limited the alternative minium tax foreign tax credit to 90% pursuant to section 59(a)(2). Petitioners in Jamieson argued that the application of section 59(a)(2) violates articles XXIV(4)(b) and XXIX(2),(3) of the U.S.-Canada Tax Treaty. The Court cited Lindsey v. Commissioner, 98 T.C. 672 (1992), for the proposition that where a Treaty provision conflicts with section 59(a)(2), the later in time rule must control. The Court in Jamieson pointed out that the U.S.-Canada Treaty became effective August 16, 1984 and section 59(a)(2) was enacted during 1986. Therefore, since section 59(a)(2) was the last expression of the sovereign will, the Court held petitioners were subject to the 90% limitation of section 59(a)(2). Petitioners alternatively argued that the Third protocol to the U.S.-Canada Tax Treaty overrides section 59(a)(2). The Court pointed out that the protocol was not effective for the 1987 taxable year. Therefore, section 59(a)(2) remained the last expression of the sovereign will.

The Court in Jamieson assumed that a conflict existed between section 59(a)(2) and the U.S.-Canada Tax Treaty and disposed of the case pursuant to the later-time rule citing Lindsey.[2] The Treaty provisions contained in the U.S.-Canada Tax Treaty differ from the provisions in the U.S.-Swiss Confederation Treaty of 1951 at issue in Lindsey. The U.S.-Swiss Tax Treaty, unlike the U.S.-Canada Treaty, did not contain the language that the U.S. shall provide credits subject to U.S. limitations **as may be amended from time to time**. Article XV(1)(a)(Reciprocal Credit Provision) of the U.S.-Swiss Tax Treaty provides "the U.S. shall...subject to the provisions of section 131, Internal Revenue Code, **as in effect on the date of the entry into force of this convention...**". Section 59(a)(2) was not in effect as of the effective date of the U.S.-Swiss Treaty. Therefore, the Treaty did not incorporate the 90% limitation of section 59(a)(2) and a

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[2]Unlike our case, the petitioners in Jamison were individuals. Article XXIV paragraph 4 of the U.S.-Canada Tax Treaty provides that the United States shall allow to a U.S. citizen a credit against U.S. tax the income tax paid or accrued to Canada. The Court considered this language in concluding that a conflict existed between section 59(a)(2) and the U.S.-Canada Tax Treaty. Since our facts involve a U.S. corporation the provision is inapplicable. In cases involving U.S. citizens, it is the position of the Service that no conflict exists between the U.S-Canada Tax Treaty and section 59(a)(2), withstanding the language of paragraph 4 of Article XXIV.

conflict did exist between the Treaty and the later enacted section 59(a)(2). The U.S.-Canada Tax Treaty incorporates limitations on foreign tax credits imposed by U.S. law as amended from time to time regardless if enacted before or after the effective date of the Treaty. Therefore, unlike the U.S.-Swiss Tax Treaty, no conflict exists between section 59(a)(2) and the U.S.-Canada Treaty (as amended by the third protocol).

2) Assuming a conflict exists.

Assuming that a conflict exists, the Third Protocol of the U.S.-Canada Tax Treaty does not override section 59(a)(2). The Third Protocol to the U.S.-Canada Tax Treaty entered into force on November 9, 1995. The amendment to Article XXIX is effective for taxable years beginning on and after January 1, 1996. See Article 21(2) of Revised Protocol Amending the 1980 Tax Convention with Canada. Therefore, any amendment to Article XXIX which is inconsistent with section 59(a)(2)(enacted during 1986) would prevail under the later-in-time rule.

Article XXIX(3) of the Treaty contained the exact same language cross-referencing XXIV after the protocol as before the protocol. The purpose of the protocol to Article XXIX(3)(a) was to conform the cross references in the paragraph to changes in other parts of the Convention. See Tech. Explan. of the Protocol to the U.S.-Canada Tax Treaty, Article 17. In addition, the paragraph also added Article XXIX(B) to the exceptions to the savings clause. The protocol did not alter, in any way, the cross reference in Article XXIX(3) to Article XXIV. in addition, there is no indication in the technical explanation that the protocol was intended to override the impact of U.S. limitations on foreign tax credits claimed pursuant to the Tax Treaty. As such, the protocol did not impact the original Treaty provision of Article XXIX(3) with respect to the cross reference to Article XXIV. Therefore, in determining which prevails under the later in time rule, the focus should be on the original effective date of the Treaty, August 16, 1984. Since section 59(a)(2) was enacted after such date, it prevails.

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