



# TaxNewsFlash

## United States

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### **D.C. Circuit: Taxpayer's refund claim invoking treaty benefits allowed to proceed**

The U.S. Court of Appeals for the D.C. Circuit today reversed the federal district court's dismissal of the taxpayer's refund claim based on benefits under the income tax treaty with Switzerland.

The federal district court held the refund claim raised a "nonjusticiable political question" relating to the tax rate benefits available under the U.S. income tax treaty with Switzerland. The appeals court found that the lower court's understanding of the tax refund claim and this "political question doctrine" was incorrect, and remanded the case to the district court.

The case is: *Starr International, Inc. v. United States*, No. 17-5238 (D.C. Cir. December 7, 2018). Read the D.C. Circuit's [decision](#) [PDF 219 KB]

#### **Background**

The taxpayer (a privately held parent company to various insurance and financial businesses) established its tax residence in Switzerland in 2006. The taxpayer then sought to pay a reduced tax rate under the United States-Switzerland income tax treaty. Because the taxpayer did not automatically qualify for treaty benefits, it relied on Article 22(6) of the treaty—a provision that allows for discretionary tax relief as follows:

*A person that is not [otherwise] entitled to the benefits of this Convention . . . may, nevertheless, be granted the benefits of the Convention if the competent authority of the State in which the income arises so determines after consultation with the competent authority of the other Contracting State.*

The U.S. Treasury Department's "technical explanation" of the United States-Switzerland income tax treaty provides that a Swiss taxpayer will be denied relief

under Article 22(6) if the U.S. Competent Authority determines that obtaining benefits under the treaty was one of the taxpayer's "principal purposes" in establishing itself in Switzerland.

The taxpayer sought discretionary relief from the U.S. Competent Authority (the IRS Deputy Commissioner for the Large Business and International Division) for the 2007 tax year. The U.S. Competent Authority denied this request after concluding that obtaining treaty benefits was a principal purpose of the taxpayer's move to Switzerland.

The taxpayer then filed a refund claim for approximately \$38 million in taxes with the IRS. The taxpayer asserted this amount of tax had been improperly withheld. When that refund claim was denied, the taxpayer filed suit in federal district court, alleging that the IRS erred in denying the taxpayer the tax treaty benefits.

The federal district court dismissed the tax refund claim on the ground that it raised a nonjusticiable political question.

The taxpayer then amended its complaint to bring a claim under the Administrative Procedure Act (APA), challenging the IRS's denial of treaty benefits as arbitrary and capricious. The district court granted the government's motion for summary judgment on the APA claim. It held that the IRS had reasonably interpreted and applied the tax treaty measures in denying the refund.

## **D.C. Circuit**

On appeal, the taxpayer claimed that the IRS had misinterpreted and misapplied Article 22(6) and the Treasury technical explanation's "principal purpose" test, and asserted that the tax refund claim did not raise a political question.

The D.C. Circuit generally agreed with this argument, and reversed the portion of the district court's decision dismissing the tax refund claim as raising a nonjusticiable political question.

The D.C. Circuit held that the district court's understanding of the taxpayer's refund claim and the political question doctrine was incorrect. The appeals court explained that whether the IRS had properly found that the taxpayer was ineligible for treaty benefits under Article 22(6) did not raise a political question. This determination did not, as the appeals court noted, grant the taxpayer the right to review the consultation between the U.S. and Swiss authorities. Rather, as the court found, the consultation would be just one element of the IRS's deliberative process, and the taxpayer would have no right to challenge the consultation itself.

The D.C. Circuit thus reversed the district court, and remanded the case so that the taxpayer could proceed with its tax refund claim.

Because the D.C. Circuit held that the taxpayer could proceed with its tax refund claim, it further held that the taxpayer did not have a cause of action under the APA, and thus vacated the district court's decision granting summary judgment for the government on the taxpayer's APA claim and remand with instructions to dismiss that claim.

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