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# T 19/5 TAX CONVENTION WITH THAILAND

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HEARINGS  
BEFORE THE  
SUBCOMMITTEE OF THE  
COMMITTEE ON FOREIGN RELATIONS  
UNITED STATES SENATE  
EIGHTY-NINTH CONGRESS  
FIRST SESSION  
ON  
EXECUTIVE E, 89TH CONGRESS, 1ST SESSION  
INCOME-TAX CONVENTION WITH THAILAND

AUGUST 11, 13, 16, 18, AND 25, 1965

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TAX COMMISSION WITH THAILAND

HEARINGS

OF THE

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON FOREIGN RELATIONS

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## TAX CONVENTION WITH THAILAND

WEDNESDAY, AUGUST 11, 1965

UNITED STATES SENATE,  
SUBCOMMITTEE OF THE  
COMMITTEE ON FOREIGN RELATIONS,  
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10 a.m., in room 4221, New Senate Office Building, Senator Albert Gore presiding.

Present: Senators Gore, Long and Pell.

Senator GORE. The subcommittee will come to order.

The subcommittee is called into session this morning to consider the tax convention between the United States and the Kingdom of Thailand. (See appendix.)

Senator GORE. The convention with Thailand is one of a contemplated series of income tax conventions which the administration expects to conclude with a number of developing countries.

Although the pending treaty was patterned after tax conventions presently in force between the United States and other countries, it does contain several unique provisions which I believe require careful study by the Subcommittee on Tax Conventions.

### SCOPE OF PROVISIONS

For example, under the provisions of article 5 of the convention, U.S. residents and corporations investing in certain Thai enterprises would be entitled to claim as a credit against the U.S. income tax 7 percent of their investment in such enterprises.

Another provision, which is new insofar as existing tax conventions are concerned, is set forth in article 6. It provides that U.S. residents and corporations may elect to defer tax on income resulting from the transfer of property, technical services or know-how to a Thai corporation in exchange for its stock. The tax thus deferred may be imposed when the stock is eventually disposed of.

The convention also contains a provision dealing with charitable contributions which would allow U.S. citizens, residents, or corporations, to deduct from their income subject to American taxes, contributions made to certain charitable organizations in Thailand.

The only other of our tax conventions with similar provisions are, I believe, those with Canada and Honduras.

There are also important permanent establishment rules set forth in this convention.

Since this Thai convention contains provisions not found in tax treaties now in force, particularly the investment credit device for reducing directly U.S. taxes on U.S. taxpayers on income earned in the United States, it should be considered very thoroughly prior to seeking Senate advice and consent to its ratification.

A device somewhat similar in its effect, the so-called tax sparing provision, first presented to the Senate in the Pakistan Treaty negotiated in 1957, was never approved by the Senate.

#### ERA OF LEGISLATING BY TREATY

In my view the Senate must proceed with utmost caution in approving any treaty which is legislative in nature. Generally speaking, I am disposed to consent to ratification of a treaty unless there are good and sufficient reasons for not doing so. This is particularly true of a treaty which is reciprocal in nature and which has as its central purpose a bargain between or among governments. We have in fairly recent years entered a new era in treaty-making. Now, we often do not strike bargains with other governments so much as we state a rule of law. And in the United States, this automatically has the effect of an internal law.

This process of legislating via treaty requires careful examination. If the treaty-making process is to continue to serve us well, we must make doubly sure that these legislative treaties are well understood. We must be sure of public confidence, knowledge, and consent.

I expect, therefore, to hold several hearings on the convention with Thailand, as well as the other tax treaties pending before the Committee on Foreign Relations, or such other treaties as the President may subsequently submit to the Senate on this general subject.

Our first witness this morning is Mr. Solomon of the State Department.

#### STATEMENT OF ANTHONY M. SOLOMON, ASSISTANT SECRETARY OF STATE FOR ECONOMIC AFFAIRS; ACCOMPANIED BY LAURENCE G. PICKERING, OFFICER IN CHARGE, THAI AFFAIRS; AND VERNON G. SETSER, ADVISER, OFFICE OF INTERNATIONAL TRADE

Mr. SOLOMON. Thank you, Mr. Chairman.

I am appearing before the subcommittee in support of the convention between the United States and Thailand for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed March 1, 1965 (Executive E, 89th Cong., 1st sess.).

#### TAX TREATIES AND INTERNATIONAL TRADE AND INVESTMENT

The Department of State considers that agreements for the avoidance of double taxation serve to encourage and support the growth of international trade and investment. Income-tax agreements can help to bring about desirable adjustments in national tax systems. They reduce or eliminate conflicts between tax policies. And they establish a considerable degree of stability and certainty in tax matters. Our business community is for similar reasons very much interested in expanding our network of 22 tax conventions that we already have. In addition, through the tax-treaty vehicle, a host of possible discriminations, both national and individual, and irritants to the relationships between the United States and friendly countries such as Thailand

can be avoided, as for example, in the case of persons participating in cultural activities or in Government programs in each other's territories.

A major weakness in our tax-treaty program has been our inability to make progress in negotiations with less developed countries. Only two of our existing conventions are with less developed countries, and in the case of one of these our treaty partner has given notice of intention to terminate. This arises from the one-way flow of investment income between the less developed country and the United States, and consequently the tendency of the less developed country to feel that it has little to gain from a treaty which, among other matters, restricts taxation at the source of income.

At the same time, a major goal of our foreign policy is, of course, to bring about more rapid economic development in the less developed countries. We provide aid for this purpose from public funds, both bilaterally and through multilateral institutions. We also seek to encourage private investment, through such means as investment guarantees and general commercial treaties. As American private investment increases in the less developed countries, and as more Americans take up temporary residence there, international tax agreements become more and more necessary.

The extension of tax-treaty benefits to American investors and businessmen in less developed countries, and reinforcement by means of tax agreements of our policy of promoting economic development, requires some changes in the character of the agreements. Essentially, we need to provide through tax agreements a further encouragement of the private investment that is essential to the development process in these countries.

The convention with Thailand which is before the subcommittee includes such a recognition. Specifically, it does two things. First, it provides for limitations compatible with investment abroad in Thailand's ability to tax income remitted out of the country. Second, it gives American investors in Thailand a 7-percent tax credit, comparable to the tax credit on domestic investment, on that portion of their investments which is represented by the provision of American goods and services. I will leave to the Treasury officers present today the task of giving a technical evaluation of these new clauses. I do wish to say, however, that the Department of State strongly supports these innovations as being in the foreign policy interests of the United States.

#### POLITICAL ASPECTS OF TAX TREATIES

While it was largely a matter of chance that Thailand is the first country with which this new type of treaty has been negotiated, there are substantial foreign policy reasons for applying the new approach to that country and which are to the political interest of the United States. Thailand is a country of relative stability in the troubled region of southeast Asia. Nevertheless, its border areas already are subject to Communist subversion and there is little doubt that any domestic unrest will be seized upon by Communist forces to put pressure on the independent Government of Thailand. Thailand's ability to maintain its independence depends in considerable measure upon the continuing growth of the Thai economy.

Thailand has not relied solely on the United States to solve its problems. It has adopted effective measures of self-help. Although its policy of promoting economic development has drawn the Government directly into a number of economic activities, Thailand is mainly a free-enterprise society. The Industrial Investment Promotion Act of 1962 was adopted to attract foreign investment and to encourage domestic investment by providing special facilities and assurances for investments in specified industries. These include exemptions from certain taxes and customs duties, assurances about the withdrawal of capital and earnings, liberalized admission of foreign technicians, and assurances against the nationalization of private property and competition from publicly owned enterprises. A commercial treaty between the United States and Thailand, concluded in 1937, provides additional guarantees of fair treatment for American investment and trade, and against the nationalization of private property without fair compensation.

While U.S. investment in Thailand is not as great as in many countries, it has been steadily growing under the measures of encouragement provided by the Thai and United States Governments. A considerable number of American companies have established subsidiaries and have built plants there. Fields of investment activity include automobile assembly, oil refining, banking, the construction and operation of hotels, and the manufacture of pharmaceuticals, automobile and truck tires, reconstituted milk and milk products, metal products, sewing machines, soft drinks, soap, and storage batteries.

We believe that the convention now before the subcommittee will help to decide additional private American investors in favor of investment in Thailand. There has been a good deal of interest in investment possibilities there, as reflected in business surveys and tentative business plans. The new agreement should bring many of these projects to realization.

As the subcommittee knows, there has been some concern about capital outflows on account of our balance-of-payments deficit. I should like to point out, in relation to the subject of new American private investment in Thailand, that this concern is not much of a factor since the steady increase in Thailand's foreign exchange reserves since 1959 has been voluntarily held by the Thais in U.S. dollars.

There is no need, Mr. Chairman, for me to prolong my general statement regarding the convention with Thailand. The Department of State considers its ratification to be in the political and economic interest of the United States. I hope that you and your colleagues will report favorably upon it to the full committee. As the subcommittee is aware, there are also tax treaties with Israel and the Philippines now awaiting its consideration, and it is hoped that such treaties can be negotiated, on a selective basis, with other friendly less developed countries where such treaties appear appropriate. If you have any questions of a general nature, I shall endeavor to answer them. On technical and fiscal aspects, I shall defer to Assistant Secretary Surrey and his colleagues.

Thank you, Mr. Chairman.

## GENESIS OF THE TREATY

Senator GORE. Would you enlighten the committee as to the genesis of the proposed treaty?

Mr. SOLOMON. Mr. Chairman, in general, the Department has been anxious to conclude tax treaties, to avoid double taxation, and to clarify the rules, so to speak, under which business concerns operating here and our businessmen operating abroad can operate generally.

We have concluded in the past, as you know, approximately 22 tax conventions, mostly with developed countries. It is our hope that we can continue this process and expand our network of conventions with less developed countries as well. I think this is part of a general process of trying to rationalize international tax matters, and attempts to reduce the irritants that we frequently find in relations with friendly countries when we do have a tax treaty of a reciprocal nature.

Senator GORE. Since the proposed treaty with Thailand is in some, but not in all respects, typical of the general pattern that is sought, it is my purpose in taking this one up first to examine it and the innovations proposed therein thoroughly.

With respect to this specific treaty, did the suggestion for its negotiation originate with the Department of State, with the Department of the Treasury, or with what you describe as our business community?

Mr. SOLOMON. Well, I can answer only in a general sense, since I am new to the Department. But it is my understanding that this reflects a general policy. I am informed that there were negotiations several years ago by Treasury. But I think the basic answer to this is that since we think of it as a general policy, we are willing to encourage the beginning of these negotiations with selected countries wherever it is appropriate. I think that the fact that these three happen to be coming up is a matter of coincidence, and results from the fact that the negotiations had been concluded here first.

I understand there has been a negotiation just concluded, or tentatively concluded, with the Government of India. And since we think of this as an expanding policy, it is one that the Department of State is actively encouraging.

Senator GORE. I notice you say that you cannot give specific information because you are new to the Economic Division.

When did you assume your duties?

Mr. SOLOMON. Approximately 2 months ago, Mr. Chairman.

Senator GORE. Then you came after this treaty was negotiated and signed.

Mr. SOLOMON. Well, I am sorry—I am not familiar with the genesis of who initiated the negotiations. But I think it fair to say that the Department of State actively supports them, that the Department would be perfectly willing to assume that this was a matter initiated by interagency consultation.

Senator GORE. Mr. Solomon, I am always pleased to have any information you can offer, but unless you are prepared to answer questions with respect to the pending treaty, I shall ask the Department to send someone before the committee who is so prepared.

Mr. SOLOMON. Well, may I check—you wish to know, Mr. Chairman, as to where the specific suggestion initiated as to the negotiation and conclusion of a tax treaty with Thailand?

Senator GORE. That is one of the specific questions I have in mind with respect to the pending treaty. We are gathered today to consider the pending treaty in detail.

Who was head of the Economic Division at the time the treaty was negotiated and signed?

Mr. SOLOMON. When the negotiations were started, Assistant Secretary Johnson. Now, Assistant Secretary Surrey, I think, could tell you, since he was in charge of negotiations, as to exactly where the specific initiation arose.

Senator GORE. I appreciate the limitations under which you appear, and I certainly do not wish in any way to be unpleasant with you—quite the contrary. I appreciate the information you have given, and the study you have devoted to the subject in the 60 days you have been in your present position.

I suppose unless you have an alternative suggestion, it would appear to me to be the course of wisdom to submit to you specific questions with respect to the pending treaty to which answers from the Department of State would be requested. Then from the records in the Department and from your predecessors perhaps the answers could be obtained.

Do you have an alternative suggestion to that?

Mr. SOLOMON. I would be glad to answer any questions, Mr. Chairman, by looking at Department records which I am not able to answer today. I believe that the only question that you made which I have not been able to answer is as to where the specific idea initiated, whether it was with the State Department or the Treasury or with the business community, for this treaty.

Senator GORE. That is the only question I have asked.

I would have a question as to whether the Department of State had suggested the investment credit, or whether this suggestion originated in the Treasury, the business community, or in Thailand.

Mr. SOLOMON. It originated originally in the Agency for International Development, which is within the State Department. This idea has been discussed, the idea of a credit on investment abroad, to be used by the U.S. parent organization, or parent corporation, in its U.S. income taxes. This has long been discussed and studied in the Agency for International Development. And it has been felt that it would be a definite contribution to our objective to increase the flow of the U.S. investments to less developed countries. The adaptation of the idea for use in tax treaties—that is, the 7-percent credit proposal has been worked out primarily by the Treasury officials.

Senator GORE. Suppose I proceed with some questions and you supply such answers as you are qualified to submit, and then I will submit further questions in writing as to specifics.

#### RECORD OF PREVIOUS TAX TREATIES

What has been our experience to date with tax treaties between our country and less developed countries? Has the treaty with Pakistan been satisfactory?

Mr. SOLOMON. Our experience in what sense, Mr. Chairman? Do you mean in general? We have found in the case of Honduras that Honduras is not satisfied with the nature of the treaty that was negotiated. We believe the Pakistan Government is reasonably satisfied.

But I think Assistant Secretary Surrey can answer that in more detail than I can.

We have only had these two experiences: Honduras and Pakistan. This is really a new field we are venturing into.

Senator GORE. What benefits have accrued to the United States, in the opinion of the State Department, from the tax treaty with Pakistan?

Mr. SOLOMON. I am sorry—I will have to answer that after checking with the Department.

Senator GORE. I submit the same question with respect to the tax treaty with Honduras.

Mr. SOLOMON. In both those treaties there was, as you know, no tax credit. The general objectives that were sought there, which were to create a reciprocal arrangement, which would limit the taxation at its source, and which would therefore create rules whereby the U.S. investors in those countries would benefit from knowing under what conditions they were operating—and would provide a forum in which individual cases could be taken up between the two Governments—those general objectives I believe have been achieved.

The fact that the Honduras Government—

Senator GORE. What general objective has been achieved?

Mr. SOLOMON. The general objective of creating a set of provisions whereby the U.S. business community, investing in Pakistan and Honduras, is aware and is certain of what taxes it will have to pay, it is protected against assessments on earnings outside of those countries, because of some special interpretation by Pakistan or Honduras tax authorities. It does limit the amount of taxation at source by those Governments. These treaties—the provisions of those treaties have been implemented and to the best of my knowledge—and have therefore achieved those objectives.

Whether the treaties have resulted, however, in a greater flow of U.S. investment to Pakistan and Honduras I do not think anybody would be able to give you a definitive answer.

Senator GORE. You have cited as a benefit, generally speaking, a decrease in taxes on U.S. investors in Pakistan and Honduras. What are the benefits, reciprocal or otherwise, of a government-to-government nature?

#### ADVANTAGES OF TAX TREATIES

Mr. SOLOMON. There are many advantages in the area of government-to-government relations in having a clear understanding put down in treaty form of what taxation is permissible by one party and the nationals of the other party operating businesses or earning income in their country.

Not only does this tend to reduce the number of friction cases that arise—

Senator GORE. The number of what kind of cases?

Mr. SOLOMON. Friction cases—on which the U.S. embassy is asked to intervene. But even if the question of interpretation arises, since these treaties provide for consultation between the two Governments in a prescribed framework, it makes much simpler, Mr. Chairman, the amicable solution of these problems that do tend to arise from time to time on the question of interpretation.

## TREATIES WITH HONDURAS AND PAKISTAN

Senator GORE. Does the Department of State have detailed information as to the operation of the treaties with Honduras and Pakistan?

Mr. SOLOMON. I cannot answer that Mr. Chairman. I believe Treasury would have more detailed information. But I can check with my people and submit that for the record.

(The Department of State subsequently submitted the following statement:)

The only information that the Department of State normally receives with respect to the operation of tax treaties would be in the form of complaints by American citizens or business enterprises raising questions as to the applicability of the treaties to their problems, or communications from one or the other Government making representations in the interest of its nationals or responding to such representations, or dealing with proposed changes in the treaties. In the case of both Honduras and Pakistan, there is little information available regarding operation of the treaty.

The Honduras treaty has been in force only since 1957, and the Pakistan treaty only since 1959. As concerns Honduras, there appear to have been no significant complaints under the treaty by nationals of either country. That American businessmen consider it beneficial is shown by the fact that a number have expressed serious concern at the announcement that it is to be terminated, and urged action by the U.S. Government to continue it in effect. The Government of Honduras expressed dissatisfaction with it as early as 1960, however, and has been pressing from time to time since for its revision so as to check the alleged revenue loss by Honduras, and to provide greater encouragement for foreign investment there.

In the case of Pakistan, there have been two or three cases within the last 2 years in which the possibility of contravention of the treaty has been raised, and these are still under consideration by the two Governments. The Pakistan convention originally contained a "tax-sparing" provision which was nullified by a Senate reservation. The Pakistan Government has been dissatisfied with the convention's lack of positive terms for encouraging private investment, and has indicated its wish to undertake negotiations for a revision that would remedy this lack and perhaps modify the convention in other ways.

The advantages for the United States in both the Honduras and Pakistan treaties consist mainly of the general ones of removing irritants, providing American business with assurances of stability and certainty in tax matters, and contributing in a modest way to the U.S. objective of encouraging private investment for economic development in the two countries.

Senator GORE. Have you recently received notice from the Government of Honduras of that country's intention to withdraw from the treaty?

Mr. SOLOMON. Yes; effective as of January 1966 the treaty will be canceled.

Senator GORE. Why, in the view of the Government of Honduras, as stated to the Government of the United States, is Honduras taking this step?

Mr. SOLOMON. The Government of Honduras feels that the treaty provided in effect only substantive concessions to the United States—what is of substantive value to the United States and not to the Honduran Government, because the limitations on the Honduran Government to tax income at source in Honduras were quite severe from their point of view, in their hindsight judgment, and because of that, they have expressed the hope that they can renegotiate a new treaty which would be less restrictive on their ability to tax income at source.

Senator GORE. Does the Honduran Government maintain this treaty to be beneficial to the investor or to the U.S. Government, or do they consider the two the same?

Mr. SOLOMON. Sir, I did not hear that.

Senator GORE. Does the Honduran Government maintain that the treaty has benefited the U.S. Government or the U.S. company or citizens who have invested in Honduran development?

Mr. SOLOMON. They would maintain by restricting too severely the taxation at source it has benefited the U.S. Government, because that would mean a larger differential paid into the U.S. Treasury. This is my understanding.

Senator GORE. Has the treaty had that effect?

Mr. SOLOMON. Yes. To the extent that the Honduran Government does not tax, for example, any interest remitted, then this is a smaller tax credit, foreign tax credit, that the U.S. company can use against its U.S. income tax, and therefore the payments to the U.S. Treasury are larger.

Senator GORE. How much do the payments to the U.S. Treasury amount to on an annual basis?

Mr. SOLOMON. I do not know, Mr. Chairman. I think Mr. Surrey may be able to answer that.

#### TREATIES WITH GREECE AND FINLAND

Senator GORE. We have a treaty with Greece and also one with Finland. How do they differ from the proposed treaty with Thailand?

Mr. SOLOMON. The treaties with Greece and Finland do not include the investment credit of 7 percent. I understand that they follow the more or less general form that our treaties with fully developed countries have.

Greece and Finland are in that borderline area—questionable whether they are treated as less developed countries or developed countries. I believe in the tax treaties that have been concluded, the form there, the general pattern was the same as that followed for the countries of Western Europe and other advanced countries.

Senator GORE. Then, as I understand your statement, the treaties with Greece and Finland follow rather generally the pattern of treaties with developed countries rather than treaties with underdeveloped countries.

Mr. SOLOMON. That is my understanding, sir.

Senator GORE. So the two treaties with Greece and Finland would not be of particularly exemplary value in considering the pending treaty?

Mr. SOLOMON. I am not familiar with the details, but certainly insofar as the treaties' failure to provide any tax credit, they would not be a relevant precedent.

#### CREDIT FOR CHARITABLE CONTRIBUTIONS

Senator GORE. Do the treaties contain the provision that the U.S. taxpayer is given credit against his U.S. taxes for contributions to so-called charitable institutions in Greece or Finland?

Mr. SOLOMON. I do not believe they do, sir. The charitable provisions, I believe, are only in the Honduras treaty—that is the first treaty that was put in; and Canada, also—Honduras and Canada.

Senator GORE. We will want to examine the experience of the Canadians and Hondurans with this so-called charitable provision. As you know, that has been the subject of a great deal of abuse within

our own country. We will want to examine to what extent it has been abused in the foreign country and to what extent the U.S. Government can examine—police, so to speak—the contributions to and activities of organizations to which deductible contributions are made.

We have found the charitable provision a difficult subject to administer within our own country. I am not sure that it is administratively feasible with respect to charitable contributions to organizations which may or may not remain the same in form in foreign countries.

This is a subject, however, that I think will need to be taken up with Treasury rather than State.

I gathered from your prepared statement and your answers that the pending treaty with Thailand initiates a new series of treaties containing new provisions and new principles of taxation, having effect on both international and domestic tax laws.

Is that a correct statement?

Mr. SOLOMON. Under domestic tax laws of Thailand, yes.

Senator GORE. Also on domestic tax law of the United States, isn't that correct?

Mr. SOLOMON. Well, I am not competent to answer that, Mr. Chairman. I do not see how it affects—you know laterally we do recognize foreign tax credit. I understand that this treaty does not change our existing custom, our existing practice. There may be certain minor changes which I am not aware of.

Senator GORE. Foreign tax credit is not a matter of treaty. That is a matter of statutory law.

Mr. SOLOMON. Correct.

Senator GORE. You don't really wish to question whether this treaty would have an effect on domestic tax law, do you?

Mr. SOLOMON. You mean that insofar as the 7 percent credit represents a change in the U.S. taxpayer's responsibility to the U.S. Treasury, yes, it does change domestic tax law in that respect. I thought you were talking about it in a larger sense.

Senator GORE. I am speaking of it in a larger sense. That is a specific example, but there are several specifics in which the same general principle is true, for instance, the deduction for contributions to an organization in a foreign country that is said to be charitable, and also the deferral of taxes on income in the form of stock acquired in a Thailand corporation in exchange for patent rights or other valuable assets that are transferred.

Mr. SOLOMON. I interpreted your word "domestic" more narrowly, Mr. Chairman. You are right. I thought you meant did this introduce changes in our domestic tax law under domestically earned income. But in the sense in which you are speaking, certainly that is true, yes.

Senator GORE. Does the change affect the U.S. tax law with respect to domestically earned income in the United States—that is, income earned in the United States?

Mr. SOLOMON. No; except in the sense that I mentioned above. Obviously, any tax treaty that involves limitations of taxation at source or includes new provisions like the tax credit on investment will affect the amounts of domestic revenue entering the U.S. Treasury.

Senator GORE. I think you had better reread it.

I don't want to take up too much time. Senator Long?

## CREDIT ON INVESTMENTS

Senator LONG. The new feature you have in this treaty is that you propose to give a company 7-percent tax credit on what they invest in certain less-developed countries. Is that the idea?

Mr. SOLOMON. On U.S. investment in those countries; yes, sir.

Senator LONG. Suppose I am General Motors. If I go over there and I invest a million dollars in Thailand, I would get a 7-percent credit against the tax that I would owe this year to the U.S. Government. Is that the idea?

Mr. SOLOMON. That is correct, to the extent that the 7 percent is represented by U.S. goods and services.

Senator LONG. Yes, I understand.

So to the extent that I ship American machinery, American services overseas, I get credit for that amount invested in Thailand.

Is the Department going to recommend that we do this for Germany?

Mr. SOLOMON. No, sir. The Department already has tax treaties concluded with virtually all the advanced countries in the world. This tax credit is just with certain selected less-developed countries.

Senator LONG. In other words, you want to use this 7-percent tax credit to encourage American investment to go into less-developed countries because you think it is in our national interest that American investment should go there?

Mr. SOLOMON. Yes, sir; and this is particularly true where we have aid programs, because we have found that maximizing the flow of private investment tends to help us achieve our development objectives in those countries, and is a more effective way of transmitting resources than public sector loans from the AID program. Those are legitimate, where we are talking about large infrastructure power projects and highway projects. But we really cannot get successful development in these countries unless there is investment in the manufacturing sector primarily, and this involves know-how, technology, managerial ability and everything else that goes with the private investment process.

Senator LONG. Some of our friends are worried about the idea of setting up textile mills in less developed countries which will then compete with American products in the United States. What is your opinion on this?

Mr. SOLOMON. On the textile problem, we have a long-term textile arrangement, multilaterally concluded, under which we have negotiated restraint levels, levels on the quantity, types and categories of textile exports to the United States. So I feel that this is not—

Senator GORE. May I interrupt? Would you tell us if this arrangement applies to manmade fibers as well as natural-grown fibers?

Senator LONG. What is your answer to that question?

Mr. SOLOMON. The long-term textile agreement applies only to cotton textiles. We are now attempting to investigate further possibility of a multilateral agreement on wool textiles—as Senator Pell knows.

Senator LONG. My reaction to that is as far as our textile-producing friends are concerned, we would be out of business now if we were not limiting imports from Japan, Hong Kong, and other areas. In other words, our textile manufacturers are already subject to competition from developed areas, such as Japan, from which American producers

need protection. It seems to me that what you are trying to do is to encourage investments in less developed countries, where you think you want American capital to help make our system of government prevail, and where you think those investments would be desirable and in our interest and theirs.

I take it you are going to have a treaty with regard to Israel.

Mr. SOLOMON. Israel and the Philippines.

Senator LONG. Do you hope to reduce your request for foreign aid by this approach?

#### EFFECT OF TAX TREATY ON FOREIGN AID

Mr. SOLOMON. We hope that we will get either a reduction in the need for aid funds, or a faster rate of development, which is, in effect, making more effective use of the funds that we have.

In the case of Thailand, Senator Long—about promoting not only the development process, but promoting it in the kind of society that we would hope to see prosper in Thailand—I think it is a particularly interesting situation. The Thai Government reflects a rather ambivalent attitude toward the private sector. On the one hand it has a large number of State-owned enterprises.

On the other hand, it has in the last 2 or 3 years begun to recognize that it would do better relying on the private sector. It has passed an investment industrial promotion act in 1962 and given many incentives to business. It has stated that it will follow a policy of not expanding the public sector. And in general I think at this point it is a rather critical point in their movement toward a conception of a developing society in a free enterprise framework. I think any encouragement we can give them at this time is very useful, and I think this treaty is one of the ways we can encourage this kind of democratic attitude toward free enterprise.

Senator LONG. I don't think I can support this tax convention if you are going to come in one of these days and ask to do the same thing for Germany, England, Japan, and Hong Kong. I just do not think I could support it if you are going to do that. Do I understand that is not going to be done?

Mr. SOLOMON. Definitely, sir, that is out of the question.

Senator LONG. I think it would even have a serious impact on our balance of payments.

You are not proposing that. All you are proposing is that you do this in certain less developed countries. You do propose to extend this to Israel, is that correct?

Mr. SOLOMON. Israel; yes, sir.

Senator LONG. We are sending a lot of money to Israel in both the private and the public sector. I think the United Jewish Appeal has probably done more than any private group I have seen to help some foreign country in raising funds to help those people make their government succeed there.

Do I take it to be your hope that, with that treaty, you are going to help reduce the need of sending all this American money over there by encouraging Americans to invest in factories, plants, and establish profitable commercial enterprises?

Mr. SOLOMON. We certainly feel that to the extent that you can increase the investment flows into these countries, that you not only

get a faster rate of growth, but that you diminish the pressure on aid funds for this type of purpose; namely, investment in the manufacturing sector and related sectors.

Now, this does not mean, Senator, of course, that the need for assistance for the construction of highways and ports and other projects that are clearly in the Government responsibility would be diminished.

#### STATE DEPARTMENT ATTITUDE TOWARD INVESTMENT

Senator LONG. That is something else that irritates me. I keep hearing you people from the State Department say that you cannot expect people to pay for their own ports, because that is something that does not pay its way. That is how we built the port of New Orleans. We went and borrowed the money, and we put tolls on the ships that came in. We charged them for the use of the port and the facilities, and we paid it back with interest. We are doing that right now in Baton Rouge. We just got through building that port. If we can build our ports, borrow the money and pay it back, why can't those people do it over there?

Mr. SOLOMON. Well, our aid loans for these projects are loans, Senator, which will be paid back. The only factor is that they usually are low terms of interest and long maturities.

Senator LONG. I can find you contractors that would go in almost any of these countries, if you can find a good port location where you have some tonnage. They will build a port and collect the tolls on it, and when they get themselves paid out with a profit they will give it to the country. They will do that if you give them an investment guarantee against confiscation.

If they are willing to do that, why do you come in here and tell us that a port cannot pay for itself?

Mr. SOLOMON. I am not saying that, Senator.

Senator LONG. Or a road cannot pay for itself. We have toll roads right in Louisiana.

Mr. SOLOMON. You are suggesting that instead of the AID program making the loans for the building of ports and related projects, that why can't toll arrangements be set up in some way whereby it liquidates itself so that private enterprise, foreign private enterprise, can build a port?

Senator LONG. There is a contractor from my hometown who is trying to put together a combine to build a road to a port, and then build the port. He will let people use the road free of any charge, but he wants to collect his ordinary tolls on the port to pay for the road and the port. And do you know who is stopping him? The State Department people. The Department has a man named Daughters down there who has been frustrating that project for 4 years. Then he comes in demanding more money to build roads and ports. Why don't you let them go ahead and build the port and take a chance? All the man wants is an investment guarantee. Wouldn't it be cheaper for us to do that than for us to build it and give it to them?

Mr. SOLOMON. That is in Ecuador.

Senator LONG. Yes. You come in and say, "No; it cannot pay for itself." There is a contractor in my own hometown who is trying to build some of these things that will pay for themselves. You spend a lifetime trying to keep it from happening so you can give it to them

in foreign aid. How do you defend that? Americans want to do it with private capital and you insist on giving it to them when Americans want to invest their own money. And they could finance it out of foreign money markets and let it pay out like the port of Baton Rouge. Why do you insist on giving money to them when the project will pay for itself, and when you have commercial establishments begging for the right to go in and do these things?

Mr. SOLOMON. I do not insist, Senator, nor does the Department. I think there may be specific cases, such as the Ecuador one you are raising, and we are looking into that, where a project could be financed and paid off through tolls, and where you could interest U.S. investors to assume the responsibility. I think that in most cases you will find, Senator, that this is not true for most public sector infrastructure projects—that airports do not pay for themselves, most highways do not pay for themselves. There is not enough traffic on them in these less-developed countries to be able to make it attractive to the United States or other foreign investment.

But there may be certainly specific cases where it is, and I think that where there are we ought to encourage that. We will be giving a report on this Ecuadorian case as soon as we have this full examination completed.

#### PRIVATE INVESTMENT ENCOURAGED

Senator LONG. That is how private enterprise is supposed to work. Sometimes it makes money, sometimes it loses money. If you have somebody that wants to take a chance, why not let them do it?

You did not answer the question. I saw you nod. I take it you are nodding that you understand, but you do not propose to answer the question.

Mr. SOLOMON. No—I thought—I think in general there is no question about the fact that we want private enterprise to assume the risks and the investment responsibility. As I say, there may be cases where the problems outweigh, and there are real disadvantages to issuing an investment guarantee. But normally, I would say that there were U.S. investors willing to take the risk, and even if it is an area of what we normally think of as public sector activity, he should be encouraged to do so.

Senator LONG. Do you know what one response of the State Department officials was to me when I urged them to let private industry do this job? They said, "If you let them build that road and port, other Americans might want to build roads and ports." Now, if they did that, of course, it would just save you billions of dollars of foreign aid requests at the expense of the American taxpayer. That particular proposition was—"Let us build a road and a port. Anybody can use it for private vehicles and pay us nothing, but we would like to collect a toll on the tonnage that goes through that port. We think we could make money at it. If we lose money that is all right with us, but let us negotiate with the Government to collect reasonable tolls for 20 years, and after that you can have the whole thing."

That is what we do at our port at Baton Rouge.

But the State Department said—"We are afraid of that. If that succeeded, others might want to do the same thing."

So instead you ask us to give them money, and you make the flat statement that a port is something that could not pay for itself; we have to give them that.

Mr. SOLOMON. Well, I think you may be right, Senator. There are exceptions where the ports will. In much of our experience, we have found that the governments of those countries wish to build ports themselves. Now, Ecuador may be an exception. You were talking about a highway.

Senator LONG. We have got a port right there at Baton Rouge. We went to the State legislature and said, "We would like the State to say that if we default, the State would back us up and pick up the tab—that way we can sell the bonds."

So we went out and sold the bonds and built a fine port there. We have ships all over the river waiting to get alongside the port. The port has all the tonnage that it can handle, and it is making good money. Everybody is happy about the whole thing. They are paying off the interest and the principal ahead of time. If we can do that, my reaction is why not let somebody else do it?

I just make that suggestion because frankly it seems to me that that is one of the things you could be doing to help develop some of these countries.

Mr. SOLOMON. Well, this would be—to the extent that a U.S. investor was willing to make an investment in building a highway or a port, this credit and this tax convention would apply.

Senator LONG. Well, thank you very much. Thank you, Senator Gore. I appreciate very much the opportunity to examine the witness.

Senator GORE. Thank you, Senator.

#### GUARANTEES FOR AMERICAN INVESTMENT

In connection with the questions of Senator Long, according to the information I have, AID cannot guarantee American investment in Pakistan and Honduras against revolution, war, or insurrection. Should we encourage investment by tax policy in places where we cannot protect it?

Mr. SOLOMON. I am sorry, Senator, I will have to do my homework on that. We have no investment guarantee treaties with Pakistan. We do have with Thailand, though. Are you saying we do not have one with Pakistan?

Senator GORE. I am asking you.

Mr. SOLOMON. My impression was that we did have one with Pakistan. The only limitation on AID issuing an investment guarantee, Senator, is we must have a treaty relationship which sets the framework for issuing these guarantees. This is an AID policy. And I have been under the impression that we did have one with Pakistan.

(The following statement was subsequently submitted by the Department of State:)

An investment guaranty agreement (TIAS 3269) concluded in 1955 with Pakistan provides for guaranties to American investors against loss from inconvertibility of foreign currency earnings into dollars or from expropriation. It has not been revised to include guaranties for losses to war, revolution, or insurrection.

Senator GORE. Did the suggestion that taxes be deferred on income from the sale of patents and other properties to a corporation in Thailand originate in the Department of State, Treasury, or elsewhere?

Mr. SOLOMON. I do not know, sir. I assume that all these fiscal matters which have been handled entirely by Treasury represent Treasury's best view of what is appropriate for the United States.

Senator GORE. You are here representing the Department of State.

Mr. SOLOMON. Yes.

Senator GORE. Did this treaty originate with the State Department or the Treasury Department?

Mr. SOLOMON. The gentlemen who are assisting me, Mr. Pickering and Mr. Setser, inform me this originated with the Treasury Department.

#### REASON FOR DELAY IN SUBMITTING TREATY

Senator GORE. I will submit only one other general question.

This treaty was signed on March 1, 1965. It was submitted to the Senate only a few days ago. I am not critical about the delay. I just wondered if you can tell the committee why it was so long delayed in transmission to the Senate.

Mr. SOLOMON. It is my understanding that since the three treaties with less developed countries, Thailand, the Philippines, and Israel, all represented a new approach in certain respects to this question of tax treaties with less developed countries, that they would be submitted altogether.

Senator GORE. If you waited for three, why didn't you wait for four? A tax treaty with India is just now being concluded.

Mr. SOLOMON. I am sorry, sir. India is not ready yet. I think the negotiations are almost concluded. They are not completely. But apparently since it was felt that all three were concluded about the same time, it would be useful to send them all on at the same time.

Senator GORE. The Philippine treaty was signed last year. Do you know why it was delayed?

Mr. SOLOMON. No, sir; I do not.

Senator GORE. Of course, the treaties are not identical. For instance, the Philippine treaty does not contain investment credit, and the Thailand treaty does. The treaty with Israel does not contain the charitable contribution deduction, and the one with Thailand does.

I am just wondering why there has been a delay. I am not critical. I am just wondering if there is a reason for it.

Mr. SOLOMON. I am not familiar with whether there is any special reason, sir, other than the fact that as I understand it all three were being concluded about the same time.

Senator GORE. I would like to submit specific questions in writing and you can supply the answers from your predecessors and the records of the Department. (See pp. 18-23.)

Senator Pell?

Senator PELL. I am a little disappointed at the lack of specific response to the questions of my colleague by the representative of the State Department, so I will limit my specific questions to the Treasury Department.

I just have one comment concerning policy. Why are we turning over to the Treasury Department the questions of aid to the development of foreign nations? It would seem to me that increasing the industrial potential of underdeveloped nations is one that should be

done through the AID program and by the State Department. Are you not abdicating your responsibility in turning it over to Treasury to work it out through tax gimmicks?

Mr. SOLOMON. Well, it has been the practice and must necessarily be, I imagine, Senator, that tax treaties have to be negotiated by the Treasury. They have the competence and the expertise for this which we do not have.

#### DISCUSSION OF 7-PERCENT TAX CREDIT

Now, on the policy of giving the 7-percent tax credit, there the State Department fully agrees. And as I said earlier, possibly before you came into the room, this idea was carefully considered and launched in the Agency for International Development—the idea of the investment tax credit—not any particular percentage, but this whole question of giving a tax credit to encourage private investment process in less developed countries, where the U.S. objective was to hasten growth.

So I do not feel that State and AID policywise have abdicated their responsibility, Senator. It is true that we are not involved in the mechanics of the fiscal negotiation.

Senator PELL. Why would not the 7-percent investment credit apply to our old and best friends in the Far East, the Philippines and Thailand?

Mr. SOLOMON. My understanding is that the Philippine Government wished to place so many different restraints on which type of industries could be used, to qualify for the 7-percent credit, that it was—the U.S. Government felt that it would be an unwise policy to encourage an approach which would discriminate among different categories of U.S. investment to an excessive degree.

Senator PELL. As I understand it, investment by an American in Thailand in any kind of enterprise would receive the 7-percent credit. It would not matter if it was a gambling casino, a hotel, a house of ill repute, or a factory.

Mr. SOLOMON. No, sir; there is a section which defines what is a qualified investment and this includes manufacturing and utilities. It is in article V. It excludes the extractive sector. But it does include other activities which are judged to be important to the overall development of the Thai economy.

Senator PELL. Why did you not include the oil industry and the extractive industries as well?

Mr. SOLOMON. Well, after considerable review of this problem within the AID agency, and also with other agencies, it was felt that it was advisable to exclude the extractive sector for a combination of reasons. One is that in many of the less developed countries the government has a different juridical concept of natural resources. They believe—it is part of their doctrine that the state owns those.

Secondly, there are restrictions against foreign investment in the extractive sector. They do not encourage indiscriminate or liberal investment by foreigners in their extractive sector.

Thirdly, it was felt, I understand, by Treasury and other agencies that there was a very generous treatment already of operations abroad in this area.

Fourthly, it was felt that since the decision whether to make an investment or not in the extractive sector depends so primarily upon the quantity and the richness of the ores, of the natural resources, that it would not be significantly influenced by tax credit.

Senator PELL. I have no further questions.

Senator GORE. Does the State Department endorse a further extension of investment credit by way of legislation beyond the 7-percent credit provision?

Mr. SOLOMON. The administration did send up a 30-percent tax credit proposal last session. No action was taken on it by the Congress. I understand that consideration is being given to its resubmission in the present session.

Senator GORE. That did not originate with the State Department, or did it?

Mr. SOLOMON. Again, the idea originated in the Agency for International Development.

Senator PELL. Mr. Chairman, according to your definition, a textile plant would be eligible for the 7-percent credit; is that correct?

Mr. SOLOMON. Any manufacturing plant would.

Senator PELL. Thank you; that is all.

Senator GORE. Thank you very much, Mr. Solomon.

Mr. SOLOMON. Thank you, sir.

(The following information was subsequently supplied by the Department of State in response to questions submitted by Senator Gore:)

1. *What has been our experience to date with less developed country tax treaties? Have our treaties with Pakistan and Honduras been of material assistance to our Government, or to U.S. businessmen?*

Our experience with our existing treaties with less developed countries has been limited since we have few such treaties. The conventions with Pakistan and Honduras are in general similar to our treaties with industrialized countries and we believe them to have been of material assistance to American citizens having business, cultural or other contracts with the less developed countries that might subject them to the tax jurisdiction of such countries. The assistance arises from the treaty provisions, among others, that contain rules regarding the taxation (or exemption) by one state of various types of income received by residents or corporations of the other, that forbid discrimination against U.S. residents and companies in tax matters, that adjust the foreign tax rates downward in certain instances so as to assure full credit under U.S. tax law for foreign taxes paid, and that assure exemption from tax of alien employees on temporary assignments.

The convention with Honduras appears to have operated smoothly and satisfactorily as far as American businessmen are concerned. No controversial cases are known to have arisen under it. A number of American business interests have expressed serious concern at the giving of notice by Honduras of termination of the treaty and have urged action by the United States to keep it in effect. The Government of Honduras has, however, on a number of occasions since 1960 indicated its dissatisfaction with the convention and sought revision for the purpose of reducing an alleged revenue loss to the Honduran treasury, and of providing greater encouragement to foreign private investment by requiring the United States to grant a "tax sparing credit." Discussions have been held with Honduras and some progress has been made toward revision of the convention. These discussions have suggested that Honduras would very likely consider a 7-percent investment credit to be a satisfactory substitute for a "tax sparing credit."

The operation of the convention with Pakistan appears to have been equally helpful to American businessmen. There have arisen, however, two or three tax cases in which the assistance of the U.S. Government has been sought. These matters are under consideration by the United States and Pakistan authorities, and the treaty provisions are expected to facilitate settlement. As originally negotiated, the Pakistan convention contained a "tax sparing" provision.

This was made the subject of a Senate reservation that voided it. The Government of Pakistan has expressed a desire to renegotiate the convention to provide a substitute provision for the encouragement of private investment.

2. *Are we now, with this Thailand treaty, beginning a new treaty series?*

Although there is nothing in the convention with Thailand that provides a basis for any formal designation of it as beginning a new series of U.S. tax conventions, it might be referred to as such: (1) if the Thailand convention is approved by the Senate, and (2) the negotiations with the other interested countries should result in a group of conventions following the pattern of the Thailand convention. Its objectives are in general the same as, and many of its provisions comparable to, those of existing U.S. conventions. It contains certain provisions (the 7-percent tax credit for U.S. investment in Thailand, the provision for deferral of tax on transfers of technical information, for example) designed particularly for negotiations with less-developed countries. A number of less-developed countries have indicated a desire to enter negotiations for tax conventions with the United States. Some of them, at least, are presumed to be interested in considering these new provisions.

3. *What, specifically, do we expect this treaty to accomplish?*

We have in mind the accomplishment of the following objectives, if the Thailand convention is approved:

1. Establish the basis for what it is hoped will become a network of treaties with less-developed countries, having similar major provisions though not necessarily the same details as the treaty with Thailand, assuring to American citizens and corporations having business and other interests in such countries advantages comparable to those provided for by U.S. tax treaties with 20 developed countries;

2. Provide such advantages particularly for the growing American business community in Thailand, for the U.S. citizens and corporations having investments there, and for U.S. citizens engaged in cultural activities or governmental service in that country;

3. Create a practical procedure for the resolution of problems that may arise with respect to taxation in the relations between the two countries;

4. Provide for the exchange of information between the tax authorities of the two countries with a view to assisting in the prevention of tax evasion;

5. Contribute to the economic development of a friendly country which occupies a strategic political position in Asia by providing substantially the same tax credit for investment in Thailand that is provided by law for investment in the United States, and by facilitating American participation in joint ventures through the elimination of a tax barrier to the flow of technical know-how and services from the United States to Thailand;

6. Provide reciprocal advantages for citizens and corporations of Thailand that engage in activities in the United States.

4. *What corporations are now the major U.S. investors in Thailand? What increased activity—over and above that already planned—is expected to be induced by this treaty?*

The following U.S. companies have establishments in Thailand, most of them with some degree of Thai participation through stock ownership in the local subsidiary: Singer Sewing Machine; Firestone Tire & Rubber; Kaiser Aluminum; Electric Storage Battery; Colgate-Palmolive; Merck, Sharp & Dohme (pharmaceuticals); International Pharmaceutical; Siler Bakery Co.; Union Carbide (tin smelter); Ford Motor Co.; Caltex; Standard Oil of New Jersey; Bank of America; Chase Manhattan Bank; Thompson Silk Co. This list does not include a few American investments for which promotional certificates were issued in 1964.

In 1964, 63 promotion certificates were issued under the Thailand Industrial Investment Promotion Act of 1962. The total registered capital for these investments amounted to approximately 509 million baht, of which 51 percent is Thai, 49 percent foreign, the American contribution amounting to about 7 percent of the foreign total. The American investment was scheduled to go into two hotels, a stone quarry, and an aluminum rolling mill. Plans for the establishment of a kraft paper mill by an American firm are reported to have reached an advanced stage.

There is no basis upon which a calculation can be made of the increased U.S. private investment that may be induced by the tax treaty. The actual effect

can only be determined by experience. The placing of investment in Thailand upon the same basis as domestic investment with respect to tax credit should result in additional firms deciding in favor of establishments in Thailand.

5. *Since there can be no true reciprocity in a tax treaty between a developed and a less developed country, the developed country must make concessions. Are we, in effect, bribing Thailand to do some of the things she ought to do of her own volition in order to attract needed development capital?*

The provisions of a tax convention, particularly a tax convention between a less developed country and an industrialized country, are not necessarily provisions which a country would be well advised to adopt unilaterally as part of its internal law. For example, a reduction by Thailand in its dividend withholding rate may not as a matter of Thai self-interest be desirable for general application. The reduced rate is designed to deal with a specific situation involving investment by U.S. firms. It may not be appropriate as applied to investment from the United Kingdom or Japan because different tax rates there may make a Thai rate reduction meaningless to investors in those countries. The same thing may be said of the rules of source which are laid down in the convention. It cannot, therefore, be said that the United States is "bribing" Thailand to do what she ought to do of her own volition. On the other hand, Thailand holds to the view that a reduction of its withholding tax on dividends for the purpose of attracting U.S. investment would not produce a sufficient inflow of capital and that the investment credit is necessary to add to the incentive which its reduced tax rate and other treaty provisions would provide for increased capital flows from the United States.

It should nevertheless be noted that Thailand has not been backward in taking measures of her own for the purpose of attracting needed development capital. One important measure was the Industrial Investment Promotion Act of 1962, which provides a number of special facilities and assurances for investments in specified industries, including exemptions from income and other taxes. Thailand has signed an agreement with the United States making possible investment guarantees under the AID legislation against inconvertibility, expropriation, and war risks. Other steps to strengthen the private sector of the economy have also been taken.

6. *In exchange for the direct reduction of U.S. taxes on U.S. taxpayers provided by this treaty, does our Government expect to be able to reduce economic assistance to Thailand? By what amounts?*

If new private investment should contribute substantially to an increased economic growth rate in Thailand, the need for governmental aid could be expected to decrease. There is no basis for an attempt to calculate the amount of such reduction that might be attributed to the effect of the tax treaty, however.

7. *Does Thailand welcome all types of foreign capital?*

In general, a climate favorable to foreign investment exists in Thailand. There are, however, as in most countries, restrictions on the entry of foreign capital into certain types of enterprises. The Government maintains for itself a monopoly of the production of arms, ammunition, and explosives; the manufacture of cigarettes; the operation of railways and ports; and domestic civil aviation. In certain other industries, some government participation in enterprises is required. These include production of alcoholic beverages, passenger transportation (other than railway), electricity production, water supply, telecommunications, the telephone system, mining, petroleum production and refining, forestry, banking, and insurance. In addition, there are in operation a number of government enterprises in various lines of industry from which private industry is not excluded, but in which government competition creates an obstacle to private investment. The Thai Government has recently adopted a policy of limiting or reducing its undertakings in competition with private enterprise. There are a small number of callings (for example, rice cultivation, barbering and hairdressing) reserved to Thai nationals.

8. *What controls are employed by Thailand on capital movements into and out of the country?*

All outward transfers of capital by residents or nonresidents of Thailand are subject to prior approval under Thailand's exchange control regulations. Concerning foreign direct investments in Thailand, there is an approval system designed to encourage those investments which Thailand considers would be of

benefit to the economy. Under the Industrial Investment Act of February 10, 1962 (which superseded a similar law of October 17, 1960) preferential treatment may be accorded approved investment insofar as exchange controls are concerned. The transfer abroad of profits, dividends, and the proceeds of liquidation of capital is guaranteed on approved investments, subject to the requirements of the balance-of-payments situation.

For instance where investments in Thailand have not been approved, the transfer abroad of profits and capital is considered on a case-by-case basis, and is normally allowed. In practice, the transfer of profits and dividends is permitted freely if the company has paid its taxes. In cases of repatriation of unapproved investments, transfers abroad of liquidation proceeds may be required to be made in annual installments to prevent large pressure on the exchange rate.

Foreign exchange from inward capital movements must be sold to authorized agents.

9. *What is Thailand's tax structure? What income tax rates are applicable to corporations? Does taxable income in Thailand approximately equal taxable income as defined in the United States on comparable business?*

According to information supplied by the Treasury Department the major elements of the Thai tax structure include a corporation and personal income tax, a business tax levied on gross income at rates that vary from industry to industry, stamp taxes and a variety of excises. Both the personal income tax and the corporation income tax are imposed at graduated rates, the former ranging from 10 to 50 percent and the latter from 15 to 25 percent. The top corporate rate applies to income in excess of \$50,000. The determination of taxable income, broadly speaking, follows the same lines employed in the United States and in other countries imposing taxes on net income. Various costs incurred in earning income are allowed as a deduction. However, we do not have precise information on administrative practices or regulations which may limit the deduction of various elements of costs. In general, it appears that taxable net income may be closer to a gross income figure than in the United States. That is, rates of depreciation, amortization, and depletion are apt to be lower, some items of expenses may be disallowed as being in excess of an arbitrary limit, etc. But, on the whole, tax is based on the concept of net income.

10. *Did the idea of the investment credit by treaty rather than by statute originate in the State Department or Treasury?*

The provision for the 7-percent investment credit was developed in the Treasury Department as a replacement for the unacceptable "tax sparing" formula that was included initially in the Pakistan convention and in the conventions negotiated with India, Israel, and the United Arab Republic. Investment credit by statute could not achieve all the objectives sought through the tax-treaty program. The Department of State agreed to the Treasury formulation as a promising measure for achieving the objective of the extension of the tax-treaty network to the less developed countries and of giving further encouragement to private investment in such countries.

11. *On page 13 of the annual report to the Congress on the foreign assistance program, dated May 1965, the statutory investment tax credit proposal is prominently mentioned. Why was there no similar mention of the treaty program? If the 30-percent proposal is enacted, what effect will this have on the treaty program?*

The annual report referred to records the activities of the Agency for International Development during the calendar year 1964. The preparation of the legislative proposal for a 30-percent tax credit was an important project of that Agency during that year. AID has no responsibility with regard to the tax-treaty program and, consequently, had no reason for including reference to it in the annual report.

The effect upon the treaty program of the enactment of the 30-percent tax credit would depend upon the specific terms of the legislation. Two possible ways, among others, in which the Congress could deal with the tax conventions are as follows: (1) it could suspend and replace the 7-percent arrangement by the statutory arrangement; or (2) it could apply the 30-percent investment credit only to a country with which we have a treaty, and apply a lesser statutory rate to investment in other less developed countries with which we do not have a treaty.

12. *As a result of our treaties with Pakistan and Honduras, does State Department receive any meaningful information on activities of U.S. businessmen in those countries? Is any expected from Thailand?*

Tax treaties do not establish any new channels for obtaining general economic information regarding the activities of American businessmen in foreign countries. The Department of State would have to continue to rely upon reports from the diplomatic missions for such information. If reference is intended in the question to information of the type dealt with in article 25 of the convention with Thailand, it should be noted that the information referred to in that article is information exchanged between the tax authorities of the two countries, is usually of a confidential nature, and does not ordinarily reach the Department of State. However, we are informed by the Treasury Department that there has been no occasion for the Internal Revenue Service to seek information from Pakistan or Honduras concerning American firms operating in those countries for purposes of U.S. tax administration.

13. *We have tax treaties with Pakistan and Honduras. The Philippines treaty has been signed. A treaty with India is about to be concluded. Yet, according to my information, AID cannot guarantee American investment in any of those countries against revolution, war, or insurrection. Is this somewhat anomalous? Should we encourage investment by tax policy in places where we cannot protect it?*

It is correct that the United States has not as yet succeeded in negotiating with the countries mentioned an extension of the investment guarantee agreements to cover losses caused by war, revolution, or insurrection. Agreements are in force with each of them, however, with respect to guarantees against loss from inconvertibility of currency and expropriation. There would appear to be no good reason for withholding other forms of assistance and protective measures from investors in these countries merely because of the failure of the foreign authorities to sign the agreements relating to war risks. The threat of this class of risk may seem relatively remote to those authorities. The foreign assistance legislation does not make the signing of the war-risk agreements a requirement for the extension of aid under the legislation. Whether or not they invest in the less-developed country is entirely a matter of free choice of the investors. The offer of a tax credit or tax deferral for investment abroad carries with it no suggestion of compulsion. We see nothing anomalous in the situation. Efforts will continue to be made to conclude agreements providing for the extended coverage.

14. *What criteria are employed by the State Department in determining which countries should be contacted by Treasury with a view to negotiating seriously on a tax treaty?*

The schedules for tax negotiations are arranged by the Treasury Department after consultation with appropriate officers in the State Department. Among the points taken into consideration in arranging negotiations are: (a) the political and economic interest of the United States; (b) the urgency of the international tax problems involved; (c) the date of the foreign government's indication of interest in a negotiation; (d) the importance of the negotiation from the standpoint of advancement of the treaty program; (e) convenience of including a visit to a particular country on the itinerary of the U.S. negotiators; and (f) travel plans of foreign negotiators. The State Department would ordinarily interpose an objection to the inclusion of a country on the schedule only if it believed that our relations with such country made negotiations undesirable.

15. *Does Treasury ever begin negotiations without specific instructions from the State Department?*

Arrangements for negotiations are normally made by Treasury by communications through the Department of State. Tax-treaty negotiations have been exempted from the requirement, imposed in the case of most other types of negotiations, of formal individual authorization by the Secretary of State prior to the initiation of discussions. Clearance of all important steps in arrangements for negotiations for tax treaties are obtained from appropriate State Department officers.

16. *Article 30, paragraph 5, provides for the cancellation of specific provisions in the treaty. Is it contemplated that Treasury or State would take the initiative in deciding to cancel?*

The administration of tax agreements, as of tax laws, is the responsibility of the Treasury Department. Consequently, the initiative in deciding to cancel provisions under article 30 of the convention would be taken by the Treasury Department, but the decision would be made in consultation with the State Department. Notice of cancellation of provisions would be made to the Government of Thailand through diplomatic channels by the Department of State.

17. *In 1957 when the "tax sparing" treaty with Pakistan was negotiated, marking the beginning of a new series of such treaties, the treaty was signed on July 1 and transmitted to the Senate on July 12. Hearings before the Senate Foreign Relations Committee began on July 30. The Thailand treaty, presumably the first in this new series containing the investment credit, was signed on March 1, but was not transmitted to the Senate until July 29. Why was the transmission of this treaty so long delayed?*

Since the conventions with the Philippines, Thailand, and Israel represent an adaptation of the usual U.S. tax-treaty plan to accomplish certain new objectives, it was deemed proper to submit these conventions to the Senate as a group. If this were done, it was thought that the pattern of a carefully planned program could be made evident, and that the Committee on Foreign Relations, as well as interested private persons, could better evaluate the objectives and the methods provided for their accomplishment than if the conventions were transmitted individually when signed. It was hoped that the group could be presented fairly early in the present session of Congress, but unforeseen delays, principally in connection with the final preparation of the text of the convention with Israel, prevented transmittal to the Senate until July.

18. *Is it the opinion of the upper echelon personnel in the State Department that U.S. tax concession is an appropriate and effective device for moving U.S. investment of desired types into areas of greatest need?*

The Department of State is not disposed to regard tax concessions as providing an appropriate solution in all cases for investment problems in less-developed countries. It believes that there is a definite lack of satisfactory experience data as to the effectiveness of the tax concession as a device for the stimulation of private foreign investment in such areas. It is of the opinion, therefore, that proposals for tax concessions should be given the most thorough consideration before adoption in any given instance. The Department considers, however, that the extension to investment in less-developed countries of the same tax credit that is provided for domestic investment constitutes a reasonable and practicable measure for accelerating the expansion of the U.S. tax-treaty program, and, at the same time, providing additional encouragement for private investment in such countries.

Senator GORE. The next witness will be Stanley S. Surrey, Assistant Secretary of Treasury.

The committee is very pleased to have you here, Secretary Surrey.

**STATEMENT OF STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY; ACCOMPANIED BY NATHAN N. GORDON, DIRECTOR FOR INTERNATIONAL TAX AFFAIRS; AND RICHARD LOENGARD, JR., SPECIAL ASSISTANT TO THE ASSISTANT SECRETARY**

Mr. SURREY. Mr. Chairman, I have a prepared statement which I would like to read. I might digress here and there to clarify some of the matters which you asked about earlier.

Mr. Chairman, I welcome this opportunity to discuss the pending income tax convention with Thailand. Since this is the first time this subcommittee is considering tax conventions, you may find it

helpful if I were to review the general objectives of our income tax treaty program and then discuss the specific tax convention that is now before you. Since there are also pending treaties with two other less developed countries, Israel and the Philippines, where appropriate I will refer to these treaties since they, together with the Thailand treaty, indicate the general procedure and standards being followed with respect to the negotiations of tax treaties with less developed countries.

#### U.S. PROFITS BY TAX TREATIES

As in the case of other industrialized countries, the United States has found it useful to enter into income tax treaties for the purpose of eliminating some of the troublesome tax problems that arise out of various types of international transactions. These problems may arise, for example, when sales take place between an enterprise in one country and an enterprise in another country, or when individuals from one country travel for business or cultural purposes to another country. They may arise when income is generated in one country as a result of investments made by individuals or corporations of another country, or as a result of services rendered by residents of one country to persons in another. The resulting problems of double taxation exist for all countries, and particularly industrialized countries.

These transactions cause international tax problems since each of the two—or more—countries involved in the transaction may lay claim to an income tax on the income or profits produced by the transaction. Conflict is thus inevitable.

Most of the industrialized countries have found it appropriate to include unilateral measures in their tax laws to cope with these double taxation problems. In the United States, principal reliance in meeting these problems is placed on the foreign tax credit mechanism. Under domestic law, the United States allows a credit to its taxpayers for the taxes imposed by a foreign country on income derived from that country. In a sense, we treat taxes paid to a foreign country as if they had been paid to the United States and thus, as offsetting our income tax claim against the taxpayer. Some other countries, such as the United Kingdom, also use this tax credit approach to deal with international double taxation.

Other countries, however, exempt foreign income in varying ways and degrees from their tax system. But even though the industrialized countries thus employ various unilateral measures to cope with these problems, virtually all industrialized countries have found it necessary to supplement these measures by entering into a network of tax treaties with their principal commercial partners and other countries with whom their taxpayers are concerned in trade or investment.

There are a number of factors responsible for this, which I can illustrate by reference to the experience of the United States. There are, to begin with, differences among countries concerning the scope of their income taxes. If the United States is to give a credit for taxes imposed by a foreign country, surely it must be only for taxes imposed on income which we consider has a source outside the United States.

## CONFLICTS ELIMINATED BY TAX TREATIES

But if our concept of source differs from the other country's, the credit mechanism will not be adequate to the problem—the other country will tax the income, we will not allow the credit, and the income involved will bear a tax considerably higher than either country alone would impose. If, for example, a foreign country considers the earnings from the rendition of personal services by a U.S. individual to have its source where the enterprise paying for the services is located, while the United States considers the source to be where the services are rendered, such as the United States, then our unilateral credit mechanism will not eliminate double taxation since no credit will be allowed for the foreign tax. Consider another example: One country may regard the source of income from a sales transaction to be the place where the order is accepted. The United States considers it to be the place where title to the property passes. Again the tax credit mechanism may not provide appropriate relief from double taxation. Still another example, more important, perhaps, than the others arises when two countries utilize different methods for determining the amount of income allocable to each country from transactions between related enterprises, such as a parent corporation in one country and the subsidiary in the other country. The result may be that a segment of income is taxed in both countries, with neither giving any recognition to the tax imposed by the other. Tax treaties deal with these problems by reaching mutually acceptable rules regarding the source of income and allocations of income.

There are other tax issues which often are best solved through one of the countries granting complete exemption from tax through tax treaties. For example, a businessman from the United States who temporarily visits another country for the purpose of exploring business opportunities or to consult with associates and employees on the spot is often in a difficult position from a tax standpoint. It is not merely that he may have to pay taxes in that country on his income during his stay in that country, such as a pro rata part of his annual salary. Often the filing of a tax return may constitute a more serious irritant to the conduct of business in that country than the payment of tax. The individual involved may be able to claim a credit against his U.S. tax for taxes paid in that country but that would not eliminate the annoyance and inconvenience not to speak of the consequences of erroneous interpretations or inadvertent errors, which compliance with the unfamiliar tax laws of a foreign country may involve.

Senator GORE. I would like to suggest that Treasury ought to tread lightly on the degree of annoyance and inconvenience of filing tax returns.

Mr. SURREY. I can understand that. We are trying to eliminate the annoyance of having to file two sets of tax returns.

Senator GORE. I admit that it would be a bit insufferable.

Mr. SURREY. These problems are not limited to businessmen, but involve many types of visitors such as teachers, students, entertainers, professional persons, and so on. This type of problem is generally eliminated in tax treaties by reciprocal exemption of residents of one country who visit the other for limited periods of time.

Another tax difficulty facing international business which our unilateral tax credit mechanism does not solve relates to various types of fees and royalties. It is common for a country to levy tax on outgoing payments, such as royalties, rents, or technical fees, on a gross basis. In the United States, for example, a tax of 30 percent is levied on the gross amount of such payments going to a foreign country.

A foreign tax at that rate on, say, a royalty paid to a U.S. licensor of a patent may be considerably higher than our 48-percent corporate tax on the net amount earned by the licensor after taking account of the costs incurred in earning that royalty. It may represent the equivalent of a 55 or 60 percent tax on the net income from the royalty. The excess foreign tax in such a case could not be absorbed through our unilateral tax credit mechanism.

However, a reduction in the foreign withholding tax rate, if sufficiently large, could bring the effective tax rate on the net income from the royalty down to a level which would be absorbed by the U.S. tax. Or the difficulty could be met by having the foreign tax apply on a net income basis rather than on gross income. These are the approaches generally used in tax treaties.

A somewhat similar problem relates to the determination by a foreign country of the amount of income earned therein by a branch of a U.S. enterprise. In some countries, the costs allowed as a deduction in arriving at the taxable income of a branch of a foreign-owned enterprise are limited to costs incurred within the foreign country itself. Thus overhead costs incurred in the United States which are allocable to the activities of the branch in a foreign country may not be allowed as a deduction in computing taxable profits in that foreign country.

The result is that the tax to that extent is on gross income rather than net income. Here tax treaties generally meet the problem by obligating a country to allow costs incurred abroad but allocable to the branch within its borders as a deduction for purposes of its tax.

#### OTHER PROBLEMS SOLVED BY TAX TREATIES

There are other situations which may involve a combination of problems. An American firm seeking to enter a market in another country may not only be confronted with the difficulties of complying with unfamiliar tax laws, but it may also be confronted with a foreign tax burden that is unrelieved by the foreign tax credit provision in our law because of differing tax concepts. The so-called permanent establishment provisions of our income tax conventions seek to cope with such cases. They describe certain types of activity which, when carried on in a foreign country by an American firm, are regarded as not constituting a permanent establishment within that foreign country, and therefore any profits earned through such activity are not taxable in the foreign country. Thus a firm in one country may send out salesmen to the other in an effort to penetrate a particular market without becoming subject to the tax laws of the latter country.

Other types of activities, in the other country, some involving the maintenance of a definite place of business, may also be carried on without constituting a permanent establishment for tax purposes. These include such activities as a purchase of goods or merchandise, the storage of merchandise, the conduct of advertising, and the use of

commission agents. All these activities will not subject the American firm to tax in the foreign country. This article may be of special significance in treaties with less-developed countries, where it is not uncommon to assert tax on a nonresident company which sells goods to a local firm even though the nonresident company is not actually engaged in business in that country.

Still another case where a unilateral provision such as our foreign tax credit is inadequate to deal with international tax problems is the relatively simple one where foreign tax rates are higher than our tax on the same income, so that an unused tax credit is generated. This problem arises most frequently where direct foreign investment is involved. Like the United States, many foreign countries impose not only a corporation tax on profits, but in addition they also levy a withholding tax on the dividends paid to the shareholders whether at home or abroad. We, for example, levy a 30-percent tax on all dividends going abroad.

Ordinarily, no distinction is drawn between the types of dividend recipients abroad. One recipient may be a parent corporation owning all or a major part of the company paying the dividends. Another may be an individual or corporation owning only a few shares in the company. The statutory withholding tax on both is likely to be at the same rate. Under these circumstances the total taxes payable with respect to the profits earned through direct investment and transmitted to the United States in the form of dividends may be considerably above the 48-percent rate imposed by the United States, on our domestic activity. Private investment abroad will thus be handicapped, as compared with domestic investment. To solve this difficulty, our tax conventions seek to arrive at mutually acceptable adjustments in the withholding tax rates on dividends paid by the companies in each country to shareholders in the other.

We have tried to secure reciprocal withholding tax rates on dividends which differentiated between a parent corporation and other shareholders. Most of our treaties with industrialized nations provide for a 15-percent withholding rate on dividends generally and a 5-percent rate on dividends received by a parent corporation, which are the rates recommended in the OÉCD model income tax convention.

In our conventions with less-developed countries, we have taken the view that withholding tax rates on dividends paid to U.S. parent companies should be reduced to the point where the total taxes imposed on the profits earned in the foreign country and remitted to the United States do not exceed the U.S. tax on corporate income generally. This objective is consistent with the policy of eliminating tax obstacles to the flow of private capital into the less-developed countries.

Our tax conventions also seek to assure nondiscrimination in tax treatment for American individuals and business ventures abroad. It is not uncommon for nationals of one country to find themselves subject to heavier taxes in a foreign country in which they are residing than the nationals of that foreign country. Through tax conventions we have been able to secure commitments from other countries that U.S. citizens will get the same tax treatment as nationals of the country in which they are living.

## CREATION OF CONSULTATIVE MACHINERY

One of the important contributions of tax conventions to international trade and investment is that they open the door to consultations between the tax authorities of the signatory countries. The creation of this consultative machinery offers the enterprises of one country some assurance that where appropriate there will be official discussions on a technical level with the authorities of the other country to secure a reasonable determination of taxable income. And perhaps even more important is the tacit assurance that in appropriate cases there will be the same determination reached in each country as to the amount of the taxable income present, so that tax would not be imposed by both countries on the same items of income without each recognizing that a tax has been imposed by the other.

Closely related to the consultation provisions are those concerning exchanges of information between tax authorities, which afford them a means for improving enforcement of their tax laws. This involves primarily the routine transmission to one country of data on income received by its taxpayers from the other country. In selected cases more elaborate information may also be transmitted.

These in general are the objectives of the 22 income tax conventions now in existence between the United States and foreign countries. They are also the objectives of the 150 or 200 income tax treaties entered into by the other countries of the world with each other. They are the objectives of the Model Income Tax Convention adopted by the OECD. Their general purpose, I repeat, is to encourage international trade, investment, and cultural intercourse through the elimination of tax barriers and irritants that can arise from the application of the tax laws of two or more countries to the same transactions. They represent the principal achievements in the three tax conventions now pending before the committee.

Of course, as in our existing treaties, there are variations among the particular provisions depending on the concerns that the other countries bring to the negotiation of the conventions. I shall develop some of the specific clauses to demonstrate how these objectives are attained and to show how we have moved forward in some respects from the treaties now in effect. But before doing so, I would like to stress that the three pending treaties are with less developed countries, Thailand, Israel, and the Philippines, and therefore in some instances involve different problems and consequently require somewhat different solutions from our treaties with industrialized countries.

The transactions which take place between the United States and less developed countries ordinarily produce a flow of income from those countries to the United States, but not the reverse.

In industrialized countries, there is generally a reciprocal flow from one country to the other. But that is not true in the less developed countries. In the less developed countries, dividends flow from investments in these countries to the United States; royalties come from foreign licensees to the United States; American businessmen go aboard to these countries; American manufactures are sold to these countries. In contrast, the movement of such goods and services from the less developed countries to the United States is generally quite limited. Under these circumstances, less developed countries are reluctant to enter into the standard type of tax treaty even through the rules are emi-

nently reasonable and equitable, because those rules involve a revenue loss to them without an adequate offset. Their need for revenues is so pressing that nearly always they seek a recognition of their problems that goes beyond the usual tax treaty pattern and thus compensates for the difficulties they face in entering into any agreement involving a revenue loss for them, no matter how small.

Since their need for foreign capital is usually urgent, this search by the less developed countries for a different pattern in their tax treaties is generally centered on seeking an approach which will move the industrialized countries in the direction of incorporating a provision which presents a reasonable likelihood of increased capital flows to the less developed countries.

As a consequence, the other industrialized countries entering into tax treaties with less developed countries—and there appear to be over 30 of these treaties—have found it necessary to incorporate a provision which the less developed countries consider a stimulus to capital inflows in order to obtain a treaty with them.

One approach followed involves exemption by the industrialized country of various forms of income received by its taxpayers from activities in the less developed country. Another approach is the so-called "tax sparing credit." In treaties incorporating such a provision, the capital exporting country agrees to allow a credit against its tax, not only for the taxes actually paid to the less developed country, but also for the taxes that would have been paid to the less developed country if that country had not reduced its income taxes under some special tax concession scheme.

#### DIFFERENT TAX REQUIREMENTS FOR UNDERDEVELOPED COUNTRIES

Thus, all of the treaties entered into with industrialized countries by Israel, and this includes the United Kingdom, France, Italy, Germany, and Sweden, involve either an exemption clause or a tax-sparing credit granted by the industrialized country. This is also true of the two treaties which Thailand has with Japan and Sweden. There appear to be some 20 "tax sparing" treaties in force between industrialized countries and the less developed countries.

In our view these approaches are undesirable. Thus, tax exemption of income derived from investment in less developed countries would be viewed as a highly inequitable provision by American taxpayers engaged in business in the United States and would have a highly erratic effect on the relative tax burden of foreign producers as compared with those engaged in domestic production. It would be basically inconsistent with the principle of the foreign tax credit which seeks to maintain uniformity in tax burdens as between domestic and foreign economic activities.

A tax sparing credit would equally be undesirable since it would operate capriciously, providing the largest tax benefits to investors in countries having the highest nominal tax rates and without any necessary relationship to the fundamental economic needs of a country or to such policies as the "Alliance for Progress." Moreover, it would stimulate the rapid repatriation of profits from less developed countries rather than the reinvestment of profits in those countries.

When the Kennedy administration came into office in 1961, there were pending in the Senate three income tax conventions with less

developed countries—India, Israel, and the United Arab Republic—which contained “tax sparing” clauses. The administration was convinced for the reasons I have stated, and others that could be added, that such tax sparing clauses were not in the best interests of the United States and of economic development in less developed countries.

Senator GORE. There was one other reason—the Senate refused to approve it.

Mr. SURREY. That is right. I was going to add that. Moreover, it will be recalled that this committee had entered a reservation to the tax sparing clause in the Pakistan treaty in 1958. Those three treaties lay dormant for several years and were withdrawn by the administration from consideration by the Senate in 1964.

The administration was desirous, however, of negotiating tax treaties with less developed countries for it regarded tax treaties as beneficial to both the United States and the less developed countries. Indeed, the Congress expressly declared this policy in the Foreign Assistance Act of 1961 when it directed the President to—

accelerate a program of negotiating treaties for commerce and trade, including tax treaties, which shall include provisions to encourage and facilitate the flow of private investment to and its equitable treatment in friendly countries and areas participating in programs under this Act.

Senator GORE. Was that a provision contained in a bill which the administration submitted, or was it an amendment which originated in the legislative branch?

Mr. SURREY. It was in the bill introduced in 1961 on behalf of the administration, Senator. Moreover, the other industrialized nations have been following such a course and extending their network of treaties to include less developed countries.

As I said earlier, there are over 30 treaties with the other industrialized countries.

The question presented was whether a suitable approach could be found which would give recognition to the requirements of the less developed countries for provisions looking to the encouragement of capital inflows to those countries and at the same time did not run counter to settled tax policies of the United States.

Fortunately, developments in our tax law as a result of the Revenue Act of 1962 and later legislation pointed the path to an appropriate answer.

As a result of the Revenue Act of 1962, our present tax law now provides a credit—the investment tax credit—against U.S. income tax of 7 percent of the amounts spent for machinery and equipment for use in the United States. Since this credit did not extend to investment abroad, that act established in effect a preference for domestic investment as compared with foreign investment.

Senator GORE. That was one of the principal reasons which former Secretary Dillon advanced in favor of the investment credit.

Mr. SURREY. I think that is right, Senator. As I go on to say, such a policy is understandable with respect to investment in other industrialized countries.

Secretary Dillon presented charts which showed, taking together the investment credit and the liberalized depreciation which we adopted, they were comparable to what was given in other industrialized countries. The comparisons were always with the other industrialized countries of the world.

## INVESTMENT CREDIT AND BALANCE OF PAYMENTS

Senator GORE. One of the principal purposes in recommending the investment credit was to affect favorably the balance of payments by giving a tax preference to investment and modernization within our own country. Now you propose to eliminate that preference. We will go into that later. But I thought it was pertinent to bring this up at this point.

Mr. SURREY. Such a preference is understandable with respect to investment in other industrialized countries.

Looked at from the standpoint of less developed countries, however, this provision would be regarded as presenting an impediment to investment in those countries. Consequently, the extension of the 7-percent investment credit by treaty to these countries offers itself as a fitting approach to the recognition those countries seek with respect to the encouragement of capital inflows. It would, so far as the United States is concerned, remove an impediment to investment in less developed countries and thereby in this respect establish a general parity of treatment between domestic investment and investment in the less developed country. In establishing this parity and thus assisting investment in these countries, we would also be pursuing a policy reflected in other tax legislation recently adopted by Congress. Thus, the Revenue Act of 1962, which was directed to "tax-haven" or "base companies" abroad, contains a number of provisions favorable to investment in less developed countries as compared with industrialized nations. Moreover, under the interest equalization tax, loans made to enterprises in less developed countries and investments therein are treated in the same way as domestic loans and investments and thus are exempt from the tax.

Extensions to the less developed countries of incentives granted to domestic investment is in keeping with a policy recently favored in a report of the OECD Fiscal Committee on "Fiscal Incentives for Private Investment in Developing Countries, 1965":

Inadequate recognition of foreign taxes is not the only feature of the tax systems of industrialized countries which tends to produce discrimination in favor of domestic investment compared with investment in developing countries. Many industrialized countries grant tax benefits to their taxpayers in the form of accelerated depreciation, initial allowances and investment allowances or credits, but grant them only with respect to domestic investments and deny them for investment abroad even though they tax income from foreign investment. The result is, of course, a tax advantage for domestic investment. If capital exporting countries using such allowances also granted them with respect to investment in developing countries, they would be taking another important step toward promoting increased investment in developing countries.

Moreover, the investment credit approach is far more appropriately suited to less developed countries than the tax sparing approach or the exemption of income approach, from the standpoint of equity, efficiency, and administration. Since the investment credit operates on the act of investment, it eases the risk of investment at the very outset. Since the credit does not turn on the receipt of income in the United States from the foreign investment, as do tax sparing and tax exemption, it does not encourage quick repatriation of profits. Since the credit does not turn on foreign tax concessions, as does tax sparing, it does not have the capriciousness of that device nor does it transfer from the United States to a foreign country the decision as

to whether a tax benefit is to be conferred and, if so, the extent of such benefit. Since the extension of the investment credit to less developed countries would but follow the treatment accorded domestic investment, it does not involve the treaty process in favoring the foreign investor as against the domestic investor in a matter closely linked to the rates of tax, as did tax sparing.

With our basic tax laws thus providing an approach that could be adapted to a less developed country in the negotiation of a tax treaty so that the United States would not be at a disadvantage compared with the other industrialized countries in this endeavor, we proceeded once more to enter on a program of negotiation. We felt obliged to renegotiate the agreements with the three countries which had been withdrawn, Israel, India, and the United Arab Republic. Of the three, the treaty with Israel, the first to respond, is before you, and negotiations with India are virtually concluded.

#### PAST NEGOTIATIONS ON TAX TREATIES

I might add prior to 1960 we had made considerable progress in a negotiation of a tax treaty with Thailand, which however involved a tax sparing credit. In the fall of 1963 the Philippine Government had indicated in a conversation between myself and the Ambassador from the Philippines their interest in a treaty, and Taiwan had indicated its interest in a treaty. Consequently, in the winter of 1963-64 it was decided to send a mission to the Far East to see whether the countries of the Far East were interested in treaties with the United States if an investment credit approach rather than a tax sparing approach were used. A trip was thus made late in 1963 and early 1964 which covered the Philippines, Taiwan, Thailand, and Malaysia, and that was the occasion for the recommencement of these negotiations.

As a result of that trip, it became apparent that some of these other countries felt that the investment credit approach would be the kind of an approach which they could understand and for which they would be willing therefore to consider entering into treaties with the United States. The three treaties with India, Israel, and the United Arab Republic were therefore withdrawn, and offers were made to those countries to enter into new negotiations.

But I repeat the treaty with Thailand had been in a stage of negotiation prior to 1960. It happened to have a tax sparing credit within it. Consequently it had not been pushed after 1960.

Senator GORE. During these negotiations, what guidance did the Treasury have from State?

Mr. SURREY. The Treasury Department does not enter into the discussion of any tax treaty with any country without the explicit approval of the State Department—because that is regarded as a political matter. With respect to tax treaties generally negotiated in the United States, there is a representative of the State Department that sits with the Treasury delegation. If it is negotiated in a foreign country, there is also generally a representative of the State Department who is involved. Sometimes it might be the economic officer who is involved or it may be a special person. But there is a representative of the State Department—and he and the ambassador of the particular country involved are kept in touch with the treaty negotiations.

With respect to these treaties with the less-developed countries, and the utilization of the investment credit, that approach had been thoroughly discussed between the Treasury Department and the State Department in conferences, I would say, in 1963 between my office and offices in the State Department, to obtain a combined judgment as to whether this was a feasible approach to less developed country treaties.

Senator GORE. Both Departments negotiate for the United States insofar as the treaty is concerned. But for our own information it would be of interest to know the genesis of the Thailand treaty with respect to the departments or the business community directly affected.

Mr. SURREY. Generally speaking, Senator, in my experience, which goes back to 1961, these treaties arise as a result either of the interest of the Treasury Department and the State Department on the one hand, or the interest of the foreign country on the other hand.

For example, in this trip with respect to the Far East, Taiwan approached the United States. The Philippine Government, to the best of my recollection, either approached the United States or in a conversation I had with the Philippine Ambassador, where the question was, "How can we bring our countries closer together?" The question came up, "Are you interested in a tax treaty?" They never have had a tax treaty with any country, and they said, "Well, that is something we could consider."

With respect to Thailand, I do not personally know, because that was initiated prior to 1961. It may have been at the initiative of the United States.

Israel was at the initiative of their Government, as respects the renegotiation of the treaty.

What I am saying is that treaties originate between governments, with the impetus coming from either our Government or their Government.

Senator GORE. I don't mean in any sense to imply that there is anything wrong per se with a suggestion regarding the provisions of a treaty, whether it is proposed by the Treasury, by the State Department, by a foreign government, or by business enterprises or individuals who are directly affected thereby. The same is true of legislation in the Congress. It sometimes comes from the mind of a Senator, from the needs of his constituents, from the administration, or elsewhere.

I only asked the question as a means of exploring the advisability of the pending treaty.

Mr. SURREY. I appreciate that. And I wanted to give the answer in detail because, as I say, it is a varied situation. The initiative sometimes is with us, sometimes it arises at the request of the foreign country.

#### GENESIS OF TAX TREATY WITH THAILAND

Senator GORE. You do not know the genesis of the pending treaty with Thailand?

Mr. SURREY. The pending treaty with Thailand arose out of, I would say, discussions back in 1958 and 1959, somewhere in there, when the United States was discussing treaties with less developed countries. There had been these negotiations with Thailand. These negotiations, since they evolved a tentative draft that included tax

sparing, were not pushed forward after this administration came to power. So that consequently in 1963, in view of the interest of the Philippines, Taiwan, and the other Far Eastern countries, we reviewed the treaties with those countries with which we already had had negotiations, and we ascertained whether they were interested in bringing up to date their negotiations. That is how the Thailand treaty came about.

Senator GORE. During that particular period I was in Thailand and became familiar with the lack of cooperation of the Government of Thailand with the United States and other countries with respect to the international control of narcotics traffic. In 1961, Thailand did ratify the international convention on narcotics. I am glad that has been done. I will want to have some further information about the extent of cooperation and the effectiveness of cooperation. This requires information from the Treasury Department.

Mr. SURREY. Yes, sir.

Senator GORE. I suggest that you complete your statement.

Mr. SURREY. The less developed countries with whom we have had discussions have responded favorably to our suggestion that extension of the 7-percent investment credit is a recognition of their desire for an encouragement to capital inflows. Thus the treaties with Thailand and Israel now before you contain this extension of the investment credit. Whether the less developed countries will in their other treaties adopt this approach instead of tax sparing, we cannot tell. Yet it seems clear that they find it at least a satisfactory alternative viewed from their side of the negotiation, so that tax treaty discussions with the United States can once more proceed.

It must be recognized that the United States in these negotiations is quite clear on its view that extension of the investment credit is appropriate only where the other country is receptive to U.S. investment and where its tax system, taken as a whole, does not involve measures that can be regarded as significantly working at cross purposes with such investment. In many cases the existing tax systems of less developed countries do not meet this standard. But the treaty process itself permits the foreign country to modify its tax system through the treaty and thus deal with the contradictions and with provisions which act as disincentives to investment from the United States. For example, the existence of a complex of corporate taxes and withholding taxes on dividends in a less developed country, which brings the effective rate of tax on profits earned there above the general level of the U.S. corporate tax, creates a tax barrier to U.S. investment in such countries. It would generally be difficult to justify a tax credit for U.S. investment in such a country unless that country is prepared to reduce its taxes to the level prevailing in the United States. This can be done by a treaty but not otherwise, since that country may not be prepared to reduce its taxes on its own nationals or those of third countries.

The treaty process also permits complementary modifications where appropriate in the tax laws of the other country which are conducive to improved international trade. Where the other country is not yet ready to make certain modifications, or is more concerned with continuing a somewhat restrictive approach to foreign investors, then the investment credit need not be extended. While it may well be that in most of these cases a treaty may presently not be negotiable,

this need not always be the result, as the Philippine treaty before you indicates. That treaty—unlike the treaties with Thailand and Israel now before you and the treaty with India which is nearing conclusion—does not contain an extension of the investment credit. Certainly the United States seeks no overreaching of any less developed country, and to the contrary is understanding of their problems and their desires to conserve revenues. The treaties before you evidence the recognition of these attitudes and the basic truth that a tax treaty is a negotiation in the true sense of the term, and one that will be satisfactory and worthy of the United States only if each country genuinely believes its policies and problems have been fairly handled.

#### PERMANENT ESTABLISHMENT PROVISION

Turning now to the specific provisions of the convention with Thailand, I should like to point out how some of the more important provisions achieve the objectives that I previously discussed. The first of these is article 3 dealing with the definition of a permanent establishment. It contains the rules in most of our other tax treaties which permit a firm in one country to engage in certain activities in the other without thereby acquiring a permanent establishment. I want to take special note of a provision of Thai law which is altered by the tax convention, because it deals with a problem that we find exists in other less developed countries.

Under Thai law, an American firm which sells its products to a Thai enterprise through a commission agent or broker and without in any way engaging directly in business in Thailand is nevertheless subject to tax in Thailand at the regular rates applicable to any Thai enterprise. Because the Thai are unable to arrive at the net income which the American enterprise may derive from such a sale, they arbitrarily assess a 2 percent tax on the gross amount received by the American firm from the transaction. The tax is required to be paid over by the commission agent, presumably by withholding that amount from the price due the American firm. This frequently creates difficulties in trading activities, since the American seller may not be aware of this liability and the amount of tax may be relatively high. Under the convention, the tax is eliminated in such cases where the commission agent is an independent agent thus removing these difficulties. However, an agent acting "exclusively" or "almost exclusively" for the American firm is not treated in the convention as an independent agent. The position of Thailand is that a nominally independent broker operating in Thailand is not really independent if this business depends on a single firm, and therefore, as where it acts through a dependent agent, the firm should be considered to have a permanent establishment in Thailand. A similar provision is to be found in the tax convention between Thailand and Japan.

#### BUSINESS PROFITS

Article 4 of the Thai convention deals with the determination of business profits and, in addition to its principal operative provision that a company not be taxed on business profits unless it has a permanent establishment in the country, it provides that in computing the industrial or commercial profits of the permanent establishment in

Thailand there shall be allowed all deductions reasonably connected with those profits. This has been a problem for companies operating in Thailand, because administrative costs incurred in the United States by the home office on behalf of a Thai branch have been disallowed by Thailand as a deduction in computing the profits of the branch. Under the convention, this will no longer occur.

I have already discussed the investment credit provisions which are in article 5 of the draft. Additional details are contained in the technical memorandum which has been transmitted to the staff of the Joint Committee on Internal Revenue Taxation and which we shall submit for the record. The revenue effect of this provision would be quite small, since the flow of U.S. investment to Thailand is limited. Based on the average net capital movement to Thailand in the last few years, and ignoring capital repatriation to the United States, the cost would have been less than \$150,000 annually. I should like also to point out that this article may be terminated by the United States after 5 years, without such termination ending the entire treaty.

#### TAX DEFERRAL FOR TECHNICAL KNOW-HOW

One of the special needs of less developed countries is the technical knowledge and skill which have been developed in the industrialized countries of the world. Companies which have developed such skills may sometimes be prepared to supply them to less developed countries in exchange for stock in new enterprises provided such an exchange does not require them to make cash contributions to the venture abroad as well. Unfortunately such transfers of technical knowledge, know-how, and skills in exchange for stock must frequently be accompanied by cash outlays in the form of tax payments on the income resulting from the stock received in the exchange. This is true under U.S. law and it is also true under foreign tax laws.

Article 6 of the convention with Thailand seeks to remedy this difficulty by deferring tax on such transfers until the stock received by a transferor is disposed of. This article in the convention alters both United States and Thai law in this respect. Under U.S. law, tax on transfers may be deferred only if the U.S. company has an 80-percent interest or more in the foreign corporation to which it transfers the know-how and if the know-how constitutes property. These requirements may be appropriate in many cases. However, insofar as less developed countries are concerned, there is great need for services as well as property and for encouraging joint ventures where the American company may not necessarily possess even a majority of the stock let alone 80 percent.

Under Thai law, no deferral is granted irrespective of the ingredients of the exchange or of how much stock in the acquiring corporation the donor company has. The tax deferral provided by article 6 cannot be effectively granted as a unilateral measure since deferral by the United States would be of little use if tax is imposed by the foreign country. Accordingly, the tax convention is a uniquely appropriate method for matching the tax laws of the two countries with respect to this important problem. The United States or Thailand may also terminate this article after 5 years. I should like to add that the treaty provision is not intended to be a substitute for existing statutory provisions but a supplement to them.

## SHIPPING AND AIR TRANSPORT

To turn to another provision, international transportation enterprises face unusual tax burdens by virtue of the fact that their income may be derived from many places and the tax laws of various countries which they touch may vary significantly. As a result it has become an objective for most countries to seek reciprocal exemption of the profits, if any, earned by their international transport enterprises. Tax exemption also assures that such enterprises will not be taxed by some countries if their overall operations turn out to be unprofitable, as is frequently the case. Article 7 of the convention provides for complete exemption of aircraft operations in international traffic. We have airlines going to Thailand. Thailand does not have airlines going into the United States.

The Thai were not prepared to agree, however, to full exemption of shipping, partly because of the lesser likelihood that they would acquire international shipping lines going to the United States to offset the loss derived from their exemption of American shipping firms. I understand we have about 10 shipping lines and they have 1 going to the United States. Nevertheless, the Thai did agree to reduce the tax payable by shipping enterprises to one-half the amount that would otherwise be payable. While this provision does not relieve American shipping companies of the necessity to comply with the Thai tax laws, it does reduce the likelihood that they would pay taxes to Thailand which could not be credited against their U.S. tax liability.

## TAX ON DIVIDENDS AND INTEREST

The dividend article in the Thai convention, article 9, provides that the maximum rate of tax that would be imposed on dividends paid by a corporation in one country to a parent corporation in the other would not exceed 20 percent. The Thai tax on dividends is graduated from 15 to 25 percent, and most dividends are subject to the 25-percent rate. At that rate, the Thai tax on profits derived in Thailand by an American parent through a Thai subsidiary combined with the Thai tax on the dividends transmitted by the Thai subsidiary exceeds the U.S. corporate tax on the same income. By reducing the withholding tax from 25 to 20 percent, the total combined Thai tax is kept slightly below the level of U.S. tax on remitted profits, so that no excess credit is generated in Thailand. As a matter of reciprocity, which the Thai desired, the U.S. tax on dividends leaving the United States is also limited to 20 percent.

The tax on interest is not affected by the convention, except in the case of interest received by the respective governments on their instrumentalities, in which case exemption is granted at the source. This provision, article 10, eliminates the uncertainty which in some cases has surrounded U.S. governmental lending programs in Thailand.

## ROYALTIES

Article 11 of the convention deals with royalties and provides that the maximum withholding tax rate on royalties will be 15 percent compared with the Thai statutory rate of 25 percent and the U.S. statutory rate of 30 percent. The reduction in the rate of withholding

on royalties is a reflection of the view that a high rate of tax on the gross amount of royalties will frequently result in a higher rate on the net earnings and lead to an unused tax credit. The reduced rate is thus a device to compensate for the fact that costs have been incurred in developing and administering patents, films, and other property rights which costs are not given any recognition when gross royalties are the basis for the tax.

#### INCOME FROM PERSONAL SERVICES

Article 13 of the convention deals with income from personal services and makes it possible for American firms to send their employees to Thailand for periods up to 6 months instead of 3 months—which is the case under present Thai law—without their becoming subject to tax in Thailand. The value of this provision is that greater flexibility in assigning technical personnel is attained by firms which find it necessary to have such persons temporarily stationed in Thailand. The article also provides exemption of entertainers. However, in these cases the exemption applies only if the earnings do not exceed \$100 a day or an aggregate of \$3,000 for the entire period the entertainer is in Thailand.

#### TEACHERS, STUDENTS, AND TRAINEES

As in the case of most of our other tax conventions, this one with Thailand contains provisions designed to promote cultural exchanges. Thus, under article 14 teachers from one country may go to the other for a period of 2 years and remain exempt from the tax of the latter country during that period. Similarly, under article 15, students and trainees may come from one country to the other and be tax-exempt in the latter country for varying periods of time, depending on the circumstances involved.

#### CHARITABLE CONTRIBUTIONS

Article 18 of the convention deals with charitable contributions. Under that article, American citizens and corporations may take a deduction in computing their U.S. income tax for contributions made directly to a Thai organization provided it qualifies as a charitable organization under our law. Of course it also provides that the organization must be exempt from tax under Thai law. Similar provisions are included in the income tax conventions with Honduras and with Canada, although in the latter treaties the maximum deduction is based upon the amount of income derived within the respective countries. This article reflects the fact that American citizens and companies in Thailand feel an obligation to participate in community affairs and that charitable contributions are an important part of such participation. The United States may also terminate this article after 5 years.

#### SOURCE RULES

Since the convention provides that Thailand will impose a tax on the commercial and industrial profits of American firms only if they have a permanent establishment in Thailand deriving income from

sources within Thailand, it becomes important to have rules relating to the source of income. Such source rules are found in U.S. law, but there are none under Thai law. In article 19 of the convention, the Thai Government has agreed to adopt rules which are embodied in U.S. law. This will introduce a degree of certainty in tax determination for American businessmen engaged in business in Thailand which does not exist at present and to which they attach a good deal of importance. The principal departure from the U.S. source rules relates to interest paid by a U.S. branch in Thailand. Under our law, an American firm paying interest on funds borrowed from a bank, for example, is considered to be paying interest from U.S. sources and therefore must withhold a 30-percent tax even though the borrowing was done by its branch in Thailand and the interest is paid by the branch in Thailand out of its funds. The treaty establishes Thailand as the source in such a case so that our tax would not apply.

Under existing Thai law, no provision is made for allowing taxpayers a credit for taxes imposed on income they receive from sources outside Thailand. The result is that American citizens resident there or branches in Thailand of American companies which derive income from sources outside Thailand may be subject to tax both in Thailand and in the country from which they derive income. By virtue of article 4 under which Thailand may tax a branch of a United States company only on income from sources within Thailand, and as a result of article 22 which requires Thailand to grant a credit for United States tax on United States income, the double taxation that now exists for these persons would be eliminated.

#### NONDISCRIMINATION

In most of our conventions, the nondiscrimination article applies with respect to individuals from one country who are resident in the other. Many conventions go beyond that and provide that nondiscrimination shall apply in each country to a local branch of a foreign company. Article 23 of this treaty goes even further and makes the nondiscrimination principle applicable to a local corporation of one country, Thailand, which is owned by nationals or corporations of the other. This comprehensive nondiscrimination article represents a marked step forward in securing fair treatment for American interests in foreign countries.

I hope, Mr. Chairman and members of the committee, that this rather lengthy presentation has served to clarify the nature and purpose of our tax treaty program. We believe this program can make a useful contribution to international trade and investment in less developed countries by eliminating a number of tax problems, introducing sounder tax practices and establishing the basis for cooperation between our tax authorities and those of the foreign countries. This program will enable the United States to develop a network of tax treaties with these countries and thereby permit us to keep pace with the other industrialized countries, who are extensively using tax treaties as a significant means of cementing their economic relationships with the less developed countries of the world.

I would like, Mr. Chairman, to submit at the end of my statement a technical memorandum which goes into more detail from a technical

viewpoint in describing the various articles of the Thailand Convention.

Senator GORE. Thank you, Mr. Secretary. That will be printed in the record.

(The document referred to follows:)

TECHNICAL MEMORANDUM OF TREASURY DEPARTMENT CONCERNING PROPOSED  
INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND THAILAND

The proposed tax convention between the United States and the Kingdom of Thailand (hereinafter referred to as Thailand) was signed at Bangkok on March 1, 1965. Its purposes are to avoid double taxation of income, to prevent fiscal evasion, to facilitate trade and investment between the two countries, and to encourage joint ventures.

This convention is one of a series recently negotiated by the United States with less developed countries. The first such convention was concluded with the Republic of the Philippines and signed in Washington on October 5, 1964. As respects countries traditionally classified as less developed, the United States presently has conventions with only two, Honduras and Pakistan. In addition, the United States has tax conventions with several less developed countries, e.g., Jamaica, to which treaties with developed countries were extended before such less developed country became independent, which treaty was continued in effect after independence.

The convention benefits the United States in various respects. It deals with the taxation of business income, items of investment income, the definition of the term "permanent establishment" and the allocation of expenses to income-producing activities in both countries. The convention includes a provision guaranteeing reciprocal allowances of a foreign tax credit to afford relief from double taxation of the citizens, residents, and corporations of one country deriving income from sources within the other country. Further to this end, source rules are provided to prevent disallowance of the tax credit and provision is made for consultative procedures to work out problems of double taxation arising in contravention of the terms of the convention. Furthermore, the treaty forbids discriminatory tax treatment for citizens of one country resident in the other, for corporations of one country engaged in business in the other and corporations of one country controlled by citizens, residents, or corporations of the other.

In general, the convention affords a measure of certainty to businessmen in both countries and provides rules for determining net income for purposes of the imposition of tax by each country. For example, it provides specific rules for determining what activities within one of the states will make a resident or corporation of the other subject to tax in the former state on the operating income from its business there. Moreover, the convention specifically provides that if a resident or corporation is taxable on such income, he shall be permitted to deduct any expense incurred within or without the latter country which is directly related to the business conducted there. Specific rules limiting the right of either country to tax business visitors are also provided. These provisions represent significant concessions on the part of Thailand since they substantially limit its statutory power to tax in these instances. Furthermore, the additional certainty with respect to Thai taxes which these rules give U.S. businessmen and their employees is a significant benefit to be gained from the treaty. This is particularly true because of the general unfamiliarity of Americans with Thai legal concepts and practices.

In addition to the foregoing provisions which are usually found in tax conventions, this convention includes certain provisions specifically designed to encourage or facilitate investment in Thailand by United States residents and corporations. It allows U.S. residents and corporations investing in qualifying Thai enterprises to claim as a credit against their U.S. income tax 7 percent of their investment in such enterprise. Such investment includes the original investment and under certain circumstances part of the earnings accumulated by the Thai enterprise. The United States presently allows a 7-percent credit for investment by U.S. taxpayers in certain types of business property located in the United States, and this treaty provision is intended to offer a similar incentive to private investment in Thailand. The article allowing the credit also contains provision for recapture of the credit under certain circumstances.

Another provision in this convention grants U.S. residents and corporations an election to defer tax on income resulting from the transfer of property, tech-

nical services, or know-how to a Thai corporation in exchange for its stock. The purpose of this provision is to enable U.S. investors to furnish property, services, or know-how to a Thai corporation without being required to pay, either in the United States or Thailand, tax at the time of such transfer. Payment of tax would require an additional initial cash outlay which might necessitate some disposition of the stock. Tax thus postponed may be imposed when the stock received is eventually disposed of.

Another provision of this convention allows U.S. citizens, residents, or corporations to deduct from their U.S. taxable income amounts donated to a qualifying Thai charitable organization. Similar provisions are included in the existing conventions with Honduras and Canada and the proposed convention with the Philippines.

The treaty does not include all of the limitations on tax at the source, primarily as respects rates of tax on investment income, which are usually included in conventions between developed countries. This reflects the fact that a less developed country derives limited amounts of income from sources in developed countries and that the usual restrictions on taxation at the source would tend to benefit the developed country without compensating benefits to the less developed country. Consequently, the convention provides for only a limited mutual restriction on dividend withholding tax rates and a narrow reciprocal exclusion from tax on interest. However, other provisions substantially restrict taxation at the source. As noted above, the most significant of these restrictions relate to the definition of permanent establishment and the taxation of business visitors. In addition, the treaty provides a mutual exemption from tax on the operations of aircraft in international traffic, a limited reduction of tax on income derived from international shipping, and a general limitation on the taxation of royalty income.

#### ARTICLE 1. TAXES COVERED

Article 1 designates the taxes of the respective States which are the subject of the convention. Generally, the provisions of the convention concern only the U.S. Federal income tax, including surtax, imposed by subtitle A of the Internal Revenue Code (but not including the accumulated earnings tax or the personal holding company tax) and the Thai income tax imposed by the Thai Revenue Code. The convention also applies to taxes substantially similar to those taxes specified which are subsequently imposed in addition to, or in place of, the existing income taxes. For purposes of the nondiscrimination provisions of article 23, however, the convention applies to taxes of every kind which are, or may be, imposed by the respective States, whether imposed at the National, State, or local level.

#### ARTICLE 2. GENERAL DEFINITIONS

This article sets out definitions of certain of the basic terms used in the convention and provides that any undefined term shall, unless the context otherwise requires, have the meaning which it has under the laws of the State imposing the tax.

#### ARTICLE 3. DEFINITION OF PERMANENT ESTABLISHMENT

This article defines the term "permanent establishment." The existence of a permanent establishment is, under the terms of the convention, a prerequisite for one State to tax the industrial or commercial profits of a resident or corporation of the other State. The concept is also significant in determining the applicability of other provisions of this convention, such as articles 9 and 11 dealing with dividends and royalties, respectively.

"Permanent establishment" is defined as "a fixed place of business through which a resident or corporation of one of the contracting States engages in trade or business." Illustrations of the concept of a fixed place of business are given in paragraph (2) and include an office; a store or other sales outlet; a workshop; a factory; a warehouse; a mine, a quarry, or other place of extraction of natural resources; and a building, construction, or installation site. As a general rule, any fixed facility through which business is conducted will be treated as a permanent establishment unless it falls within one of the specific exceptions described in paragraph (3).

Paragraph (3) sets out the exceptions to this general rule. These exceptions relate to sites and facilities used for—

- (1) Processing of goods or merchandise by another person.
- (2) The purchase of goods or merchandise.

(3) Storage or delivery, or storage and delivery of goods belonging to such resident or corporation, if such goods are not held for sale in a store or other sales outlet. Furthermore, this exception does not apply if the goods are purchased and resold within the State where the facility is located either by the owner of such goods or by an agent or agents acting on his behalf.

(4) Collecting information.

(5) Advertising, conducting research activities, displaying goods or merchandise, or supplying information, if these designated activities are of a preparatory or auxiliary nature in the trade or business.

(6) Construction, assembly, or installation projects if such sites or facilities are used for the designated purposes for less than 3 months.

These exceptions are cumulative and a site or facility used solely for one or all of these purposes will not be considered a permanent establishment under the treaty.

Paragraph (4) provides that notwithstanding the other provisions of article 3, a person will be considered to have a permanent establishment if he engages in business through an agent who has and regularly exercises authority to conclude contracts in the name of such person unless the agent only exercises such authority to purchase goods or merchandise. In addition, a permanent establishment will be considered to exist if an agent regularly secures orders or maintains a stock of goods or merchandise belonging to such person from which he regularly makes deliveries or fills orders.

However, paragraph (5) provides that paragraph (4) shall not apply if the agent is a bona fide broker, general commission agent, forwarding agent, custodian, or other agent of independent status acting in the ordinary course of its business. The agent will not be considered to be independent if he acts exclusively or almost exclusively as an agent for such person or for any other person controlling, controlled by, or under common control with such person. The rule provided in this paragraph modifies Thai internal law which currently provides for tax on a person in any case in which an agent, whether or not independent, regularly secures orders or maintains a stock of goods for him.

Paragraph (6) provides that the question of whether a corporation of one state has a permanent establishment in the other state is to be determined without regard to any control relationship between it and a corporation organized or engaged in trade or business in the other country. Therefore, a U.S. subsidiary of a Thai corporation may be considered an independent agent of such corporation if it otherwise meets the requirements of paragraph (5).

Paragraph (7) provides an overriding rule that a person of one state will be deemed to have a permanent establishment in the other state if he provides the services of public entertainers (described in art. 13(3)) in the latter state.

Paragraph (8) sets out a rule of general application which provides that if a resident or corporation of one country maintains a permanent establishment in the other country at any time during the taxable year, the permanent establishment will be considered to have existed for the entire taxable year.

Article 3 of the convention eliminates existing uncertainties respecting the application of Thai income tax to business activities in that country in the situations covered by the treaty. Furthermore, it operates to restrict Thai taxation of such activities. For example, under that country's law, a U.S. person will be considered engaged in business in Thailand if he acts in that country through a "go-between" (e.g., an independent broker). If considered so engaged, he will be taxed on all of his income arising from the business.

#### ARTICLE 4. BUSINESS PROFITS

This article corresponds generally to the article dealing with taxation of business profits which is found in other tax conventions to which the United States is a party. It provides that industrial or commercial profits of a resident or corporation of one State shall be exempt from tax in the other State if such resident or corporation does not have a permanent establishment in the latter State. If such resident or corporation does have a permanent establishment in the latter State, paragraph (2) provides that such latter State may tax the commercial or industrial profits of such resident or corporation which are from sources within it. This provision varies in form from the corresponding provision contained in many U.S. tax conventions in that it only permits taxation of industrial and commercial profits and does not authorize taxation of other forms of income from sources within the latter State. However, see articles 9 and 11 relating to dividends and royalties, respectively, for other cases in which

a person's tax liability is affected by having a permanent establishment within a State. The limitation on both countries' right to tax income not from sources within it conforms to existing Internal Revenue Code provisions but represents a restriction on Thailand's right to tax under its internal law.

Paragraph (3) provides that if a person has a permanent establishment within a State, such State shall allow as deductions, in computing the income subject to tax, all expenses, including executive and general administrative expenses, which are reasonably incurred in the production of such profits, wherever such expenses are incurred. This provision also represents a departure from Thailand's practice in the absence of treaty. It conforms to the rule provided by the Internal Revenue Code.

Paragraph (4) provides that the mere purchase of goods or merchandise by a person in a State where he has a permanent establishment will not give rise to income from within that State. This rule, which has the effect of exempting such income from tax in such State, conforms to existing U.S. statutory law. (See sec. 862(a)(6) of the Internal Revenue Code.) Other rules for determining the source of income are set forth in article 19.

#### ARTICLE 5. INVESTMENT CREDIT

This article provides, that subject to the specified terms and requirements, a U.S. resident or corporation shall be entitled to a 7-percent investment credit against his U.S. income tax for investment in Thailand.

The amount creditable against the U.S. income taxes is equal to 7 percent of the sum of the new investments (see discussion below) made in an eligible corporation by the U.S. resident or corporation during his taxable year and such person's pro rata share of the creditable reinvested earnings of the eligible corporation for its taxable year ending during his taxable year. The creditable reinvested earnings of an eligible corporation for any taxable year equal one-half of its earnings and profits, reduced by any dividends distributed by it during such year.

In no case, however, may the credits allowed to a person under the provisions of this article exceed the amount of U.S. property (see discussion below) invested by such person in the eligible corporation. U.S. property purchased by such corporation shall be treated as invested by such person (or if there are more than one such person, pro rata by such persons).

To obtain the credit, the U.S. resident or corporation must own 25 percent or more of the total combined voting stock of the corporation in which his investment is made. A corporation to be considered an eligible corporation—

(1) Must be organized in either the United States or Thailand;

(2) Must derive at least 80 percent of its gross income, if any, for its taxable year in which the investment is made from the conduct of a qualified trade or business (described in paragraph (3)); and

(3) On each day of such taxable year at least 80 percent in value of its assets must be used or held for use in connection with such trade or business, whether or not such assets are located in Thailand.

A trade or business is qualified to the extent it is conducted within Thailand and consists of certain activities specified in paragraph (3).

Paragraph (4) provides that in any taxable year in which a qualifying U.S. resident or corporate stockholder in an eligible corporation directly or indirectly withdraws property from such eligible corporation, such person's U.S. tax will be increased. Such increase shall not exceed the lesser of (a) 7 percent of the value of the property withdrawn by such person or (b) the amount by which such person's U.S. tax liability has been reduced in the taxable year of the withdrawal, the 3 preceding taxable years, and the next succeeding taxable year by virtue of the credit allowed by this article. Property shall be considered withdrawn from an eligible corporation if—

(1) The eligible corporation distributes property to such person or a person related to such person, unless such distribution is out of earnings and profits of the eligible corporation and does not exceed the amount which would have constituted reinvested earnings within the meaning of paragraph (1) had there been no such distribution.

(2) Payment is made of all or any part of any indebtedness owed by such corporation to such person or to any person related to such person.

(3) Such person disposes of stock in, or indebtedness of, the eligible corporation or a corporation which is related to such person and owns stock or indebtedness in the eligible corporation. Furthermore, if such person

ceases to own at least 25 percent of the total combined voting power of the eligible corporation (whether by reason of a disposition of his stock or otherwise) or if the corporation ceases to be eligible, he shall be deemed to have disposed of his entire interest. In the event of any such disposition, such person shall be considered to have withdrawn property equal to the fair market value of the stock or indebtedness disposed of.

(4) A corporation related to such person disposes of all or part of its stock or indebtedness in the eligible corporation.

A withdrawal of property from a corporation conducting in Thailand a trade or business similar or related to the trade or business conducted in Thailand by the eligible corporation shall be considered a withdrawal of property from the eligible corporation if the U.S. resident or corporate shareholder in the eligible corporation owns 25 percent or more of the total combined voting power of such other corporation.

Paragraph (5) defines the term "United States property" to mean any tangible personal property which has been manufactured, constructed, produced, grown, or extracted in the United States and thereafter continuously used, if at all, only in the United States. The term "new investment" is defined as the transfer of money or tangible property by a U.S. resident or corporation, other than a transfer in satisfaction of a preexisting indebtedness, provided—

(a) The property does not represent, either directly or indirectly, funds borrowed from within Thailand;

(b) Immediately after the transfer the transferred property is used or held for use by the eligible corporation in the conduct of a qualified trade or business; and

(c) The transferor does not receive payment for such property during the taxable year in which the transfer is made, other than stock or indebtedness of the transferee.

Paragraph (6) authorizes the Secretary of the Treasury of the United States, or his delegate, to issue regulations to effectuate the provisions of this article and to further define and determine the terms, conditions and amounts referred to in the article.

#### ARTICLE 6. TAX DEFERRAL FOR TECHNICAL ASSISTANCE

This article provides a deferral of the tax otherwise levied by the United States and Thailand on the receipt of stock (or rights to acquire stock) by a resident or corporation of one state from a corporation of the other state in exchange for certain types of property or services. The transfer of any patent, invention, model, design, secret formula or process, or similar property right, or of any information concerning industrial, commercial, or scientific knowledge, experience or skill, or the providing of technical, managerial, engineering, architectural, scientific, skilled, industrial, or similar services will serve as a basis for application of this article. The property or services transferred must be used by the recipient corporation in its trade or business in the state in which it is incorporated.

A person wishing the benefits of the section must elect for purposes of United States and Thai taxes to exclude from his income for the year of the exchange any amount otherwise includable by reason of such exchange. If this election is made, otherwise deductible expenses incurred in the transaction will not be currently deductible to the extent that they are allocable to amounts excluded from income.

When the stock or rights are disposed of, the amounts originally excludable or the amount received upon the disposition, whichever is less, must be included in taxable income. At such time, the deductions which were not currently deductible because of the election will be allowed.

For purposes of this article, the exercise of rights to acquire stock will not be considered a disposition of such rights.

Paragraph (2) provides the Secretary of the Treasury or his delegate with authority to prescribe regulations to effectuate the purposes of the article. The Thai Ministry of Finance is also given comparable authority. This paragraph also provides that a portion of stock received without tax may be required to be deposited in escrow for the purpose of assuring collection of the taxes payable upon its disposition.

The provisions of this article alter existing U.S. law relating to realization of gain on receipt of stock from a corporation. Under section 351 of the Internal Revenue Code the receipt of stock is taxable unless received in exchange for

property (not services) by a person or persons owning 80 percent or more of the voting stock and of each class of nonvoting stock of the issuing corporation. Furthermore, under section 367 income is realized on receipt of stock of a foreign corporation unless prior to such receipt it is found by the Internal Revenue Service that avoidance of U.S. income taxes is not one of the principal purposes of the transaction.

#### ARTICLE 7. SHIPPING AND AIR TRANSPORT

This article provides that a resident or corporation of the one state shall be exempt from tax in the other state on income derived from the operation of aircraft in international traffic and that the tax on income derived from the operation of ships in international traffic shall in such cases be reduced 50 percent. However, income derived by a U.S. person from the operation of a ship or aircraft shall qualify for these benefits only if the ship or aircraft is registered in the United States.

#### ARTICLE 8. RELATED ENTERPRISES

This provision corresponds in purpose and scope to section 482 of the Internal Revenue Code of 1954 and confirms the power of each government to redetermine the income of an enterprise if as a result of its transactions with related enterprises such income has been distorted. However, it is made clear that deductions shall be allowed for amounts properly paid to a related enterprise for services, including managerial or administrative services. The term "enterprise" is defined to mean a corporation, partnership, or other entity, or the income-producing activity of an individual, whether such individual is acting independently, as a member of a partnership, or in a fiduciary capacity.

#### ARTICLE 9. DIVIDENDS

This article limits to 20 percent the tax rate on dividends paid by a corporation of one state to a corporation of the other state, which does not have a permanent establishment in the former state and has owned 25 percent or more of the voting stock of the paying corporation for at least 6 months immediately prior to the date upon which the dividends become payable.

This article is more limited in scope than the corresponding article of most U.S. tax conventions, since it does not apply to dividends paid to an individual or to a corporation owning less than 25 percent of the voting stock of the payor corporation. On such dividends both countries remain free to impose their statutory withholding rates, a maximum of 30 percent in the United States and 25 percent in Thailand.

#### ARTICLE 10. INTEREST

This article provides that interest received by a government or any agency or instrumentality wholly owned by a government shall be exempt from tax in the other state. The treaty does not otherwise limit the tax which may be imposed by either state on interest derived from sources within it. The rules for determining the source of interest is set out in article 19.

#### ARTICLE 11. ROYALTIES

This article provides that royalties, other than natural resources royalties, derived from sources within one state by a resident or corporation of the other state will not be taxed in the former state at a rate in excess of 15 percent, if such recipient does not have a permanent establishment in such state. A source rule for royalties is provided in article 19. Natural resource royalties are taxed under article 12.

Paragraph (2) defines the term "royalties" to mean royalties, rentals, or other amounts paid for the use of, or the right to use—

(a) Copyrights, artistic or scientific works, patents, designs, plans, secret processes or formulae, trademarks, motion picture films, films or tapes for radio or television broadcasting, or other like property or rights, or

(b) Information concerning industrial, commercial or scientific knowledge, experience, or skill.

Any income derived from the sale or exchange of any of the property or information specified in paragraph (2) is also considered a royalty. However, the recipient may elect, with respect to such income, to deduct expenses attributable to such income and be taxed in the state of source as if he were engaged in trade or business there.

Absent this provision, Thailand taxes royalty income at the rate of 25 percent, except that on film royalties deductions are allowed which reduce the rate to 22.5 percent.

#### ARTICLE 12. INCOME FROM REAL PROPERTY

This article provides that a resident or corporation of one state subject to tax in the other state on income from real property, including gains derived from the sale or exchange of such property, or on royalties in respect of the operation of mines, quarries, or other natural resources, may elect for any taxable year to compute that tax on such income on a net basis. A similar provision appears in many tax conventions to which the United States is a party.

#### ARTICLE 13. INCOME FROM PERSONAL SERVICES

This article provides that an individual resident of one state is exempt from tax by the other state with respect to income from personal services performed in such other state if—

- (1) such person is physically present there for not more than 180 days during the taxable year for which the exemption is claimed;
- (2) such amount is not deducted in computing profits subject to tax in the latter contracting state; and
- (3) in the case of employment income, the services are rendered as an employee of a resident or corporation of the former state.

Absent the treaty both the United States and Thailand do not allow exemption for business visitors present for more than 3 months.

"Income from personal services" includes income from the performance of personal services in an independent capacity and "employment income." Employment income includes from services performed by officers and directors of corporations. However, income from personal services performed by partners is treated as income from the performance of services in an independent capacity.

The exemption applicable to personal service income is limited in the case of public entertainers, such as musicians, actors, or professional athletes. These persons are taxable if their income from such activities exceeds an average of \$100 (or its equivalent in baht) for each day the individual is present within the State or if the aggregate amount received for such services exceeds \$3,000 (or its equivalent in baht).

#### ARTICLE 14. TEACHERS

This article provides a reciprocal exemption from tax of the personal service income of visiting teachers. It applies only if the teacher is invited by the Government, a university or other accredited educational institution to teach or engaged in research activities, or both, at a university or other accredited educational institution. The exemption applies only to income received by the visiting teacher as compensation for such teaching or research activities. If the visit exceeds a period of 2 years, this exemption applies only to the income received by the visiting teacher before the expiration of such 2-year period.

#### ARTICLE 15. STUDENTS AND TRAINEES

This article provides that a resident of one State visiting the other State for the purpose of studying at a university or other accredited educational institution, securing training for qualification in a medical profession, or studying or doing research as a recipient of a grant, allowance, or award, is exempt from tax in the host State on—

- (1) Gifts from abroad for his maintenance or study;
- (2) The grant, allowance, or award; and

(3) Income from personal services performed in the host State not in excess of \$2,000 (or its equivalent in baht) for any taxable year. This exemption is increased to \$5,000 (or its equivalent in baht) if the student is training for qualification in a medical profession.

These exemptions continue for such period of time as may be reasonably or customarily required to effectuate the purpose of his visit but in no event for more than 5 taxable years.

Furthermore, a resident of one State, employed by or under contract with a resident or corporation of the other State, who visits the latter country for a period not in excess of 1 year for the purpose of studying or acquiring technical, professional, or business experience, is exempt from tax in such latter State on income from personal services rendered there not in excess of \$5,000 (or its

equivalent in baht). In order to qualify for the exemption, the visiting individual must study at a university or accredited educational institution in the host State, or receive his experience from a person other than the resident or corporation by which he is employed or under contract.

A resident of one State who visits the other State for a period not in excess of 1 year as a participant in a program sponsored by the Government of the host State for the primary purpose of training, research, or study shall be exempt from tax in the host State on income not in excess of \$10,000 (or its equivalent in baht) received for personal services performed in the host State in respect of such training, research, or study.

#### ARTICLE 16. GOVERNMENTAL SALARIES

This article exempts from tax wages, salaries, and similar compensation, pensions, annuities, or similar benefits paid by, or from public funds of, one of the States or a political subdivision thereof to a national of that State for services rendered to it or its political subdivisions in the discharge of governmental functions. U.S. social security payments will only be exempt from tax under this article if related to services rendered to the United States or its political subdivisions in the discharge of governmental functions.

#### ARTICLE 17. RULES APPLICABLE TO PERSONAL SERVICE ARTICLES

This article provides that articles 13 through 16 shall not apply to individuals who are citizens of or have immigrant status in the host state, and that for purposes of those articles, reimbursed travel expenses will be exempted as income from personal services but will not be taken into account in determining whether the maximum income exemptions in articles 13 and 15 have been exceeded. If an individual qualifies for the benefits of more than one of the provisions of articles 13, 14, and 15, he may choose the provision most favorable to him but he may not claim the benefits of more than one article in any one taxable year.

#### ARTICLE 18. DEDUCTION FOR CHARITABLE CONTRIBUTIONS

This article provides that a U.S. citizen, resident, or corporation may deduct for U.S. tax purposes contributions made to charitable organizations in Thailand if the following conditions are met:

- (1) The Thai organization has qualified as a charitable organization under the income tax laws of Thailand;
- (2) The contributions are used entirely within Thailand; and
- (3) The Thai organization has qualified as a tax-exempt organization under section 501(c)(3) of the U.S. Internal Revenue Code.

If these conditions are met, the contribution shall be treated as a charitable contribution as defined in section 170(c) and shall be deductible subject to the limitations contained in section 170 of the U.S. Internal Revenue Code.

#### ARTICLE 19. TAXATION AT SOURCE

This article provides that a resident or corporation of one state may be taxed by the other state only on income from sources within that other state and also sets forth the rules for determining the source of certain types of income.

The following items of income are to be considered from sources within a state:

(1) Interest paid by that state, including any local government within such state, or by a resident or corporation of such state. However, interest paid by a resident or corporation of one state with a permanent establishment in the other state or outside both states, directly out of the funds of such permanent establishment on indebtedness incurred for the sole use of, or on banking deposits made with, such permanent establishment, shall be treated as income from sources within the state where such permanent establishment is located. The rule set forth in the first sentence corresponds generally to the Internal Revenue Code provision dealing with interest (other than interest on deposits with persons carrying on the banking business). The exception to this general rule, contained in the second sentence, is not contained in the Internal Revenue Code provision.

(2) Dividends paid by a corporation of that state.

(3) Compensation for personal services performed aboard ships or aircraft operated by a resident or corporation of that state, provided the services are

performed by a member of the regular complement of the ship or aircraft. Compensation for personal services performed by a member of the regular complement of a ship or aircraft operated by a U.S. resident or corporation shall be considered from U.S. sources only if such ship or aircraft is registered in the United States.

(4) Compensation for personal services performed within the state (including private pensions or annuities paid in respect of such services) and income from providing personal services performed within that state.

(5) Rentals from personal property located within the state.

(6) Royalties for using, or the right to use, in the state, copyrights, artistic or scientific works, patents, designs, plans, secret processes or formulas, trademarks, motion picture films, films or tapes for radio or television broadcasting, or similar property or rights, or information concerning industrial, commercial, or scientific knowledge, experience, or skill. For the sources of natural resource royalties, see paragraph (8) below.

(7) Gain from the sale of property or rights specified in (6), if such sales takes place within the state. The gain shall also be considered from sources within the state if the sale is of rights to use the specified property, rights, or information in the state and are purchased by a resident or corporation of the state or out of funds of a permanent establishment located in the state.

(8) Income from real property located in the state, including the gain from the sale or exchange of real property, and royalty income from the operation of mines, quarries, or other natural resources located within the state. Interest income from mortgages or bonds secured by real property is not considered income from real property, but see (1) above.

(9) Income from the production of goods, either wholly or in part, in one state and the sale of such property to a buyer in the other state will be allocated in part to production and in part to the sale. Where possible, this allocation of income will be made by reference to prices and terms normally agreed upon by independent parties engaged in the same or similar activities. Otherwise, the allocation of such income is to be made with reference to the aggregate sales and property of the taxpayer within the state and other relevant factors. For purposes of this paragraph, production of goods includes manufacturing, fabricating, extracting, processing, or growing.

Any income of the types described above which is not specifically considered to be from sources within a state, will be treated as income from sources outside that state.

Several of the source rules set out in this article differ to some degree from those existing in the Internal Revenue Code. Since article 21 provides that the treaty shall not increase a person's U.S. tax, a taxpayer is entitled to use the more beneficial of the code or convention rules, in calculating his income for U.S. tax purposes or, in the case of a citizen, resident or corporation of the United States, his foreign tax credit. For example, the rule on interest in this article permits Thailand, under the proper circumstances, to impose a tax on any interest paid by a permanent establishment in Thailand of a United States corporation. While the rule appears to be fully reciprocal, the United States will not, because of section 861(a)(1)(B) of the code, impose on nonresident aliens and foreign corporations a tax on interest paid by a permanent establishment in the United States of a Thai corporation unless the Thai corporation derives 20 percent or more of its income from U.S. sources.

It should also be noted that, except as provided in article 20, the source rules do not serve to extend the benefits of this treaty to persons other than residents or corporations of the two states. Generally, the rules are only applicable to taxing residents or corporations of either state, and, therefore, are quite applicable in determining source of income of residents of other states, although the income of such other residents is of a type referred to in this article.

#### ARTICLE 20. EXEMPTION FROM TAX FOR INCOME FROM SOURCES IN OTHER CONTRACTING STATE

This article provides that residents and corporations of third countries receiving interest, dividends, or personal service income earned aboard ships or aircraft which under article 19 is considered to be from sources in one state, shall be exempt from tax by the other state on such income. This exemption does not apply to a citizen, resident, or corporation of the other state. This restriction parallels provisions in other treaties to which the United States is a party (e.g., Canada) except that it has been extended to apply to personal service income.

This provision may be illustrated by the following example: M, an individual national of Great Britain, is temporarily present in Thailand. While in Thailand, M receives dividends from a U.S. corporation. Article 19(1)(b) provides that such income is from U.S. sources. The dividend income is exempt from taxation in Thailand unless M is a resident of Thailand, regardless of the source rule provided for in Thai law.

#### ARTICLE 21. PROTECTION OF TAXPAYERS' RIGHTS UNDER OTHER LAW

This article provides that no provision of this convention will be construed so as to restrict in any manner any exclusion, exemption, deduction, credit, or other allowance presently or subsequently accorded by the laws of one of the states in determining the tax imposed by that state or by any other agreement between the two states.

This provision may be illustrated by the case of an alien individual resident of Thailand who is an employee of a foreign, but not a Thailand, corporation not engaged in trade or business in the United States. He is present in the United States for fewer than 90 days during the taxable year and receives less than \$3,000 for the services he performs in the United States during that period. His compensation is not exempt from tax under article 13 (taxation of personal service income) because that provision applies only to employees of Thailand corporations who otherwise satisfy the requirements of article 13(1)(c). Nevertheless, his compensation is exempt from U.S. tax by virtue of the provision of this article 21 since section 861(a)(3) of the U.S. Internal Revenue Code provides that such income is not to be considered to be from sources within the United States.

#### ARTICLE 22. RELIEF FROM DOUBLE TAXATION

This article provides that each state will allow a foreign tax credit for the appropriate amount of taxes paid to the other state. Thai law does not presently allow a credit absent a treaty provision of this nature.

For purposes of the U.S. tax credit, a taxpayer may use the source rules set out in article 19 in lieu of the source rules provided in the Internal Revenue Code. In all other respects the credit is to be computed under the rules provided in the code.

A Thai resident or corporation will be allowed a credit against Thai income tax for the appropriate amount of taxes paid to the United States. For this purpose, such amount shall be limited to that portion of the Thai tax which net income from sources within the United States bears to the total net income of such resident or corporation subject to Thai tax. The source rules set out in article 19 shall be applied to determine source of income. In computing the total income subject to Thai tax a loss incurred in any country shall not be taken into account.

#### ARTICLE 23. NONDISCRIMINATION

This article provides that the United States and Thailand will not discriminate in their tax law against their residents who are citizens of the other state nor against permanent establishments within their jurisdiction owned by nationals or corporations of the other state. This does not prevent either state from imposing whatever tax it desires on citizens of the other state, resident within its border, so long as such residents are treated no worse than its own citizens. Furthermore, if one state grants personal allowances or deductions only to its residents, it need not grant such allowances or deductions to nonresidents who are nationals of the other state.

A corporation of one state, the stock of which is completely or partly owned by citizens or corporations of the other state, may not be taxed more heavily than one owned wholly by citizens or corporations of the former state. There is no provision corresponding to this one in prior conventions to which the United States is a party.

The provisions of this article apply to State and local as well as National taxes.

#### ARTICLE 24. CONSULTATION AND TAXPAYER CLAIMS

This article provides that the competent authorities of the two states may—

- (1) Settle by mutual agreement all questions of interpretation or application of the convention;
- (2) Resolve any matter concerning the relation of this convention to any convention concluded by either country with third countries;

(3) Consult in regard to reaching a fair and equitable apportionment of industrial or commercial profits between a resident or corporation of one state and its permanent establishment in the other state; and

(4) Consult concerning the allocation of income between related enterprises as provided in article 8, and to adopt appropriate procedures for effectuating such apportionment or allocation.

#### ARTICLE 25. EXCHANGE OF INFORMATION

Article 25 provides for a system of administrative cooperation between the competent authorities of the two States and specifies conditions under which information may be exchanged to facilitate the administration of the convention and to prevent fraud or fiscal evasion of taxes to which the convention relates. This provision does not differ substantially from those found in existing tax conventions to which the United States is a party.

#### ARTICLE 26. ASSISTANCE IN COLLECTION

This article, which corresponds to articles in our existing treaties, provides that each State will assist the other in the collection of taxes imposed by such other State to the extent necessary to insure that any exemption or reduced rate of tax granted under the convention by the other States will not be enjoyed by persons not entitled to such benefits. However, neither State is required to take measures at variance with its administrative practice or which would be contrary to its sovereignty, security, or public policy. Nor is either State required to enforce the tax claims of the other or entertain suits on such claims in its courts.

#### ARTICLE 27. EXCHANGE OF LEGAL INFORMATION

This article specifically provides that the competent authority of each State shall advise the competent authority of the other State of any addition to or amendment of the tax laws of the country which concern the imposition of taxes which are the subject of this convention.

#### ARTICLE 28. TAXPAYER CLAIMS

Under this provision, where a citizen, resident, or corporation of either State shows proof that the action of the other State's tax authorities has resulted, or will possibly result, in double taxation in contravention of the provisions of the convention, such person may present his case to his State's competent authority, who may attempt to come to an agreement with the competent authority of the other State with a view to the avoidance of double taxation.

#### ARTICLE 29. SAVINGS CLAUSE

This article provides that with the specified exceptions the United States may tax its citizens, residents, and corporations as if the convention had not come into effect. A clause of this nature is found in most existing U.S. income tax conventions. The exceptions from this "savings clause" provision are made to preserve benefits which are specifically intended to apply to citizens (e.g., the investment credit provided by art. 5) or Thai nationals resident here (e.g., the nondiscrimination provisions of art. 23). Other excepted provisions are those relating to deferral of tax on technical assistance (art. 6), certain income from personal services, etc. (art. 13-17), the deduction for charitable contributions (art. 18), the convention source rules (art. 19), and the foreign tax credit (art. 22).

Corresponding rules apply to the right of Thailand to tax its residents and corporations.

#### ARTICLE 30. EFFECTIVE DATES AND RATIFICATION

This article provides for the ratification of the convention and for the exchange of instruments of ratification. It also provides that in general the convention will be effective for taxable years beginning on or after the 1st day of January of the year following that in which the exchange of the instruments of ratification took place. However, the investment credit provisions shall be effective retroactively to the 1st day of January of the year in which the instruments of ratification are exchanged. For this purpose, the credit for

reinvested earnings of an eligible corporation shall be allowable with respect to earnings for taxable years ending after the 1st day of January of the year in which such exchange takes place. Furthermore, the tax deferral for stock or rights to acquire stock received in exchange for technical assistance in article 6 will be effective on or after the 1st day of January of the year in which the exchange of instruments of ratification takes place.

The convention shall continue in effect indefinitely, but it may be terminated by either state at any time after 5 years from the first day of January of the year following that in which the instruments of ratification takes place. A state seeking to terminate the convention must give at least 6 months' prior notice of termination.

If the convention is terminated, such termination shall be effective for taxable years beginning on or after January 1 of the year following the end of the 6-month notice period. However, the United States may terminate without prior notice the provisions allowing the investment credit (art. 5) or the deduction for charitable contributions (art. 18) at any time 5 years after January 1 of the year following that in which the exchange of instruments of ratification takes place. Either state may similarly terminate its deferral of taxes for its residents and corporations under article 6 after 5 years. Such a termination will not affect the tax deferral allowed by the other state unless such other state also gives notice of such termination.

Any termination of the provisions of articles 5, 6, or 18 shall not apply to transactions entered into prior to such termination.

Senator GORE. Your statement is an able one. It accords to this issue the importance which I think the new features proposed in the treaty deserve.

I have found your statement very helpful.

As you say in conclusion, you hope that it helps to clarify and state the purposes which the administration has in mind. You may be sure that it has done so.

It is a technical matter, complicated and involved.

I think it would be helpful for the committee if, before interrogating you, we have a factual presentation by the director of the Joint Committee on Internal Revenue Taxation. It might be conducive to clarification, understanding, and expedition if tomorrow Mr. Woodworth makes his presentation, as he has been requested to do, and then you be available for questioning and for response to any points which he may have raised.

Mr. SURREY. That is quite satisfactory.

Senator GORE. Would you be available tomorrow?

Mr. SURREY. Yes, sir.

Senator GORE. The committee will adjourn until 10:30 tomorrow.

(Whereupon, at 12:25 p.m., the subcommittee recessed, to reconvene at 10:30 a.m., Thursday, August 12, 1965.)

THE HISTORY OF THE UNITED STATES

The history of the United States is a story of growth and change. It begins with the first settlers who came to the shores of North America. These early pioneers faced many hardships, but they persevered and built a new life for themselves. Over time, the colonies grew and became more independent. The American Revolution was a turning point in the nation's history, as the colonies fought for their freedom from British rule. The new nation was born, and it set out on a path of progress and innovation.

The early years of the United States were marked by westward expansion. Settlers moved across the continent, seeking new lands and opportunities. This period of exploration and settlement shaped the geographical and cultural landscape of the nation. The American Dream, the belief that anyone can achieve success through hard work and determination, became a central theme in the national identity. The United States emerged as a powerful and influential nation on the world stage.

The American Civil War was a defining moment in the nation's history. It was a struggle over the issue of slavery, which had long been a source of division and conflict. The war resulted in the preservation of the Union and the abolition of slavery. It led to the Reconstruction era, a period of rebuilding and reform. The United States emerged from the war as a more unified and powerful nation, with a stronger sense of national identity.

The late 19th and early 20th centuries were a time of rapid change and progress. The Industrial Revolution brought about significant advances in technology and industry. The United States became a world power, with its influence extending across the globe. The Progressive Era was a period of social and political reform, as Americans sought to address the challenges of a rapidly changing society. The United States continued to grow and evolve, shaping the course of world history.

The 20th century was a time of great challenges and achievements. The United States played a leading role in the world during the two world wars. The Cold War era was a period of tension and competition between the United States and the Soviet Union. The United States emerged as a superpower, with its influence and leadership shaping the global order. The civil rights movement was a defining moment in the nation's history, as Americans fought for equality and justice for all.

The United States continues to evolve and shape the world. It remains a nation of innovation, progress, and opportunity. The American Dream continues to inspire and motivate people from all over the world. The United States is a land of hope and possibility, where the future is bright and full of promise. The history of the United States is a story of resilience and triumph, a testament to the power of the human spirit.

## TAX CONVENTION WITH THAILAND

FRIDAY, AUGUST 13, 1965

UNITED STATES SENATE,  
SUBCOMMITTEE OF THE  
COMMITTEE ON FOREIGN RELATIONS,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10:20 a.m., in room 4221, New Senate Office Building, Senator Albert Gore presiding.

Present: Senators Gore, Symington, Pell, and Williams.

Senator GORE. The committee will come to order.

Today is the second day of hearings on the proposed treaty with Thailand. The committee is going into this proposed treaty with Thailand with care because, if it is approved, similar treaties are likely to be entered into with many countries. Therefore, the Chair feels that this is important in and of itself but far more important because of its precedential nature.

The witness this morning is Mr. Laurence N. Woodworth, chief of staff, Joint Committee on Internal Revenue Taxation.

The Chair requested testimony of Mr. Woodworth, not as a proponent or opponent but to give technical analysis of the tax features involved in the proposed treaty.

Mr. Woodworth, the committee will be very pleased to hear you.

Before you start, I want to take this opportunity to express my pleasure and my admiration in the work which you are doing with the staff of the Joint Committee on Internal Revenue Taxation.

### STATEMENT OF LAURENCE N. WOODWORTH, CHIEF OF STAFF, JOINT COMMITTEE ON INTERNAL REVENUE TAXATION; ACCOMPANIED BY CARL NORDBERG

Mr. WOODWORTH. Thank you very much, Mr. Chairman.

As has been indicated, I appear at your invitation, and for the record, my name is Laurence Woodworth, chief of staff of the Joint Committee on Internal Revenue Taxation, and this is Mr. Carl Nordberg of our staff who is with me.

I have a prepared statement which I would like to submit for the record. It is an analysis of what I consider to be the major provisions of the convention now before this committee. Apart from that, however, I think it might be most useful to the committee if I were simply to discuss with you the most significant articles in this convention.

Senator GORE. Without objection, your full statement will be printed in the record, and now, the committee will be pleased to hear you ad lib.

(The prepared statement of Mr. Woodworth follows:)

## STATEMENT OF LAURENCE N. WOODWORTH, CHIEF OF STAFF, JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

Mr. Chairman, my name is Laurence N. Woodworth. I am chief of staff of the Joint Committee on Internal Revenue Taxation. I appear today at your invitation. This is in accord with the policy followed by the joint committee staff in the past in providing for technical assistance on these treaties. The matter before this committee is the proposed income tax convention between the United States and Thailand. The principal purpose of tax conventions in the past has been the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. While these purposes include the stimulation of investment, I believe the treaty with Thailand emphasizes this much more than prior treaties. My discussion follows the articles of the convention but is concerned only with those provisions which I consider to be the most significant. In most instances I shall endeavor to sketch in the general approach existing tax treaties have taken to similar problems.

## ARTICLE 3. DEFINITION OF PERMANENT ESTABLISHMENT

*A. General treaty approach*

The basic concept utilized in tax treaties to avoid double taxation is that a nonresident alien who is a citizen or resident of the one country is generally not taxed on his profits from the other country, unless the profits are allocable to a so-called "permanent establishment" of the taxpayer within that other country. Although the "permanent establishment" concept is basic to all tax treaties, each case must be decided on the basis of the particular treaty, protocol, and regulations involved, for this term is defined so as to have a somewhat different scope in different treaties.

Income tax conventions to which the United States is a party, without exception, start with the proposition that the term "permanent establishment" requires the maintenance of an office, factory, mine, or other fixed place of business in a country by an enterprise of the other country. Invariably, however, this general rule is modified to permit the maintenance of an office, etc., without being treated as "a permanent establishment" provided the functions performed in the office are restricted to specific activities. More recent conventions extend the scope of the activities to permit the purchase and storage of goods, while the most recent conventions permit substantial economic penetration of a host country through the use of an office, etc., without causing the maintenance of the office to be considered a "permanent establishment."

The definitions adopted also provide that the term "permanent establishment" includes the presence within the host country of an agent who has the power to conclude contracts for its principal if the agent habitually exercises that power. In general, however, an agent having "independent" status is not considered a permanent establishment. [Examples are a bona fide commission agent, broker, or other independent agent (including a subsidiary corporation) acting in the ordinary course of its business.]

*B. Thai convention*

Generally, the proposed convention adopts the basic concepts contained in existing conventions to which the United States is a party by defining a "permanent establishment" as the maintenance of a fixed place of business, such as an office, factory, mine, etc. Moreover, the proposed convention essentially adopts the approach taken in the most recent U.S. income tax conventions, and that contained in the OECD draft convention, by modifying this general rule to provide that even though an office, etc., exists, the enterprise will not be deemed to have a permanent establishment if it is used—

(a) For the storage, display, or delivery of goods belonging to the enterprise (the Thai draft precludes application of this provision in the case of goods held for sale in a store or other sales outlet);

(b) For the purchase of goods or merchandise;

(c) For the processing by another person of goods belonging to the enterprise;

(d) For advertising, the conduct of scientific research, or the supply of information; and

(e) For construction, assembly or installation projects if used for that purpose for less than 3 months.

Thus, the fixed place of business portion of the "permanent establishment" definition is, in general, comparable to that contained in recent income tax con-

ventions to which the United States is a party. However, the definition of a permanent establishment varies from the definitions usually followed in the past in one important respect. Let me explain:

As in the past, the proposed convention provides that, notwithstanding the absence of a fixed place of business, an enterprise of one country will be deemed to have a permanent establishment in the other if it has an agent in that country who has power to contract on the part of his principal and regularly exercises that power (other than for the purchase of goods) or who regularly maintains a stock of goods in the country from which he regularly fills orders or makes deliveries.

The proposed convention extends this rule to also provide that a permanent establishment will be deemed to exist if an agent regularly secures orders for the enterprise.

Prior income tax conventions usually provided that the agency rule does not apply in the case of bona fide commission agents, brokers, or other agents of independent status acting in the ordinary course of its business. However, the proposed convention while providing such a limitation imposes a new restriction on it. It provides that a permanent establishment will be deemed to exist, *even though* the agent is of "independent" status if the agent acts exclusively, or almost exclusively, for the enterprise, whether or not the agent is related to, or controlled by, the enterprise. In other words, if a U.S. corporation has an exclusive agent in Thailand, it is deemed to have a permanent establishment in that country. I understand that the Treasury in any new negotiations will see if this particular point can be met without a conclusive finding that a permanent establishment will exist in such a case.

#### ARTICLE 5. INVESTMENT CREDIT

##### A. General treaty approach

At the present time the United States has in effect tax conventions with most of the developed nations of the world, while the only two less developed countries with which the United States has treaties are Pakistan and Honduras. We also have treaties with Greece and Finland which are sometimes classified as less developed countries. The effecting of a tax treaty between a developed country, such as the United States, and a less developed country, such as Thailand, has always been confronted with the problem of the absence of equivalent reciprocal benefits. Although, as a consequence of a treaty, the revenue of each country is reduced reflecting the benefits obtained by the investors and traders of the other country, similarly, each country has gains for its own investors and traders. However, there are fewer investors and traders in less developed countries with activities in the United States. In addition, the revenue losses involved in standard treaty provisions are likely to be a more significant percentage of the overall revenues of a less developed country. Also, as a psychological matter, a sacrifice of revenues from income accruing to foreigners is likely to be viewed by the less developed countries as a more serious step. Consequently, less developed countries have been reluctant to enter into tax treaties with the United States unless the standard treaty provisions are altered so as to grant them what they believe to be significant benefits.

In response to this problem, in the past, our treaty negotiations with less-developed countries led into the concept of "tax sparing." However, this concept was not accepted, with the result that three treaties which contained the tax-sparing concept (India, Israel, and United Arab Republic) were withdrawn. The Thai convention contains a new incentive for less-developed countries to enter into tax conventions with the United States which is the investment credit concept. A similar provision may be found in the Israel convention.

##### B. Thai convention

The proposed Thai convention contains provisions which would allow United States taxpayers an investment credit for investments made in eligible Thai corporations. The allowance of the credit is unilateral. The investment credit provision in the proposed convention differs in certain respects from the credit allowable with respect to domestic investment provided by the Revenue Act of 1962 (sec. 38 of the Internal Revenue Code). In large measure, the treaty provision is patterned after a bill recommended by President Johnson in a message to Congress dated March 19, 1964, and introduced in the House of Representatives on June 9, 1964, by Mr. Boggs, as H.R. 11524, the Less Developed Country Investment Act. However, the rate of credit provided in the proposed conven-

tions is 7 percent, rather than 30 percent as recommended in the President's message and provided in H.R. 11524.

(1) *Who receives the credit?*—Generally, individuals, resident in the United States and U.S. corporations owning 25 percent or more of the total combined voting power of stock of "eligible corporations" are, subject to certain limitations, entitled to the 7-percent investment credit.

(2) *Eligible corporations.*—An "eligible corporation" must be a U.S. corporation or a Thai corporation which derives 80 percent of its gross income from the active conduct of a qualified trade or business, and uses 80 percent of its assets in the conduct of one or more of its qualified trades or businesses.

A qualified trade or business under the Thai convention may consist of—

(a) The manufacture or production of property; however, the extraction, smelting, or refining of any mineral, ore, oil, or gas does not constitute a "qualified trade or business." The exclusion of these activities apparently is, at least in part, based on the theory that the allowance of an investment credit with respect to such investment would be superfluous since minerals must, of necessity, be extracted from the spot where nature placed them. Other reasoning would appear to be required in denying the credit for investments in refineries and smelting, since this activity need not take place at the point of extraction.

(b) The sale of tangible personal property to the general public through retail establishments.

(c) The catching or taking of fish.

(d) The processing and/or marketing of agricultural or horticultural products or commodities (including livestock, poultry, fur-bearing animals, etc.).

(e) The furnishing of industrial, financial, technical, scientific, engineering, or architectural services which are utilized in Thailand.

The foreign investment credit is available with respect to investment in these businesses regardless of how the eligible corporation employs its retained earnings or any new investment funds it receives from a U.S. shareholder. Thus, while the domestic investment credit is primarily limited to investments in depreciable personal property with a useful life of 8 years or more (a reduced credit is available for property with useful lives of between 4 and 8 years), the foreign investment credit is available with respect to the acquisition of land, inventory, securities, and cash (provided the corporation does not unreasonably accumulate income).

(3) *Base on which credit is determined.*—Under the proposed convention, the credit allowable is equal to 7 percent of (a) new investment in the eligible corporation made by the U.S. shareholder entitled to the credit and (b) the U.S. shareholder's pro rata share of the undistributed earnings and profits of the eligible corporation for the current year to the extent they exceed one-half of the earnings and profits for that year. The reinvested earnings provisions, in effect, assume that one-half of the earnings and profits would, under normal circumstances, be retained by the eligible corporation, so that the credit is not available with respect to that portion of the earnings and profits. For example, if an eligible corporation had current earnings and profits of \$100 and distributed \$20 as a dividend, the investment credit would be based on \$30, that is the excess of the undistributed profits (\$80) over one-half the current year's profits (\$50).

(4) *Limitation.*—The 7-percent credit is limited to the amount of U.S. property which the shareholder contributes to the eligible enterprise or to purchases by the eligible enterprise of U.S. property. However, the credit may equal 100 percent of the U.S. shareholder's tax liability as otherwise determined. There is no limitation based on the amount of income generated by the investment upon which the credit was granted. The domestic credit is limited to \$25,000 plus 25 percent of the U.S. taxpayer's liability in excess of \$25,000.

(5) *Rollover.*—Up to this point, I have described primarily features of the foreign investment credit which are more liberal than the domestic credit. However, in one important respect, the foreign investment credit is less liberal than the domestic credit. The domestic credit represents amounts spent for tangible personal property—and in some cases, real property. Because of this, each time the same funds are used to purchase property a new investment credit is available. For example, in the case of property with an 8-year life there is an investment credit for the first purchase. Then when the depreciation reserve is accumulated to a sufficient size at the end of 8 years to acquire a new asset and such an asset is acquired, a second investment credit is available. It

is important to note that the investment credit in this case is granted every 8 years with respect to the same sum of money. Under the foreign investment credit, in the case of contributions to capital only one investment credit is available for all time. Much the same thing is true of the investment credit which arises from the retained earnings. While it is true that they were from capital which may itself have given rise to an investment credit, nevertheless, they represent a separate fund of money rather than a mere rollover of existing funds. As a result, in this respect, the foreign investment credit will be smaller than the presently available domestic investment credit. On the other hand, I have already pointed out areas where the foreign investment credit is more generous.

(6) *Recapture.*—The proposed convention contains a recapture provision which provides in effect that in any year in which a qualifying U.S. resident or corporation directly or indirectly withdraws his investment from an eligible corporation such person's tax will be increased by approximately the amount of the credit which the taxpayer had taken for the year in question, the 3 preceding years and the 1 succeeding year.

#### ARTICLE 6. TAX DEFERRAL FOR TECHNICAL ASSISTANCE

##### A. *General treaty approach*

Tax deferral, like the investment credit provision, is a new concept in tax treaties designed to induce the flow of services and know-how to less developed countries in joint ventures. There are no comparable provisions in our present treaties.

##### B. *Thai convention*

The proposed Thai Convention contains a tax deferral provision which would permit U.S. residents and corporations to elect to defer either U.S. and Thai tax, as the case may be, on the receipt of stock in a Thai corporation or U.S. corporation where the stock is received in return for technical assistance. Specifically, this provision applies to the right to use—

(1) A patent, invention, model, design, secret formula or process, or similar property right;

(2) Information concerning industrial, commercial, or scientific knowledge, experience, or skill; or

(3) Technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services; (these services do not have to be furnished in connection with a right referred to in (1) or (2)).

The "property" or service received by a corporation must be used in the active conduct of a trade or business conducted in its own country.

The proposed provisions in effect allow a U.S. taxpayer to defer payment of his U.S. tax on the receipt of stock from the year of receipt to the year in which stock is sold or otherwise disposed of without regard to the provisions of the code which allow such deferral only in certain cases (sec. 351) and subject to approval of the transaction by the Internal Revenue Service (sec. 367). The deferral privilege granted in this convention is reciprocal, unlike the investment credit provision, so that it also applies to the transfer of patents, etc., by Thai residents or corporations to U.S. corporations in exchange for their stock if the patent, etc., is used in the active conduct of a trade or business in the United States.

The tax deferral privilege granted in the proposed Thai convention will normally arise in cases in which a U.S. manufacturer agrees to assist a Thai corporation to make in Thailand the same kind of products as it makes in the United States. In such a case, a U.S. corporation typically grants to the transferee (a) rights to use manufacturing processes to which the U.S. corporation has exclusive rights by virtue of process patents and/or (b) agrees to furnish technical assistance in the operation of the plant, marketing of the product, etc.

Tax deferral, in effect, exists under our tax law in cases where the U.S. corporation transfers patents, secret processes, and other similar "property" rights to a foreign corporation controlled to the extent of 80 percent by the U.S. corporation and other related corporations. Thus, the principal effects of the draft provisions in this area are to, in effect, remove this 80-percent requirement, to relieve U.S. taxpayers of the requirement to obtain advance rulings from the Treasury Department (although these are supposed to be obtainable in such cases) and to, in large part, eliminate the necessity to distinguish between transfers of property and services.

## ARTICLE 7. SHIPPING AND AIR TRANSPORTATION

*A. General treaty approach*

As a general rule, most income tax conventions to which the United States is a party provide that income derived by an enterprise of one of the contracting states from the operation of ships or aircraft registered in that state shall be exempt from taxation in the other contracting state.

*B. Thai convention*

The Thai treaty provides that income derived by a resident or corporation of either the United States or Thailand from international traffic of aircraft registered in one of the states shall be exempt from taxation in the other state.

The same rule is applied with respect to income derived from the operation of international traffic of ships, except that only a 50-percent reduction of the amount of tax which would have been imposed in the absence of this convention is provided.

## ARTICLE 9. DIVIDENDS

*A. General treaty approach*

Most income tax conventions to which the United States is a party reduce, on a reciprocal basis, source country tax on dividends paid nonresident shareholders. In the more recent conventions, the maximum source country rate has generally been set so as not to exceed 15 percent in cases of general application, with a maximum rate of 5 percent provided in the case of closely held corporations.

*B. Thai convention*

The proposed Thai convention also provides in most cases for a reduction of source country tax on dividend income paid to foreign parent corporations. No treaty rate is provided for individuals or for corporations not having a 25 percent interest in the individual payor. The Thai statutory tax on dividends paid by Thai corporations to U.S. shareholders varies from 15 to 25 percent. The provision in the Thai convention provides that a source country will limit its tax to 20 percent. The provision is reciprocal and this reduces the U.S. tax from 30 percent (or progressive rates in the case of individual taxpayers) to 20 percent on dividends paid by U.S. corporations to Thai residents and corporations which own 25 percent or more of the voting stock of the payor corporation for at least 6 months prior to payment of the dividend.

It should be noted that limiting the Thai tax rate on dividends to 20 percent has the effect of making the aggregate of Thai taxes paid on corporate profits creditable in full against U.S. tax (25 percent corporate rate plus a 20 percent rate on the remaining 75 percent of corporate profits equals a 40 percent tax).

## ARTICLE 11. ROYALTIES

*A. General treaty approach*

Almost all of the income tax conventions to which the United States is a party provide an exemption from tax in the source country for nonmineral royalties paid to residents or corporations of the other country provided the recipient does not have a permanent establishment in the source country. The OECD draft convention also provides for complete exemption of such royalty income from tax in the source country.

*B. Thai convention*

The proposed Thai convention provides for reduction in source country tax to 15 percent in the case of "royalty" income if the recipient does not have a permanent establishment in the source country. Mineral royalties will be subject to the normal tax rates (15 to 25 percent) but will be taxed on a net basis. The 15-percent rate in the case of Thailand compares with a normal statutory rate of 15 to 25 percent. In the case of U.S. source royalty income of Thai residents, the reduced source country rate compares with a 30-percent U.S. statutory rate otherwise generally applicable.

Failure to eliminate all source country tax does not normally affect the overall tax liability of the U.S. taxpayers involved, but instead does not shift the tax on income from the source country to the country of the recipient's residence. This is true because the source country tax is generally creditable in full by the recipient against his tax liability in the country of his residence. However, in those cases where the U.S. recipient incurs substantial expenses

in producing the royalty income, the application of source country rates to gross royalty income may result in a substantial tax burden in the source country against the U.S. recipient, since its rate is applied to gross income which may greatly exceed the tax on net income (offset by a foreign tax credit) in the country of residence.

#### ARTICLE 13. INCOME FROM PERSONAL SERVICES

##### *A. General treaty approach*

Under the Internal Revenue Code, the United States does not tax the income of a nonresident alien individual earned from services performed by him in the United States if—

(1) The recipient is present in the United States for less than 90 days during the taxable year;

(2) His aggregate income for services performed in the United States does not exceed \$3,000; and

(3) He performs the services as an employee of a foreign individual, partnership, or corporation which is not engaged in a business in the United States or for a foreign branch of a U.S. company.

In general, existing income tax conventions extend the period a nonresident may be present in the United States (generally from 90 days to 183 days) and, in effect, eliminate either the \$3,000 income limitation or the foreign employer requirement by not taxing nonresidents in the host country if either requirement is satisfied.

##### *B. Thai convention*

The Thai convention extends the 90-day presence exemption to 180 days and eliminates the \$3,000 per year limitation. This rule is consistent with those found in some of the prior income tax conventions to which the United States is a party.

The convention, however, provides a specific dollar limitation on the amount of earned income which may be received tax free in the source country by public entertainers (actors, athletes, etc.). Compensation of such persons in excess of \$100 for each day the person is present in the country is taxed and in no event may the exempt amount exceed \$3,000 per year. However, since the U.S. statutory law provides an exemption, notwithstanding the daily rate of compensation, of up to \$3,000 a year a Thai nonresident alien avoids the \$100 per day limitation.

#### ARTICLE 14. TEACHERS

##### *A. General treaty approach*

In order to facilitate the interchange of teachers between countries, prior income tax conventions have uniformly provided some exemption from tax in the source country for amounts paid teachers temporarily present in the source country at the invitation of the Government or an educational institution. As a general rule, the earlier conventions limit the exemption to those persons who are present in a host country for 2 years or less, while the most recent conventions provide exemption for the first 2 years of presence even though a teacher's stay may exceed that time. The most recent conventions also extend the benefits of the exemption to the salary of persons who engage in research at an educational institution.

##### *B. Thai convention*

The proposed convention follows the rule contained in the most recent U.S. tax conventions by providing that residents of one country will be exempt from tax in the other for 2 years if they are present in that country for the purpose of teaching or engaging in research at an accredited educational institution. The exemption, of course, is limited to their income from teaching or research.

#### ARTICLE 15. STUDENTS AND TRAINEES

##### *A. General treaty approach*

Our present income tax conventions generally provide that students who are residents or citizens of one country will be exempt from tax on certain income in the other country if they are present in that country for the purpose of attending school. As a general rule, this exemption is limited to "remittances" from abroad, and then only if the "remittance" is used by the student for his maintenance or education.

Outside of these exemptions, foreigners attending school in the United States are generally subject to tax on their U.S. source income, such as income from part-time jobs, in the same manner as U.S. citizens. In addition, if a foreigner receives a scholarship from a U.S.-exempt organization, the award is treated in the same manner as if the recipient were a U.S. person.

Some of the most recent conventions also provide that students will be taxed in the United States as nonresident aliens (that is, only on their U.S. source income). This rule, while probably of limited application, does prevent a controversy from arising in the country in which the student is attending school as to whether he has attained resident status in that country (and is therefore subject to tax in that country on his worldwide income).

#### *B. Thai convention*

The proposed convention goes beyond the exemptions previously dealt with; namely, "remittances from abroad" used for maintenance and study, and provides complete exemption for all grants, allowances, and awards, from whatever source derived, as well as for limited amounts of income for personal services derived from sources within the country in which the individual is attending school. Thus, for example, Thai students attending school in the United States would, under the proposed convention, be exempt on \$2,000 of income derived from personal services performed in the United States (for example, part-time jobs). In the case of Thai students pursuing a course of medical study in the United States, the exemption for earned income would be increased to \$5,000 per year. The exemptions provided may apply for a 5-year period.

It should be noted that we are granting foreign students and researchers somewhat more favorable tax treatment on U.S. source earned income and awards than that accorded students who study or conduct research in the country of their citizenship or residence.

The tax concessions outlined above obviously are intended to encourage an interchange of students between the treaty countries involved.

In addition to the exemptions applicable to students, the proposed convention, consistent with prior conventions, provides limited exemptions for earned income of technical, professional, or business employees of corporations of one country who are temporarily present in the other for training purposes (\$5,000 a year) and for recipients of earned income under Government-sponsored exchange training programs (\$10,000 a year).

### ARTICLE 18. DEDUCTION FOR CHARITABLE CONTRIBUTIONS

#### *A. General treaty approach*

Under the Internal Revenue Code of 1954, U.S. taxpayers may deduct as charitable contributions, among other things, contributions to corporations organized for religious, charitable, scientific, literary, or educational purposes if the charitable corporation is organized in the United States. In no case can a U.S. taxpayer claim as a charitable deduction contributions to a charity organized abroad.

Under existing income tax conventions with Canada and Honduras, U.S. taxpayers are entitled to deduct contributions to Canadian and Honduran charities, but only to the extent of an applicable percentage (generally 30 percent in the case of individuals and 5 percent in the case of corporations) of their Canadian or Honduran source income, as the case may be.

#### *B. Thai convention*

The proposed Thai convention would allow U.S. individual and corporate taxpayers to deduct contributions to Thai charities (subject to the statutory limitations otherwise applicable if the contributions were to U.S. charities) if (1) the foreign charitable organization has qualified as a charitable (etc.) organization under the Internal Revenue Code of 1954 (sec. 501(c)(3)), and (2) the contribution is used entirely within Thailand. One basic distinction between this treaty and the two existing treaties which contain a charitable contribution provision is that unlike the existing provisions this provision does not limit the deduction to a percentage of the taxpayer's income from Thailand.

### ARTICLE 19. TAXATION AT SOURCE

#### *A. General treaty approach*

In the case of U.S. taxation of nonresident aliens of foreign corporations, the Internal Revenue Code contains detailed rules specifying what income will, and

what will not, be considered derived from sources within the United States for tax purposes. However, similar detailed source rules are often not established under the statutory laws of many foreign countries. In the interest of conformity and clarity, most recent tax conventions to which the United States is a party specify some rules, which are generally patterned after the U.S. statutory rules, to govern transactions covered by the conventions.

#### *B. Thai convention*

The treaty provides that a resident or corporation of one country shall be taxable in the other country only on income derived from sources within such other country, and specifies various items of gross income which are to be so treated. The only unique rule relates to interest.

Generally interest received from the contracting State or a resident or corporation of that contracting State is considered to be income from sources within that State. However, where the interest is, in fact, being paid by a permanent establishment of a corporation or resident of one of the contracting States, the interest shall be considered as from sources within the State wherein the permanent establishment is located, whether that State is a contracting State or some other State.

### ARTICLE 22. ELIMINATION OF DOUBLE TAXATION

#### *A. General treaty approach*

A basic purpose of bilateral income tax conventions is to relieve or eliminate tax burdens imposed when the same income of one person is taxed in more than one country. This is accomplished in the United States primarily by the statutory foreign tax credit provisions in the Internal Revenue Code (secs. 901-905), although it has also utilized the exclusion method in limited cases (for example, in the case of interest and royalty income when, by treaty, it relinquishes its right to tax interest and royalty income derived from sources within the United States by residents of the other treaty country).

#### *B. Thai convention*

The proposed convention adopts the tax-credit approach for the relief of double taxation. Since the internal statutory laws of Thailand do not provide for a credit against their taxes for taxes paid foreign countries, their adoption of a tax-credit approach tends to relieve their taxpayers, including U.S. citizens resident in Thailand from double taxation on the same income.

### ARTICLE 23. NONDISCRIMINATION

This article provides that neither of the contracting States will treat the other nationals who reside in it any worse than its own nationals. Of particular note is that provision which extends this nondiscrimination to subsidiaries of U.S. corporations.

### ARTICLES 24-30. ADMINISTRATIVE PROVISIONS

#### *A. General treaty approach*

Most income tax conventions to which the United States is a party provide for the exchange of information between the contracting countries, for assistance in collecting taxes due, and for the negotiation of differences.

#### *B. Thai convention*

The proposed convention contains provisions comparable to those contained in prior conventions, with particular emphasis on the desirability of consultation in an endeavor to prevent inconsistent determinations with respect to allocation of income and expenses of a single enterprise.

In addition, the usual savings clause provision is provided in the treaty. This clause reserves to the United States and Thailand the right to tax their individuals, residents, or corporations as if the treaty had not come into effect. There are, however, important exceptions to this clause. These include the foreign investment credit, deferral of tax on technical assistance, charitable contributions, and the foreign tax credit.

The final title is the effective date clause.

## PERMANENT ESTABLISHMENT

Mr. WOODWORTH. Thank you.

I would like first of all to comment on article 3, the definition of "permanent establishment."

Generally in tax conventions in the past, we have had a reference to permanent establishment, and this has been an important concept in almost all of our tax treaties. It deals with the question of how profits are taxed.

Senator GORE. Is that the only thing with which it deals?

Mr. WOODWORTH. Generally speaking, yes. The problem involved is the tax treatment of business profits, not necessarily limited to those from a corporation. An individual in business abroad is affected as well. The idea of a permanent establishment is similar to the idea of a trade or business which is used more normally in the Internal Revenue Code.

Senator GORE. How do you use the word "profit"? Do you mean net, gross; do you mean income?

Mr. WOODWORTH. When I say "profits," I am using it in the general sense on purpose, because it deals ultimately with the taxable income of the business enterprise.

Senator GORE. So you consciously use the word "profit" then?

Mr. WOODWORTH. Yes, that is correct. Just as a general expression to indicate that the profits of a business are taxed.

Senator SYMINGTON. Do you mean income including profits?

Mr. WOODWORTH. I mean income from a trade or business.

Senator SYMINGTON. Yes.

Mr. WOODWORTH. Generally the idea of a permanent establishment requires the maintenance in a country of an office, factory, mine, or other fixed place of business. The mere maintenance of an office does not necessarily lead to a permanent establishment if the activities are quite limited.

For example, previous tax conventions have provided that the purchase of goods and storage of goods has not constituted a permanent establishment.

However, a permanent establishment has been deemed to exist where an agent has the power to conclude contracts unless that power is merely to purchase goods.

Senator GORE. Are you speaking of the definition as contained in the proposed treaty?

Mr. WOODWORTH. At the moment I am speaking of the definition as it appears in most tax conventions that the United States has entered into. I will refer shortly to the differences in the Thai Treaty.

Also in the tax conventions generally an agent with independent status, independent of the company that he may be representing in a particular transaction, is not considered a permanent establishment.

## UNIQUE FEATURES OF THAI TREATY

The Thai Treaty follows all of the rules that I outlined to you up to this point. However, it does have a feature which has not been generally provided in the treaties in the past and one on which I

understand there is some considerable concern on the part of the business community. It provides that even though there is an agency relationship and even though otherwise this agent is independent, if he does business, either exclusively or almost exclusively, for one particular company, then the Thai Treaty would consider that company as being engaged in trade or business or as having a permanent establishment in that country.

Senator GORE. Excuse me. Do you mean that he personally will be regarded as—

Mr. WOODWORTH. No; I mean more than that. I mean that if he acts as the exclusive agent or almost exclusively as the agent for any particular company, then that company is considered as having a permanent establishment in the country, in Thailand.

Senator GORE. You mean under the proposed treaty?

Mr. WOODWORTH. Yes.

Senator SYMINGTON. Let me get it straight. Permanent establishment would be a corporation? If a man represents that corporation as his primary interest he is involved. If he represents that corporation, but also other corporations, somewhere along the line he is not involved as his primary interest. Right?

Mr. WOODWORTH. That is correct, if his activities with respect to it are relatively limited.

Senator SYMINGTON. Suppose he is a manufacturer's agent and he represents five companies, but does 90 percent of his business with one of those companies. As to who decides. Does he, or do we or the Thai Government under the proposed treaty?

Mr. WOODWORTH. I would think that the issue that arises in the case that you cite is this; namely, whether he is considered as representing almost exclusively that company. I don't believe there would be an attempt to draw a precise line so long as he primarily represented one manufacturer.

Senator SYMINGTON. Who under the proposed treaty would have that right of decision in such a matter?

Mr. WOODWORTH. This would be established in regulations that would be worked out under the treaty.

Senator SYMINGTON. Let me be sure I understand. Would the man himself be taxed? Suppose he incorporated himself?

Mr. WOODWORTH. Yes, the man himself would be taxed since he is obviously doing business there. But the additional and more important factor is that the company whom he is representing would also be taxed.

#### PROBLEM OF MULTIPLE TAXATION

Senator SYMINGTON. How about the others he is representing; would they be taxed, too?

Mr. WOODWORTH. I would assume not in that case. I would assume that if he only represented them to a very minor extent that they would not be considered as having a permanent establishment there.

Senator SYMINGTON. I respect your assumption and noticed what Senator Gore said about you in the beginning; but this is the type and character of bureaucracy that can kill foreign trade, because if people don't know how much they are going to be taxed, or whether they are

going to be taxed at all, they would be hesitant about doing business abroad, not knowing the ground rules.

Mr. WOODWORTH. I think there is a problem here in that even if the agent is independent the company is treated as having a permanent establishment there because the company accounts for most of the agent's business. I understand that the Treasury view is that in any new negotiations they will see that, if possible, this particular point is met without a conclusive finding that a permanent establishment exists in such a case.

Senator GORE. You mean in the negotiations of a new treaty of similar nature to the pending one?

Mr. WOODWORTH. That is correct; yes.

Senator GORE. Well, now, suppose there is disagreement between the United States and Thailand on this point, and the two Governments are unable to agree but the Thai Government maintains that since this agent referred to by Senator Symington hypothetically, whether individual or corporate, is the exclusive representative of these, each of these, five companies, that the Thai Government maintains that he or it constitutes a permanent establishment for all five companies and proceeds to levy a tax, is the Government of the United States the victim or the business enterprise the victim. How does the business enterprise avoid the dilemma?

Mr. WOODWORTH. I think, first of all, I should set up these limits; namely, what is involved are the gross sales of this company in Thailand. In other words, there is that much at risk so far as the company is concerned.

Senator GORE. That could be their total foreign business in that country.

Mr. WOODWORTH. That is correct. I was trying to set that as the outer limit of what may be involved.

I would assume that the United States would aid in supplying information only to the extent that it agreed that Thailand was correct in the extent to which it was taxing this particular company.

Senator GORE. I take it your point here is that in the pending treaty this provision is not explicit. Now, will regulations by the Treasury be necessary for the implementation of this treaty and, if so, would such regulations, to be effective, require the concurrence or adherence of the Thai Government.? When is it anticipated these regulations will be issued?

Mr. WOODWORTH. As to when the regulations will be prepared, I think perhaps Mr. Surrey can hazard a guess on that. I cannot.

Senator GORE. OK. Go to the first two then.

Mr. WOODWORTH. As to the question, as to who would issue regulations: Both countries would issue them but the Thai regulations would govern as to payment of Thai tax. U.S. regulations would govern as to U.S. tax or U.S. credits. Presumably efforts would be made through diplomatic channels to work out differences.

Senator GORE. All right.

#### THAI TREATY AS A MODEL FOR FUTURE AGREEMENT

Mr. WOODWORTH. I do want to add just this one more word in connection with what I have already said. I don't believe that this par-

ticular point is very significant in the Thailand convention because the volume of trade is very small.

I think this is more significant with respect to the question of whether this is to serve as a model for future treaties. This, as I understand it, is what the business community is concerned about.

#### INVESTMENT CREDIT

The next article that I would like to discuss with you is article 5 dealing with the investment credit. This concept, as you know, is in the proposed Thai Treaty; it is also in the proposed Israel Treaty. It is not in the Philippines Treaty. It has not been used in the case of the other less developed countries that we have treaties with, Honduras and Pakistan. Also, at least technically we have two other less developed countries, Greece and Finland, but in the treaty area they frequently are not thought of as less developed although under the tax code they are.

It is my understanding that the reason for developing the investment credit concept and including that in this treaty is the belief that there wasn't much advantage in a tax treaty for a country like Thailand with the United States because of the fact that they have relatively few traders and investors. Therefore, since these treaties are primarily concerned with reducing the tax problems of investors and traders, the less developed countries, who have few such people, are not particularly anxious to enter into these treaties with us. The investment credit should be quite different in that respect and, of course, this is a followup on what was tried earlier by the former representatives in the Treasury Department when they advocated tax sparing.

Senator GORE. When what?

Mr. WOODWORTH. I said this is a followup or a substitute for tax sparing which was included in the earlier proposed tax treaties—

Senator GORE. Yes.

Mr. WOODWORTH (continuing). Other countries have not only used the tax sparing but also an exemption method.

These are, I believe, the three principal incentives that industrial countries have used in developing tax treaties with less developed countries, tax sparing, exemption, and now the investment credit.

#### EXTENT OF INVESTMENT CREDIT

In this treaty the investment credit is unilateral. That is, it applies only with respect to investment in Thailand by American investors. It does not apply with respect to investment by individuals or corporations of Thailand in the United States. Basically this is patterned after H.R. 11524, the Less Developed Country Investment Act, which was introduced by Congressman Hale Boggs in June of 1964.

The principal difference between this provision in the treaty and that in the bill introduced by Congressman Boggs is the fact that this is a 7-percent investment credit, whereas that would have been a 30-percent investment credit. This is available to individual U.S. residents and also corporations having a 25-percent ownership in a foreign business.

Senator GORE. In the case of a corporation having a 25 percent or some larger percent ownership of a corporation, this investment credit could be taken against income, domestic income, of the corporation?

Mr. WOODWORTH. Yes, that is correct, and that is true of the individual, also. The investment credit in this case is not taken against the income of the subsidiary or business in Thailand. It is taken against the U.S. income of the corporation or individual.

Senator GORE. So to take an example, if a corporation invested \$7 million in Thailand, \$1 million of that would come out of the Treasury of the United States if the owners of that corporation, the domestic owners of that corporation, had tax liability to the U.S. Government equal to \$1 million?

Mr. WOODWORTH. I think you indicated an investment of \$7 million?

Senator GORE. Yes. I am taking fractions instead of percentages. Let's convert that into percentages.

Mr. WOODWORTH. I think we might see it easier if we just took \$1 million as the illustration.

Senator GORE. All right.

Mr. WOODWORTH. In which case you would have an investment credit of \$70,000.

Senator GORE. Therefore, in effect this would be a subsidy out of the U.S. Treasury of \$70,000 for an investment of \$1 million abroad in Thailand?

Mr. WOODWORTH. It would reduce the taxes that they would otherwise pay to the United States by \$70,000.

Senator GORE. Maybe I used a prejudicial term and you are avoiding it. I am not sure that subsidy is prejudicial. It seems rather popular, particularly in Appalachia.

Mr. WOODWORTH. It has been described in that way.

Senator GORE. All right.

I take it that in the case of partial ownership by a domestic concern of a foreign concern that only that portion of the investment which is represented by the portion of ownership by the domestic corporation would be available as an investment credit to the domestic part owner.

Mr. WOODWORTH. Well, the way it works, Mr. Chairman, is the investment credit is available with respect to the amount of capital which the U.S. individual contributes. In other words, if he makes a contribution in capital of this \$1 million that we indicated, then without regard to what others contribute he would receive the investment credit of \$70,000.

Senator GORE. Suppose a foreign corporation borrows money and makes an investment.

#### AVAILABILITY OF INVESTMENT CREDIT

Mr. WOODWORTH. The credit would not be available in that case. The investment credit is available in two types of situations. One is where the investor makes a contribution of capital to the foreign concern, and the second is with respect to retained earnings of that foreign concern.

The investment credit is available with respect to half of the retained earnings. It is the second half of the retained earnings for

which you can receive this credit. The foreign concern must retain half of its retained earnings in any event. Then to the extent it retains more than half the investment credit is available.

Senator GORE. What do you mean, retain where?

Mr. WOODWORTH. Retain in the foreign business.

In other words, to take a very small example, assume that they had earnings of a hundred dollars.

Senator GORE. The foreign corporation?

Mr. WOODWORTH. Yes. The foreign corporation.

Senator GORE. Partially owned.

Mr. WOODWORTH. Partially owned by the U.S. corporation or wholly owned by the U.S. corporation.

Senator GORE. All right.

Mr. WOODWORTH. In this case, if they distributed \$20 they would be eligible for an investment credit on \$30. You see they have to retain \$50 in any event, that is the first half. Then they, to the extent that they retain more than 50 percent, receive an investment credit.

Senator SYMINGTON. When you say "retained," what do you mean by that?

Mr. WOODWORTH. Keep in the business, in the foreign country, keep for use in the business in the foreign country.

Senator GORE. They are not rewarded for repatriation of profits to the United States but they are rewarded for keeping them in Thailand?

Mr. WOODWORTH. That is correct.

Senator WILLIAMS. That is a peculiar kind of credit.

Mr. WOODWORTH. Well, the idea back of this treaty is to provide an incentive for getting funds into the less-developed country and keeping them there. This occurs either through the contribution of capital or through retention earnings. I think the reason the Treasury developed this particular concept is that it was felt that the retention of half of the earnings was more or less normal, and to the extent they retained more than the normal amount they should be, in effect, rewarded by this investment credit.

Senator GORE. Well then, the investment credit which you described in this particular instance, is not or may not, in fact, be a credit for investment in capital facilities, but rather a subsidy for retention of earnings in the foreign corporation?

Mr. WOODWORTH. That is correct: It does not require any particular type of investment by the foreign corporation. The foreign corporation can purchase land, inventory, stock, or it can hold the funds in cash. These are funds which arose from a capital contribution or a retention of earnings.

The requirement that must be kept in mind in this respect is that 80 percent of the assets must be used in the trade or business.

Senator GORE. But it can be an accumulation of cash assets and yet at the same time qualify the concern here in the United States for credit against its tax liability to the U.S. Government.

Mr. WOODWORTH. That is correct; it can be an accumulation of cash. The only limitation is that it must be used in the trade or business. I assume, however, that if you had too large an accumulation of cash, it would then be viewed as not being used in the trade or business, and it might not meet the 80-percent test.

## MERITS OF TAX TREATY

Senator GORE. I realize, Mr. Woodworth, that you are here not advocating or criticizing this proposal, and you were not asked to testify on any other basis. I won't ask you to comment on this but I would like the record to show that in advocating the investment credit within the United States, Secretary Dillon testified as follows: Investment credit "will provide substantial help in alleviating our balance-of-payments problem both by substantially increasing the relative attractiveness of domestic as compared with foreign investment and by helping to improve the competitive position of American industry in markets at home and abroad."

Whether this proposed treaty is wise or unwise, I must observe that the provision which you have just described is far from such as Secretary Dillon described as the purpose of domestic investment credit.

As I understood the investment credit as applied to domestic taxpayers, it was a credit earned by direct investment, is that correct?

Mr. WOODWORTH. Yes. The domestic credit requires the purchase of tangible personal property or in a few cases of real property with a life of 4 years or more. I think I should point out that while this was not a factor in the 1962 act, there have been occasions when the administration has differentiated less developed countries from developed in advocating investments abroad, and that probably is the basis on which they would distinguish this from Secretary Dillon's statement.

Senator GORE. I would like to come back to the question of investment credit, but right now Senator Symington would like to ask some questions on another subject.

Mr. WOODWORTH. All right.

Senator SYMINGTON. Thank you, Mr. Chairman.

In the testimony of the representative of the State Department, he says:

As the subcommittee knows, there has been some concern about capital outflows on account of our balance-of-payments deficit. I should like to point out in relation to the subject of new American investments in Thailand that this concern is not a factor since the steady increase of Thailand foreign exchange reserve since 1959 has been voluntarily held by the Thai in U.S. dollars.

That is all right as far as it goes; but they might change their mind and start selling dollars, might they not?

In other words, it is all a contingent liability against our dollars, and therefore, against our balance of payments.

Mr. WOODWORTH. That is correct. I think what they were in effect saying is it isn't as bad as if they had drawn the balance out in gold.

Senator SYMINGTON. The point is all this is an increase in the contingent liabilities of the United States.

Mr. WOODWORTH. Yes.

Senator SYMINGTON. Redeemable in gold and held by foreign nationals or foreign central banks; is it not?

Mr. WOODWORTH. That is correct.

Senator SYMINGTON. Then this statement isn't correct. It does affect the balance of payments.

Mr. WOODWORTH. It certainly affects the balance of payments. I don't think there is any question about that. It doesn't represent a gold drain so long as they continue to follow that policy.

Senator SYMINGTON. I agree with that.

#### LACK OF UNIFORM MODEL FOR TAX TREATIES

All these treaties have various different terms. There is no favored-nations clause whatever involved in them. Some have one clause, do not have another. Some have the 7 percent, some don't. Why isn't there efforts to have a more uniform concept of a treaty?

Mr. WOODWORTH. Well, first of all, some of them are negotiated over a long period of time, and the U.S. representatives who help negotiate them have had different ideas as to what is desirable in a tax treaty. I think that is one factor.

Secondly, I believe that they usually start out with a model which the representatives on the part of the United States would prefer and then negotiate from this. These ideas are largely drawn from the OECD draft, although not entirely. For example, I don't believe that the investment credit is in that draft. But for the most part, I would say that they do start out from this and that there are in fact many similar ties in the various treaties.

Of course, one of the things that the American representatives find when they start to negotiate is a differing point of view on the part of the foreign representatives as to what they would like to see in a treaty.

I know Mr. Surrey in his testimony the other day suggested that there was an effort made to obtain an exemption for registered shipping in the Thai convention as is provided in many other treaties, but that while they were willing to grant an exemption for U.S. registered airlines they were reluctant to do so in the case of shipping.

Senator SYMINGTON. So each treaty is worked out individually by the people who are trading for the United States, right?

Mr. WOODWORTH. That is correct.

Senator SYMINGTON. During Mr. Solomon's testimony, Senator Gore asked him if manmade fibers as well as natural grown fibers were included, and he said they are working on wool. How about the manmade fibers such as nylon and dacron, what is their position in this proposed treaty?

Mr. WOODWORTH. Well, let me, first of all, say that the investment credit as such is available for a very wide group of corporate activities. It covers all manufacturing—both manmade fibers and almost any other manufacturing.

To the best of my knowledge, manufacturing is covered except for extraction, refining, or smelting of minerals or oil or gas. I think apart from that it covers any type of manufacturing. It covers the sale of property in retail establishments. It does not cover apparently wholesale activities. It covers fishing and agriculture.

Senator SYMINGTON. I am asking a specific question. Is dacron included, or nylon?

Mr. WOODWORTH. Any manufacturing process with respect to dacron is included; yes.

Senator SYMINGTON. When Mr. Solomon appeared, Senator Gore said:

The Philippine Treaty does not contain investment credit and the Thailand Treaty does. The treaty with Israel does not contain the charitable contribution deduction, and the one with Thailand does.

These treaties are also different. The reason is a decision of the man on the spot who is doing the trading, is that it?

#### REASONS FOR DIFFERENCES IN TAX TREATIES

Mr. WOODWORTH. I would say that it is a question of joint decision on both sides of the table. I think that perhaps the Philippines already have a substantial volume of American investments and perhaps they are not quite as anxious to increase American investments in their country as some of the other countries are. That may be why the investment credit is not included in that case.

Senator SYMINGTON. Then the chairman asked:

Does the State Department endorse a further extension of investment credit by way of legislation beyond the 7 percent credit provision?

And the State Department representative says:

The administration did send up a 30-percent tax credit proposal last session. No action was taken on it by the Congress.

What is that proposal?

Mr. WOODWORTH. That is the bill that I referred to a little earlier which was recommended by the administration in 1964 and which was introduced by Congressman Hale Boggs. It essentially is the same type of investment credit as is contained in this treaty except it would provide a 30 percent instead of a 7 percent credit, and it would apply across the board to less developed countries, and not just to those with respect to which we have negotiated treaties.

Senator GORE. Would you yield for just a moment?

Does this legislative proposal provide the investment credit for accumulation of liquid assets as does the treaty?

Mr. WOODWORTH. Yes. The concept in that respect is the same.

Senator WILLIAMS. Would this investment credit being recommended be applied to domestic industry as well as investments abroad?

Mr. WOODWORTH. Well, no, Senator Williams. Of course, you have a domestic credit at the present time which is on a different basis, but this particular credit would not be extended to domestic investments.

Senator SYMINGTON. In the undeveloped countries you can manufacture products, like shoes relatively simply, and labor rates abroad are only a small fraction of ours.

My question is based on the able presentation from Mr. Surrey. I am getting worried about the exporting of jobs, and if we, in addition to the aid programs and the loans, subsidize the development of this competition against us in these foreign countries on items like shoes, what is going to be the result, in your opinion, as we continue to build up the productive base and capacity of these countries?

Senator GORE. I must remind you that Mr. Woodworth is the chief of staff of the Joint Committee and I don't believe he should be asked to express an opinion on it.

Senator SYMINGTON. I withdraw the question. Unfortunately I was not here at the first hearing and should have asked that question then.

Senator GORE. Secretary Surrey is going to return and I think he will be fair game on this question.

Senator SYMINGTON. Thank you, Mr. Chairman, and thank you, Mr. Woodworth.

#### TAX CREDITS FOR DOMESTIC PARENT CORPORATION

Senator GORE. I would like to take up the question of investment credit for accumulation of assets in a foreign subsidiary with another provision of the treaty which is deferral of tax on profits earned through the sale of patents, know-how, or other kind of property to the foreign subsidiary. Do I make my question plain? Let me be more explicit.

If a domestic corporation established a subsidiary in Thailand, manufacturing nylon, shoes, or any other matter other than oil and minerals and sold to this foreign subsidiary, or to the foreign corporation of which the U.S. concern was part owner, U.S. patents, copyrights, know-how or other kind of property the sale of which would result in profit to the domestic concern, but the tax consequences of which would be deferred by this treaty, could the domestic concern get an investment credit for its contribution to the capital of the foreign concern?

Mr. WOODWORTH. The definition of "new investment" would not allow this type of investment to qualify for the credit Mr. Chairman. The term "new investment" is defined here as meaning the transfer of money or tangible personal property. The patent or copyright would not qualify because that would not be tangible personal property. It would receive the deferral but it would not be eligible for the investment credit.

Senator GORE. Well, must capital contribution be for the purposes of new investment in order to obtain investment credit?

Mr. WOODWORTH. Yes, that is correct. It is new investment. But of course the case that you described would have been new investment but it isn't money or tangible personal property; that is what would deny the credit in that case.

Senator GORE. Suppose it is a going concern, not a newly established one. As I read this treaty, I became quite quizzical about the deferral of taxation on current income by a domestic concern, and particularly as it might be related to so-called investment credit or credit for accumulation of assets in a foreign corporation.

Mr. WOODWORTH. Article 5 on page 11 states that you receive "a 7-percent credit for the new investment made by such person and eligible corporations during such year" and then it goes on to also add that you receive it for a share of retained earnings or reinvested earnings. But it is limited to what they define here as new investment.

Then, new investment, defined over on page 13, means the transfer of money or tangible personal property by a resident of the United States or U.S. corporation to the eligible corporation other than in satisfaction of a preexisting indebtedness, but only to the extent that the asset does not represent directly or indirectly funds borrowed within Thailand. Immediately following the transfer the asset must

also be used or held for use by the eligible corporation in the active conduct of a qualified trade or business, and such resident or corporation must not receive in the taxable year in which the transfer is made payment in consideration thereof other than payment in the form of stock or indebtedness of the eligible corporation.

Senator SYMINGTON. This is involved.

Mr. WOODWORTH. Yes.

#### PROVISIONS FAVORABLE TO DOMESTIC CORPORATIONS

Senator SYMINGTON. This is a broad credit plan. It is going to be negotiated out as a result of the manipulations and relationships between the corporations, parent corporations, parent corporations wholly owned, parent corporations 51-49 owned, parent corporations 49-51 owned, et cetera, et cetera. This gives an open door, you might say, does it not, to negotiations which can operate very favorably to the home corporation on the basis of how it continues its investments?

Mr. WOODWORTH. Yes, I think that is correct. I think it is intended to be favorable to the home company. I think that is the purpose of the negotiators, to encourage investments.

Senator SYMINGTON. To the home company's investments in the foreign countries?

Mr. WOODWORTH. Yes; that is right.

Senator SYMINGTON. I am reading from Mr. Surrey's statement. I want to be sure what this tax credit means.

In our convention with less developed countries we have taken the view that withholding tax rate of dividends paid to U.S. parent companies should be, withholding tax rates should be, reduced only to the point where the total taxes imposed on the profits earned in the foreign country and remitted to the United States do not exceed the U.S. tax corporate income generally. This objective is consistent with a policy of eliminating tax obstacles to the flow of private capital into the less developed countries.

That has to do with equal tax equalization, as I understand it. Then he continues:

Our tax conventions also seek to assure nondiscrimination in tax treatment for American individuals in business ventures abroad. It is not uncommon for nationals of one country to find themselves subject to heavier taxes in the foreign country in which they are residing than the nationals of that foreign country. Through tax conventions we have been able to secure commitments from other countries that U.S. citizens will get the same tax treatment as nationals of the country in which they are living.

That is clear and informative but does not have anything to do with what we are talking about, does it?

In other words, this goes beyond any equalization of the American taxpayers position. This is a straight subsidy to any American company or individual to put money into any country which gets the benefit of this tax credit; isn't that correct?

Mr. WOODWORTH. I think that this is, as you state, a lowering of their domestic tax.

Senator SYMINGTON. This is no equalization treaty, at least on the point we are discussing.

Mr. WOODWORTH. No, this feature of it is not directed to equalization. There is a provision in here which makes it clear that our nationals cannot be taxed more heavily than nationals of Thailand.

Senator SYMINGTON. I understand. But this isn't a case of giving a credit to the government or the person involved, because this is a

credit which means that the government will not get the return it would have gotten if this bill is passed.

Mr. WOODWORTH. That is correct. This does give to an investor in Thailand a credit which he would not have received if he invested somewhere else and that credit does reduce U.S. tax.

Senator GORE. And also give him a deferral upon income from the sale of property to the foreign corporation?

Mr. WOODWORTH. That is correct.

#### BENEFITS FOR INVESTING IN THAILAND

Senator SYMINGTON. Would you say the domestic company considering a foreign corporation could look on this as a special reason for investing in Thailand, because they would get a credit in Thailand in addition to the very favorable labor rates they would obtain?

Mr. WOODWORTH. Yes; that is intended as an inducement to investments there. I should say this, in fairness, if he invests in this country he does receive the domestic 7-percent credit. Now the domestic 7-percent credit is, in the areas that we have discussed so far, narrower in its application than this foreign investment credit.

Senator SYMINGTON. I think that is a point Senator Gore was bringing out.

Mr. WOODWORTH. That is correct.

But there is one aspect in which it is not narrower and I think this should be understood by the committee. The domestic investment credit actually is available, if you have an asset with a life of 8 years or more, every 8 years with respect to the same sum of money. Now that would not be true in the case of the foreign investment credit, because the foreign investment credit is available when you invest in the foreign concern and only at that time.

Senator GORE. Would you make that point again?

Mr. WOODWORTH. Yes.

Senator GORE. As the late Senator Kerr used to say, "drive that one by me again."

Mr. WOODWORTH. All right, let me do it with an illustration.

Senator GORE. Well, state your principle first and then give us the example.

#### EIGHT YEAR CYCLE OF CREDIT

Mr. WOODWORTH. The principle is that the domestic credit is available with respect to the same sum of money every 8 years if you are investing in an asset that has at least an 8-year life. When you buy an asset, you receive a 7-percent credit. At the end of an 8-year period presumably you have recouped enough through depreciation reserves to replace the asset. At that time under the domestic credit you are eligible for another 7-percent credit. That is what I call the rollover effect; this is, you receive it again as you replace.

Now, in the case of the foreign investment credit that is set forth here—

Senator GORE. You get it repetitively as you replace it?

Mr. WOODWORTH. That is correct, repetitively as you replace.

Senator SYMINGTON. As I remember it, we used to take 16 percent on machinery. That would automatically handle the problem of 8

years. If you are going to replace machinery over here on a 7-percent credit, the theory is that you have washed out your depreciation allowance. Then in the case of Thailand, where you depreciated out under the theory that a machine is no good, if you had a reinvestment of capital in order to buy new machinery, you would be able to get the 7-percent under this treaty, would you not?

Mr. WOODWORTH. The point I am trying to make is this: In the example that you cite, in Thailand if you also take the money from the United States and invest it in a particular asset in your subsidiary in Thailand and your asset wears out and you have a depreciation reserve and you replace that asset out of the depreciation reserve. In this case you don't receive a second 7-percent credit.

Senator SYMINGTON. But you would if you put new money in?

Mr. WOODWORTH. Yes. But presumably if you replace assets via depreciation reserves you do get the domestic credit again without contributing new funds whereas you do not in the foreign investment credit.

Senator SYMINGTON. I see.

#### EFFECT OF RESERVES ON INVESTMENT CREDIT

Senator GORE. Let me ask you, if this depreciation reserve operates as an accumulation of assets, thus qualifying as retained earnings, does that generate investment credit?

Mr. WOODWORTH. I have tried to think of concept in terms of retained earnings because here it is true that you are receiving the foreign investments credit where you have not placed new money in the foreign concern but it doesn't seem to me as if that is quite comparable to the depreciation reserve, because this is your profit on your investment in the foreign country, whereas your depreciation reserve is merely a return of your original cost. You receive your 7-percent domestic credit for the return of cost, which is reinvested, instead of income on the property. It is true that in the case of the retained earnings that you can generate an additional foreign investment credit from your earnings abroad, but I don't believe that that is comparable to the rollover in the depreciation reserve.

Senator GORE. Well, whether comparable or not, depreciation allowances, accelerated or otherwise, become a part of earnings, not perhaps for tax purposes, but from the standpoint of retained earnings.

Mr. WOODWORTH. When we speak of retained earnings we usually mean earnings over and above your expenses, and depreciation reserves would be one of your expenses.

Senator GORE. Isn't that saying yes to my proposition?

Mr. WOODWORTH. I don't quite believe it is, Senator Gore. I think that what I am saying is that you can receive the domestic credit with respect to a reinvestment which represents a return on your existing costs whereas the foreign investment credit, as set forth in these conventions, you receive only in the case of new contributions or in the case of earnings over and above costs.

Senator GORE. This raises an interesting point. What would be the effect of the laws in Thailand with respect to depreciation and retained earnings?

Mr. WOODWORTH. I am afraid I am not sufficiently familiar with Thailand to tell you.

Senator GORE. I must race ahead of you to acknowledge that I am not either, but I wonder what effect it would have.

Mr. WOODWORTH. I don't know enough about how Thailand computes their tax to be able to answer that for you, I am sorry.

Senator GORE. Well, maybe we will look into that.

Mr. WOODWORTH. There is one other feature I have not mentioned on the investment credit.

Senator GORE. You mentioned two features and we have been talking about the second one. Are you going back to the number one?

Mr. WOODWORTH. I think at one place or another in our discussions we hit on most of the features of the investment credit, and I was more or less keeping track of them and trying to see what it was that had not been mentioned yet and I think the only basic items I need to mention, is the fact that it is limited to assets of a business where 80 percent of the assets are in Thailand and used in the business there, and 80 percent of the income has to be derived from one of these qualified businesses. I think I did list, in answer to one of Senator Symington's questions, the different types of qualified businesses.

Senator GORE. Well, you listed the types that are not qualified.

Mr. WOODWORTH. Well, the ones that are qualified are manufacturing with the exception that I noted before of extraction, refining and smelting; retail sales of property, retail establishments, fishing, agricultural pursuits and services in the case of financial, technical or scientific, engineering or architectural services. It would not cover a nightclub such as Senator Pell made reference to the other day.

Senator GORE. We will resume Monday at 10 o'clock.

(Whereupon, at 11:30 a.m., the subcommittee recessed, to reconvene Monday, August 16, 1965, at 10 a.m.)

THE HISTORY OF THE UNITED STATES

The first part of the book is devoted to a general history of the United States from the discovery of the continent to the present time. It is divided into three volumes, the first of which contains the history of the discovery and settlement of the continent, the second the history of the colonies, and the third the history of the United States from the declaration of independence to the present time.

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## TAX CONVENTION WITH THAILAND

MONDAY, AUGUST 16, 1965

UNITED STATES SENATE,  
SUBCOMMITTEE OF THE  
COMMITTEE ON FOREIGN RELATIONS,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 9:45 a.m., in room 4221, New Senate Office Building, Senator Albert Gore presiding.

Present: Senator Gore.

Senator GORE. The committee will come to order.

Mr. Woodworth, you may continue with your presentation.

### STATEMENT OF LAURENCE N. WOODWORTH, CHIEF OF STAFF, JOINT COMMITTEE ON INTERNAL REVENUE TAXATION—Re- sumed

Mr. WOODWORTH. Thank you, Mr. Chairman.

You asked some questions the other day that I was at that time unable to fully answer. I have tried to do a little research on them in the meanwhile.

#### RESPONSIBILITY FOR HANDLING REGULATIONS

One of them involved the issue of how the regulations are handled. It is my understanding now that each country prepares its own regulations in much the same manner as regulations under the Internal Revenue Code are prepared.

These regulations in both cases are prepared independently one of the other. If there is any important difference of view then there are diplomatic negotiations between the two countries.

If the differences continue, then the regulations of the country where the income is earned would govern.

If the difference was of such a major character it is possible that the treaty itself would be abrogated because of the different interpretations.

The taxpayer, if he differs from the regulations in his point of view as to what the law is under the treaty, has access to the courts in the usual manner.

Also on the question of the type of income which would be realized if you did not have the deferral under article 6 of this provision, there is a—

Senator GORE. If you did not—if the taxpayer did not avail himself of the deferral?

Mr. WOODWORTH. Yes, ordinary income is the type of gain that would occur under section 1249 in the event you make a transfer of a patent to a foreign corporation in which you have at least a 50-percent control. If the foreign corporation were controlled to the extent of 50 percent in the absence of this provision in the treaty you would have ordinary income upon the gain realized by the transfer of the patent.

Senator GORE. In the absence of which provision?

Mr. WOODWORTH. In the absence of article 6.

Senator GORE. Of the treaty?

Mr. WOODWORTH. Of the treaty; yes.

Article 6 of the treaty provides for no recognition of a gain where you make one of these transfers of patents in exchange for stock in the foreign corporation.

However, in the event that the corporation does not come under section 351, under present law if you have an 80-percent control, then again in the case of the transfer there would be no gain at all.

But if you have less than 80 percent control, and you are transferring patents, the usual case that you would have ordinary income and not capital gain income.

I believe that is—yes.

Senator GORE. The terms of the treaty cover matters other than patents?

Mr. WOODWORTH. That is correct. The treaty in article 6 covers patents, inventions, designs, models designs, secret formulas or process, or similar property right, information concerning industrial, commercial, or scientific knowledge, experience or skill or technical, managerial, engineers, architectural, scientific, skilled, industrial, commercial, or like services.

So it is true that that covers more than just patents. And I should also say that 1249 covers more than just patents, too. Section 1249 covers a patent, invention, model or design, whether or not patented, a copyright, a secret formula or process, or any other similar property right.

So that it covers much of what is included in article 6, but not all of it.

To the extent you are making a transfer for services and that is possible under article 6, to that extent, you ordinarily would receive ordinary gain in any event on a transfer.

I think that there were two points, which I did not make clear the other day on the investment credit—

Senator GORE. About this particular point, or another?

Mr. WOODWORTH. Another point.

#### PROVISIONS WHICH ENCOURAGE JOINT VENTURES

Senator GORE. Before leaving this one. Is this the provision in the treaty which in your opinion is designed to encourage or would have the effect of encouraging joint ventures?

Mr. WOODWORTH. Yes.

Senator GORE. Is there any other treaty provision which, in your opinion, would encourage joint ventures?

Mr. WOODWORTH. I suppose the investment credit itself would encourage joint ventures to some extent because you must have a 25-

percent control in the foreign corporation in order to receive the investment credit, but I can't think of any other provision.

Senator GORE. This would encourage wholly owned as well as joint ventures?

Mr. WOODWORTH. The investment credit, yes. It will encourage anything from a hundred percent down to 25 percent.

The technical assistance transfer or the tax deferral we have just been talking about actually should encourage anything from 80 percent down because you already receive essentially that same treatment under present law if you have 80-percent control or more.

The two points that I think that I hadn't made clear under the investment credit are limitations that are involved there. One is the recapture provision. Under this recapture provision the U.S. taxpayer has to recompute his tax and pay the additional amount as if no credit existed if certain things happen. What can result in this recapture of the credit is what you might call disinvestment within a 5-year period, 3 years back and 1 year forward, and then, of course, the current year, so that there is a 5-year span. Therefore, if during this period of time you have made any investment and you now reduce your investment in the foreign country, then to that extent there is a recapture of the credit previously allowed.

There, of course, is a recapture provision under the domestic investment credit which is relatively different from this. The recapture under the domestic investment credit cover a period of 6 to 8 years, which is slightly longer than the recapture provision in this convention. Moreover, under the domestic credit there is a recapture where you don't retain the asset.

The recapture provision applies under the convention where you remove part of your investment from the foreign corporation.

I do not believe I made it clear the other day that you receive the investment credit in the case of transfers of property only if you transfer American goods to the foreign concern. I assume it was designed to prevent an adverse balance-of-payments effect.

I believe that I have discussed article 6 sufficiently so that I need not go into that any more.

Article 7 relates to shipping and transportation. The convention provides an exemption for airlines which are registered in the United States, and vice versa, and also a 50-percent reduction in the tax on shipping. The usual treaty provides for complete exemption on shipping. This, therefore, is a step in the direction of the customary treaty, but does not go as far.

#### TAX ON DIVIDENDS

The next article I would like to comment on is article 9 which deals with the treatment of dividends. The more or less traditional rule that we have tried to develop in tax treaties would call for a 15-percent flat rate tax on dividends paid by corporations of either country. Of course, we have a statutory rate of 30 percent, therefore, this represents a 50-percent reduction.

In addition, under present law we have a graduated rate as far as individuals are concerned, where a higher tax would result but only in the case of incomes above some \$21,000.

In addition, under the usual arrangement we try to have a 5-percent rate in the case of treaties on dividends from closely held corporations.

The Thailand treaty actually does not go as far as the usual treaty in this respect because it provides a dividend rate of 20 percent, but only in the case of dividends received from a foreign corporation to a domestic parent. So this is really a small portion of what is usually negotiated in this area.

The Thai tax rates on these corporations range from 15 to 25 percent, with 25 percent being the more usual. As I have just indicated, the U.S. rate is ordinarily at least 30 percent, so in this area the United States has reduced its rate from 30 to 20 and Thailand from 25 to 20 in most cases.

I believe that I can explain why this was thought to be a satisfactory arrangement. This is because the relatively small reduction in the Thailand tax makes it possible to credit the entire Thailand tax against U.S. income. Let me explain it this way: The regular corporate rate on the Thailand corporation is 25 percent or maybe as high as 25 percent.

If you have a 20-percent rate of tax on the income which is left after the payment of the corporate tax, then on this 75 percent that still remains after the payment of the 25 percent you have an overall tax of approximately 40 percent. This can be computed by taking 25 percent of the 100 percent, plus 20 percent of the remaining 75, that is 25 plus 15, or 40 percent in total.

Forty percent actually can be completely credited against the U.S. tax of 48 percent. Actually you might think that a larger tax could be credited in this case, but that isn't true in most cases in the case of less developed countries because of the fact we do not gross up the dividends from these corporations.

Therefore, this relatively slight reduction from 25 to 20 percent does have the effect of making the full tax creditable.

I wanted next unless you have some question on the dividend article, to comment on article 11, royalties.

Senator GORE. Before you leave that—

Mr. WOODWORTH. I may have gone over that too fast.

Senator GORE. From what you said, it would appear that the tax of a U.S. corporation or individual doing business in Thailand might amount to very little for the U.S. Government.

Mr. WOODWORTH. That would certainly be true in the case of a corporation receiving dividends from a subsidiary. I think there will be almost no net U.S. tax paid because of the way the crediting device works. But this does not apply in the case of individuals because the special 20-percent rate does apply in that case.

#### CHANGES TREATY WOULD MAKE IN TAX TREATMENT OF DIVIDENDS

Senator GORE. Then I will confine my question to the case of a corporation. Would you distinguish once again the difference under present law, the different tax treatment, from U.S. tax treatment of a U.S. corporation doing business in Thailand with respect to dividends paid under present law, and as it would be if this treaty should be ratified?

Mr. WOODWORTH. All right.

Under present law, first of all, there is payment of a corporate tax in Thailand of approximately 25 percent. In addition, there is a payment with respect to the dividends paid by that corporation of approxi-

mately another 25 percent. This does not mean 50 percent in total, because the first 25 percent is on 100 percent of the income, and the second on 75 percent.

I believe that the two of them add up together to a tax of approximately 43, 44 percent, in that range.

Now, because we do not tax the total corporate income in the case of less developed countries, which is represented by the dividend coming back, but rather the dividend payment received after these payments of Thailand tax, the U.S. tax in terms of the original hundred dollars that we started with turns out to be between 41 and 42 percent.

Senator GORE. This is on dividend?

Mr. WOODWORTH. Yes; this is on dividends. So that as a result, there is a slight excess of Thailand tax which cannot be credited at the present time. It is 1 or 2 percentage points that cannot be credited at the present time. Lowering the Thailand tax by 5 percentage points wipes out this small excess credit. So that with the convention there is no U.S. tax as such.

Senator GORE. So that the effect on the U.S. Treasury is negligible?

Mr. WOODWORTH. Yes, that is correct.

Senator GORE. It operates really as a reduction of the Thai tax on the profits of the U.S. corporation doing business in Thailand?

Mr. WOODWORTH. Yes; that is correct. The United States in this case gets practically no tax at all, either under present law or under the treaty.

What happens is that the Thailand tax is reduced slightly, usually from about 25 to 20 percent in the case of the second of these two taxes I have named.

Apart from that, the regular dual tax system continues to apply as under present law. In other words, in the case of a dividend paid by a Thailand corporation to a U.S. individual, it would continue to be 25 percent, the withholding rate would be in the neighborhood of 20 percent, and then the U.S. recipient would receive a foreign tax credit for this which would, in effect, mean in most cases no additional U.S. tax.

I shall now discuss the treatment of royalties.

Under the tax treaty there is an exemption for nonmineral royalties. In the case of Thailand, there is a rate of 15 percent so that again, as in the case of dividends this convention does not move as far in the Thailand Treaty as is the customary procedure. The effect of that is, so far as the individual is concerned, is that the tax is paid to Thailand and not to the United States.

#### TAXES ON PERSONAL SERVICES

The next article that I was going to discuss is article 13 dealing with income from personal services.

Here we have to look both at the code and at the treaties. The Internal Revenue Code does not tax a nonresident alien if he is here less than 90 days and if income he receives in that period is not over \$3,000, if he works for a foreign individual, partnership, or corporation, which is not engaged in business here or for a foreign branch of a U.S. corporation.

The tax conventions, in most cases have extended this 90-day period either to 180 or 183 days and they usually have imposed no limitation

as to the amount of income that the individual could earn in the United States during that period. In other words, the \$3,000 limitation under the code is in effect removed in most conventions.

The Thailand Treaty adopts the general convention rule that I have just described to you, except that it does impose a dollar limit in the case of entertainers. This limit is \$100 a day, or \$3,000 a year. Apart from that the general convention rule that I have mentioned applies.

#### STUDENTS AND TRAINEES

Article 15 relates to students and trainees. Most tax conventions have limited the exclusion for students and trainees to remittances, as it is called, which they receive from abroad, if used for their maintenance or education.

Usually in most tax conventions they are taxed on their U.S. source income while they are here, and as far as scholarships are concerned, they are either taxed or not taxed, according to our general Internal Revenue Code rule.

More recently the tax conventions have also provided that the student or trainee is to be treated as a nonresident alien in all cases. This has the effect of clearing up some confusion because a student who stays here long enough finds his status as a nonresident alien coming into question, and in some cases they have provided that he would be treated as a resident alien and, therefore, subject to our tax laws on his worldwide income.

The Thailand treaty is somewhat broader in this area than previous conventions. It provides a complete exemption for grants, allowances, and awards. Also in the case of personal services rendered here in the United States it provides an exclusion of \$2,000 in the usual case, and \$5,000 in the case of medical students. It also provides that this exemption can apply for a period of up to 5 years. It should be clear that this is somewhat more liberal than is available to American students also studying here because they do not receive the \$2,000 exclusion.

Consistent with prior treaties government-sponsored trainees receive an exemption of up to \$10,000 for services performed here and \$5,000 for other trainees.

Senator GORE. Is that under the code?

Mr. WOODWORTH. No; this is under the tax treaty. This is under the Thailand Treaty, and in this regard it is consistent with what they have provided in prior treaties.

Senator GORE. Developed and undeveloped countries alike?

Mr. WOODWORTH. Yes; I believe that is true, with both developed and less developed countries.

Frequently the amount referred to in the case of the government-sponsored trainees are amounts which are provided by the government itself, either the U.S. Government or the foreign government.

#### CHARITABLE CONTRIBUTIONS

The next article that I thought I should comment on is article 18, which deals with charitable contributions.

Here there is a considerable amount of confusion as to what actually is provided under present law. Under the Internal Revenue Code

there is no deduction for a contribution by an individual directly to a foreign organization. However, it is possible for the individual to make a contribution to a U.S. organization even though it in turn spends the amount abroad directly for charitable purposes. This is a device which has been used fairly frequently.

U.S. corporations cannot make a contribution even to a U.S. foundation or trust if that amount is to be spent abroad. But, strangely enough, they can make it to a U.S. corporation if the amount is to be spent abroad.

I can't explain why the tax law is that way, except that I think perhaps it has existed over a long period of time.

We have only two treaties which contain special provisions relating to charities. One is Canada and the other is Honduras.

In this case, under these two treaties, the individual corporation can make direct contributions to the foreign organization but the amount which may be deducted is limited to the applicable percentage of foreign income. In other words, in the case—

Senator GORE. You say it is limited to what?

Mr. WOODWORTH. To the foreign income that is involved. In other words, you cannot receive a charitable contribution or deduction for a contribution to a Canadian charity except to the extent of 30 percent in the case of an individual, or 20 percent, if that limitation applies, of your Canadian income.

In the case of a corporation, of course, that limitation is 5 percent instead of the 20 or 30 percent. But the point that I am making is that it is limited to that percentage of your Canadian income or Honduras income.

Now, in the case of Thailand, the contributions can be made to a Thailand corporation or organization without regard to the proportion of your income which comes from Thailand. In other words, you can give up to, in the case of an individual, up to 30 percent of your worldwide income to a charity in Thailand.

Senator GORE. And deduct it?

Mr. WOODWORTH. And deduct it; yes.

Senator GORE. From the U.S. tax?

Mr. WOODWORTH. That is right. That is assuming, of course, that it is the kind of charity which would qualify for the 30-percent charitable contribution deduction. There are those that only qualify for the 20 percent and then, of course, in the case of corporations it would be 5 percent.

Senator GORE. This is an administrative problem and if you would like to defer to the Treasury Department for an answer, that will be all right. But I am wondering how the U.S. Treasury Department could determine when and if a Thailand organization was properly classified as a charitable organization or how it could police such changes in its nature and function as might occur?

Mr. WOODWORTH. Well, let me say, first of all, that there is a provision in here that it must be a qualified charity. Now, I have had some discussions with various people as to what exactly this means. One point of view that I have heard expressed is that the Thailand charity has to obtain a ruling from our Internal Revenue Service to the effect that it is a tax exempt organization of the appropriate type before the contribution can be deducted.

Another point of view, and frankly I can't say which is going to govern in this case at this time, is simply that it must be of the type which would qualify, and that it need not have actually obtained a ruling that it is qualified.

I think that there will be difficulties in knowing when these charities do qualify. I think that will be an important administrative problem.

Senator GORE. Would it not also be an administrative problem to police and determine whether the operations subsequent to qualifying remain of a qualifying nature?

Mr. WOODWORTH. Yes; I would assume that it would be a problem in that respect. We do have the right to request the exchange of information under the treaty, and I believe that that is the official way in which the Treasury Department would seek information on the status of the charity.

Senator GORE. I will not attempt to go into the general question of the qualification of a charitable contribution. This is a wide-ranging subject in and of itself, so I will leave that to the Treasury.

#### SOURCE RULES FOR TAXING

Mr. WOODWORTH. The next article is, that I was going to comment on was, article 19, which deals with the source rules for tax purposes. The United States in most of its tax treaties attempts, to the extent possible, to pattern these source rules after the United States Code source rules. The purpose, of course, is to prevent double taxation to the fullest extent possible, and the Thailand Treaty in general does follow the U.S. source rules and, therefore, will prevent double taxation in most cases.

There is one variation from this in that interest is considered to be derived from the source where it is earned. Interest generally is considered to be sourced where it is earned, but if paid by a permanent establishment in a country under this treaty it will be considered as being source there.

This is a slight modification of the usual rules and I might say that it probably is in accord with the source rules that are being developed in a bill on the House side at the present time dealing with taxation by the United States of nonresident aliens and foreign corporations.

Article 22 is a provision dealing with the elimination of double taxation, and I should, of course, point out that the United States has by statute a foreign tax credit designed to prevent double taxation, and under the Thai Treaty, Thailand will grant a foreign tax credit for income which is sourced within the United States.

There is another article which should be mentioned, the article dealing with nondiscrimination, article 23. It provides that our citizens are not to be treated any worse than theirs under their tax laws, and for the first time, this is extended to the fact that U.S. subsidiaries which are in themselves foreign corporations, so that Thailand will not be able to treat U.S. subsidiaries which are incorporated under their laws any worse than other corporations under their laws.

Articles 24 to 30 for the most part deal with administrative matters and I believe don't require much comment. It is in this area that you have your provision for consultation in order to prevent double taxation, if any problems should develop.

There is one provision here which I think is interesting. There is a provision which indicates that in general terms this is not to affect the right of any country to tax its own residents or citizens or its own corporations. However, there are certain exceptions put on this, and the most important of these are the provisions for foreign investment credit, for the technical assistance, for the charitable contributions, and for the foreign tax credit.

In other words, in these areas the treaty is in effect limiting the right of the United States to tax its citizens and residents.

Senator GORE. Will you say that again?

Mr. WOODWORTH. Generally speaking, the tax conventions have a rule which says that in no event are these intended to limit the right of the country to tax its own nationals.

Senator GORE. That is either the United States or the other country?

Mr. WOODWORTH. That is correct, the United States to tax its nationals, or Thailand to tax its nationals. There usually are some exceptions to this, and I have found in working on tax laws that it is these exceptions which cause the trouble when Congress changes the tax laws.

The areas where these exist under the Thailand treaty, and that is what I was pointing out, is the investment credit we have discussed earlier, the provision for tax deferral in the case of technical assistance, the charitable contributions, and the foreign tax credit.

So that in these areas the treaties are intended as a limitation on the extent to which the United States can tax its own nationals.

#### EFFECT OF TREATY ON DOMESTIC TAX PROCEDURES

Senator GORE. Is this the first treaty, or if ratified would this be the first treaty which, by its ratification, would directly reduce taxes, U.S. taxes, on its own citizens?

Mr. WOODWORTH. I assume you are referring there on U.S. income, U.S. source income?

Senator GORE. Yes.

Mr. WOODWORTH. I think there have been minor exceptions to that. I think there have been some cases where we have done it in the past, but they have been very few and quite insignificant.

Here the reduction on U.S. income is significant because of the investment credit and the tax deferral and also, to a lesser extent, the charitable contributions.

I would say that all three of those provisions represent an important departure in that respect.

Senator GORE. Would you classify this tax reduction on U.S. citizens on domestic source income to be a principal effect of the proposed treaty?

Mr. WOODWORTH. Yes; I think I would. I think that because of the importance of the foreign investment credit in this treaty, and also the deferral in the case of technical assistance, I would say that that was a major effect of this treaty.

Senator GORE. Then, did I correctly understand you to say further that even though the Congress should repeal the domestic investment credit, it could not do so with respect to the taxpayers who receive investment credit by terms of the pending treaty if ratified?

Mr. WOODWORTH. There is provision in the treaty for reconsideration of this at the end of a 5-year period. So that at the end of a 5-year period this could be reconsidered. However, I think you are correct that the treaty does not contemplate that if the domestic credit should be repealed that that would justify the repeal of the foreign investment credit.

Senator GORE. In other words, one is not related to the other?

Mr. WOODWORTH. That is correct.

Senator GORE. Now, in the case of termination of article 5, I would like to know your interpretation of paragraph 5, article 30. I will put the question more directly: If we terminate article 5, may an investment already made continue to generate a U.S. tax cut through the reinvestment of earnings in Thailand?

Mr. WOODWORTH. I would think not. In other words, it would be my impression if you terminate article 5 as such, you would be terminating any future investment credit arising from—

Senator GORE. Well, let me read you subsection (c):

Any termination under this paragraph shall not prejudice benefits available with respect to transactions entered into prior to such termination.

Mr. WOODWORTH. I agree that is subject to the interpretation of the type that you have suggested. I doubt if that is what it is—

Senator GORE. I have not suggested an interpretation. I have inquired if that interpretation would be possible?

Mr. WOODWORTH. I think it would be possible. I don't believe that it would be likely. I believe the subsection (c) that you read is designed to, in effect, say that even though you terminate article 5 that investment which you have already made down there and for which you have received a foreign investment credit will not be terminated by the termination of this article.

Senator GORE. Well, even by your interpretation just given it seems to me it might still be possible for the benefits to continue to flow with respect to investments made prior to the termination through the reinvestment of those earnings.

Mr. WOODWORTH. I recognize that it is possible to interpret this as saying that earnings which arise after the termination of the provision may be eligible for the credit. I doubt if that interpretation would be placed on it though.

Senator GORE. In any event, this is a matter which could be clarified by committee report.

Mr. WOODWORTH. Yes.

Senator GORE. If the committee desires to recommend the treaty?

Mr. WOODWORTH. Yes; that is correct.

#### DATE OF TREATY IMPLEMENTATION

The one remaining point that I believe I should comment on is the effective date. Generally speaking, the treaty is to take effect in the January following the exchange of instruments of ratification. In other words, if Congress should act favorably on this treaty and the treaty should be ratified this year, it would generally become effective next year. However, the investment credit is to become effective on the first of the year in which the ratification takes place.

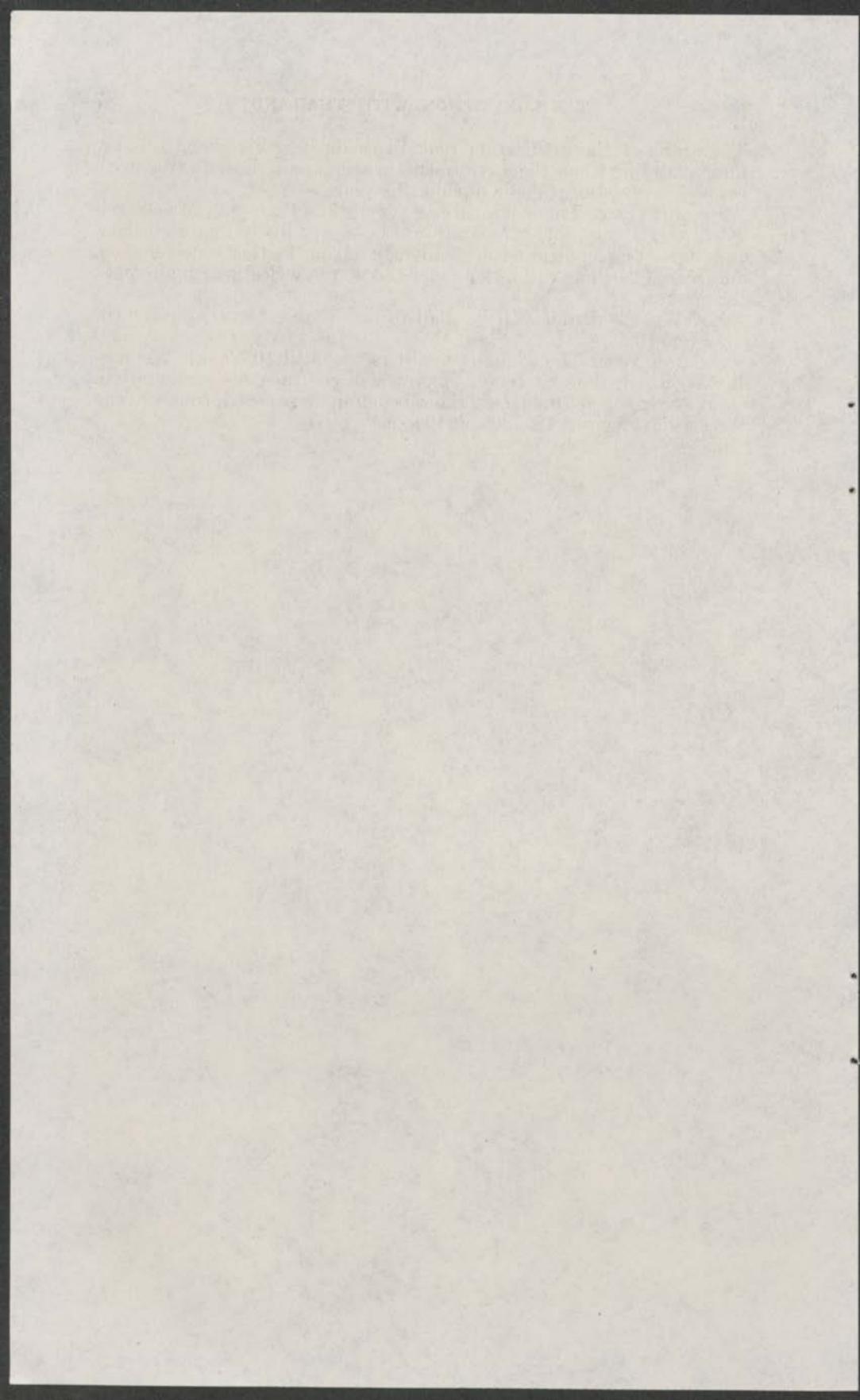
Therefore, if the ratification took place during this year, it is my understanding that the investment credit would be effective with respect to investment made during this year.

Senator GORE. The committee is very grateful to you, Mr. Woodworth, for a very able presentation. It is very likely that additional questions of a technical nature will arise during further consideration, and if so, questions will be submitted to you in writing with a request for answer.

Mr. WOODWORTH. I will be glad to make myself available for the subcommittee.

Senator GORE. The committee will recess until 10 o'clock Wednesday, at which time Secretary Surrey will continue his presentation.

(Whereupon, at 10:40 a.m., the subcommittee recessed, to reconvene Wednesday, August 18, 1965, at 10 a.m.)



## TAX CONVENTION WITH THAILAND

WEDNESDAY, AUGUST 18, 1965

UNITED STATES SENATE,  
SUBCOMMITTEE OF THE  
COMMITTEE ON FOREIGN RELATIONS,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10 a.m., in room 4221, New Senate Office Building, Senator Albert Gore presiding.

Present: Senators Gore, Lausche, and Pell.

Senator GORE. The committee will come to order.

Secretary Surrey, we have thus far examined many, and I believe most, of the details of this tax convention. And I believe that the provisions of the treaty are now pretty well understood.

It might be well then today to consider a few rather broad questions. I hope this will be the last hearing for Government witnesses. It will be necessary to schedule 1 day for public witnesses.

The main purpose of this treaty, it seems to me, is to promote foreign investment, specifically American equity ownership of Thai production and distribution facilities by granting tax concessions against profits earned in the United States or otherwise.

It may also be argued that trade will be promoted, but I think the source rules and the permanent establishment rule may well work in a somewhat perverse way in this area.

### ROLE OF TREATY IN FOREIGN POLICY

Now, my first question, Mr. Secretary, is this: In view of our experience with Pakistan and Honduras, treaties with these countries, the resentment over U.S. equity ownership in the Philippines, in Canada, and even in certain European countries, will this treaty, in your opinion, actually promote our foreign policy objectives?

### STATEMENT OF HON. STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY—Resumed

Mr. SURREY. Senator, I don't think that I would start off exactly the way you did by saying that the main purpose of the treaty is to encourage U.S. investment in Thailand.

The main purpose of this treaty is to have a double taxation treaty with Thailand, with all of the usual connotations of a tax treaty, to eliminate tax barriers to trade, commercial intercourse, cultural intercourse, and investment in Thailand.

One method, and probably the only method, of obtaining a tax treaty with Thailand, is the extension of an investment credit, similar to that granted for investment in the United States.

But the basic purpose of this treaty is the basic purpose of all our tax treaties, whether they are with industrialized countries or less developed countries, and that is to increase the commercial, cultural, and investment relationships between the United States and the foreign country.

Senator GORE. Well, you have just said what I said.

Mr. SURREY. No, I added a number of things, Senator. I added commercial relationships, trade relationships, export relationships, and cultural relationships, the whole context of relationships that a tax treaty is designed to facilitate by removing tax barriers, usually in the form of double taxation, sometimes in the form of tax irritants. This has been the purpose of our tax treaties. The Thailand treaty does not differ in that basic respect.

As to carrying out the policy of the United States, we think that tax treaties, properly written, do carry out basic political and economic interests of the United States.

Senator GORE. Well, whether wise or unwise, it seems to me that the essence of the effect of the pending treaty, if ratified, is a form of foreign aid, so to speak, by way of treaty rather than by way of the foreign aid program. Why, otherwise, would Thailand have an interest in U.S. reduction of taxes on its own nationals?

The only interest they could have in such an event would be the benefits that would be calculated, they would hope, to flow to them by way of further investment and development of U.S. corporations and nationals in their country. Is this not true?

Mr. SURREY. Viewed from the standpoint of Thailand, a tax treaty with the United States in most of its clauses operates to restrict the scope of the Thai income tax.

Senator GORE. Operates how; I didn't understand?

Mr. SURREY. Operates to restrict the scope of the Thailand income tax as it applies to Americans who trade with Thailand, Americans who visit Thailand, and Americans who invest in Thailand.

Under conditions of that character, Thailand, like other less developed countries, has a problem in entering into a tax treaty. When the industrialized countries enter into tax treaties with the United States, the United States restricts the scope of its income tax on income leaving the United States and going to the foreign country. For example, when we have a tax treaty with France, the United Kingdom or Germany, or the Netherlands, we reduce our withholding taxes and thereby restrict the scope of our income tax to the benefit of the other country in view of the dividend flows, the interest flows, and the royalty flows that leave the United States, and in view of the amount of trade that these industrialized countries have with the United States.

#### TREATY A WAY FOR THAILAND TO ATTRACT CAPITAL INFLOW

In Thailand, however, there is no such reciprocal benefit to Thailand because they have no investment in the United States, and very little export trade with the United States. Consequently, in their entering into tax treaties they feel that to justify the restrictions on their taxes they need some provision that would encourage capital inflow to their country. They have sought such encouragement in a variety of ways in order to have what is to them a balanced treaty.

With most of the other countries, they have entered into so-called tax-sparing treaties or sometimes treaties that exempt the income when it is received in the industrialized countries.

Senator GORE. I think I would agree with that. I was not attempting to criticize such a desire on the part of Thailand. I was trying to analyze the motivation on their part as well as ours for the pending treaty.

Mr. SURREY. I think that is the motivation. In other words, they have to say to themselves, do they have a balanced treaty? Do they have a document that they think they can enter into that is a fair reflection of their own interests? When all the clauses in the treaty primarily restrict the scope of the Thailand tax for the benefit of U.S. visitors, traders, and investors, then they look to see whether there are any clauses which help Thailand, and in this particular treaty the primary clause that helps Thailand is putting investment in Thailand on a par, generally speaking, with investment in the United States, insofar as the investment credit is concerned.

Senator GORE. A little later I would like to come back and inquire as to whether this objective is an advisable one on our part, and whether it can best be achieved by way of treaty, or by way of other programs. But I have, I think, had more than my share of questioning.

Senator Pell is here, a very learned Senator and very interested in this field, and I would like, if you may excuse me, to defer my further questioning and yield to Senator Pell for such interrogatories as he may wish to propound.

Senator PELL. Thank you, very much indeed, Mr. Chairman.

I would like to express my general view of being in complete sympathy with the idea of uniform, or nearly uniform as possible, tax conventions with as many nations as possible. I speak personally in this because I can remember when I was a child in a certain country where we were living at the time, we came back to the United States and we lost our house because the government in question took it for nonpayment of taxes and we were liable to taxes in both nations.

So I think probably more than many of my colleagues I recognize the inequities of not having a tax convention.

But I had two or three questions that I think might be good to set forth in the record.

#### DESIRE FOR MORE SIMPLIFIED TAX TREATY

First, as a more general question, isn't it possible to devise some kind of simple tax treaty, as I believe one is already set forth somewhere, that would apply to all nations? It might not be as good for any particular set of circumstances, but it wouldn't seek to differentiate between developed and undeveloped nations and it would be what you might call, a MFN, most favored nation, treaty that you would just apply to all those with whom we had relations, and I am wondering why you feel we have to get into each special one with each little country?

Mr. SURREY. That, I think, is a crucial question and goes to the heart of the tax treaty process, Senator Pell.

The OECD fiscal committee has worked for a number of years on a so-called model international tax treaty. We, in our negotiations with industrialized countries, attempt to follow that model as far as possible.

As a practical matter, there are bound to be variations because countries in dealing with fundamental matters such as taxation look at the flows between the two treaty countries, and as a result, the rates of withholding taxes in some of the clauses, such as the reduction of rates of tax on dividends, on interest and royalties among industrialized countries, have not been standardized even though we attempt to get them standardized. Simply and crucially, it is a matter of economic national bargaining.

But we do as far as possible in the technical clauses try to follow this international model.

With respect to the less developed countries, the model works only in part because the model was based upon the supposition that both countries would approach the bargaining table with relatively the same interests in that each was receiving income from the other country.

As I indicated to Senator Gore, when we sit down and have tax treaty discussions with Belgium, the Netherlands, and Germany which protocols will be before you, there are income flows from both countries and, therefore, each has an interest in the reductions of the taxes of the other. But when we sit down with a less developed country or when any nation sits down with a less developed country, the pattern is all one way. The concessions that are typical in the standard tax treaty are always concessions made by the country from which income flows.

In a less developed country it flows only from those countries and, consequently, they have in their interests said that they will not enter into tax treaties with the industrialized world unless there is a basic variation in the pattern, and a different concession is made by the industrialized countries, a concession different from merely reducing taxes at the source in the industrialized country because there is no income flowing from the industrialized country.

So there is a pattern of uniformity that is evolving in the world, but it is a pattern we have not liked. It is a pattern by which the industrialized countries will either grant tax sparing, which we think is unwise, which this committee has thought is unwise, or grant exemption to income coming from the less developed country to the industrialized country.

Now, that pattern is one we think unwise, and we are trying to develop our own pattern with the less developed countries.

I think we have such a pattern, and, generally speaking, the treaties that we have before you, with Israel, and Thailand, and with India soon to come, would exhibit a common pattern and follow what you ask. But you do need these two broad classes of industrialized country treaties and less developed country treaties.

Senator PELL. It may sound odd as a Democrat to say I really believe in the interplay of the free market, and I am wondering why we couldn't have the interplay of the free market here where each nation would give a credit to the other for all taxes paid, somewhat as we do with our States. I realize the difference that you have just set forth between a developed and undeveloped nation, but the undeveloped nations are just as anxious as we are to have more capital investment.

We don't have to worry about giving them concessions. They are dying to get the capital, and if we had this kind of simple arrangement, why wouldn't that work?

Mr. SURREY. Well, in a sense we do have it in this way: The United States grants a foreign tax credit unilaterally without any treaty. In other words, with every country of the world we say today, we will credit the taxes our people pay in your country against the United States tax.

Now, most other countries only do that by treaty. We have done it unilaterally. Consequently, most of our international investments and trade proceed under that umbrella protection.

#### DEDUCTIONS IN UNITED STATES FOR THAI INVESTMENTS

Senator PELL. Then, to pursue that point, with Thailand, am I correct in saying that those American firms, corporations, and individuals who have paid taxes in Thailand can deduct that as a credit from any income tax they owe this country without the treaty?

Mr. SURREY. As a general situation, yes, but it begins to break down in various aspects, as I indicated in my basic testimony. It begins to break down, for example, because we give this foreign tax credit for the Thai tax only on income which under our rules has its source in Thailand.

If Thailand tries to tax income which we think has its source in the United States, the credit arrangement breaks down. Also, Thailand, for example, will not allow certain deductions in computing Thailand income which we use in computing the amount of income which we think should be used for credit purposes, and here also it breaks down.

Now, where the credit arrangements break down is one area where you need treaties, and this treaty with Thailand takes care of the rough edges—

Senator GORE. Excuse me, when you say credit breaks down, are you speaking of the investment credit?

Mr. SURREY. No, I am speaking of the foreign tax credit, the one Senator Pell speaks about. When that foreign tax credit starts to break down on its technical edges that is where treaties help.

There is another case where the treaty helps, Senator Pell. It is one thing for us to give a credit for Thailand tax but payment of that tax can still be a very irritating process. In other words, when a businessman goes to Thailand for a visit of 2 or 3 months, he can be required to pay a Thai tax on a portion of his U.S. salary because he earned it, as Thailand views it, while visiting there. He can pay this Thai tax for the 2- or 3-month period, and we will credit that tax, but most countries say that is a big nuisance and it is much easier, through tax treaties to grant exemption for these temporary visitors, so that he doesn't have to resort to the foreign tax credit process to take care of the matter.

Senator PELL. But in the end what we are trying to achieve here is simplicity, and I still can't see why this would not work.

What would be wrong with continuing the conditions as they are with no treaty? If, as you point out, the system broke down and the Thai did not tax some income that we would consider within the area open to taxation, or vice versa, it would be just simply a credit or, to put it the other way, in the United States you would pay the

additional tax. But aren't you making the whole arrangement a little complicated with these treaties for the individual?

Mr. SURREY. No; I wouldn't say what we are doing is making it more complicated. What we are doing in part is taking care of those situations where the foreign tax credit mechanism does not work out properly due to different approaches to the definition of income in the two countries.

Secondly, we are saying in some cases we will make life easier for the trader or the investor in that he won't have to have any Thai tax and, therefore, not get into the more complicated foreign tax credit approach. That is essentially what tax treaties do.

Senator PELL. I can't see if a man trades or treats with or works in Thailand why he should not be perfectly open to paying the Thai tax. It is a nuisance, so it is a nuisance for a Thai citizen, too. He doesn't have to be there. But if he can take a credit for the total tax he has paid against his American tax it would seem to me it would come out in the wash.

Mr. SURREY. But that is always assuming that the Thai taxes are fully creditable. In some cases because of the method of computation or the rates of tax there will be an excess of Thai tax over United States, so that the Thai tax is not fully creditable.

#### TREATY AS A DEVICE OF ECONOMIC POLICY

Senator PELL. But, again, there is the hard luck of the individual engaging in trade in a country with a higher tax rate than we have. There is nobody pointing a gun at him.

My point here is that this treaty is really a device to carry out the foreign economic policy of the United States through tax arrangements because the only real provision in this treaty of a substantial nature is this 7-percent credit.

Mr. SURREY. No; there is where I would disagree. If you look at the treaty, most of the clauses in the treaty are such as to eliminate barriers under the Thai system to trade and investment in Thailand. Barriers which exist today even with our foreign tax credit.

Senator PELL. But would you not think that the most gutsy provision of this treaty, and one that has the greatest impact, is this 7-percent credit?

Mr. SURREY. No; I would not.

Senator PELL. You would not?

Mr. SURREY. No; I would not. I would say the guts of this treaty are that it extends a number of restrictions on Thailand tax and that in return for those restrictions the United States places investment in Thailand on a general parity just insofar as the 7-percent credit is concerned, with investment in the United States.

Now, Thailand may look upon this as saying, "The main concession which the United States makes to us is their willingness to extend this credit to us in return for the five, six, seven, eight, or nine tax concessions which we make to the United States." For example, this treaty eliminates the tax on our airlines in Thailand and cuts the tax on our shipping to one-half. That is a serious concession from Thailand's standpoint.

A number of countries won't grant those concessions to the United States. So that there are a number of highly important tax conces-

sions by Thailand which I would say are the essence of this treaty. But to obtain those concessions the United States, in turn, must make a concession to Thailand which Thailand thinks produces a balanced treaty which they can sign and can support.

Senator PELL. But am I correct in saying in general under our tax laws as of this year, or as of the recent past, any income taxes paid to a foreign government are credited against our taxes?

Mr. SURREY. I would say that as a general proposition that is so.

Senator PELL. So that would get rid of the inequity I was talking about earlier where an American family can lose their house abroad in a similar situation.

Mr. SURREY. Those inequities occur when the foreign tax credit does not work. But as I indicated most nations have found that the foreign tax credit in and of itself just doesn't do the full trick and therefore they have entered into these treaties.

Senator PELL. Now, another point that bothered me was the 7-percent credit. This may be political, but I can remember when in 1962, we went to our people, at least in my part of the country, and gloried and reveled the 7-percent credit, saying how it would upgrade the industrial machinery to be better able to compete with the developed and undeveloped nations in the manufacturing of textiles, including India and Pakistan, which are under consideration.

I wouldn't be a bit surprised if we saw a good textile plant with good Rhode Island machinery starting to be used with the 7-percent credit in Thailand, if a treaty like this is enacted.

So the whole idea of the credit, which enables us to compete with foreign industrialization in the upgrading of plants, contradicts the policy of 2 years later which says we should do exactly the opposite so as to upgrade foreign competition.

#### BACKGROUND TO TAX TREATY CONCEPT

Mr. SURREY. I think I would respond in this fashion: In 1961-62, we were concerned with the fact that there were a number of reasons for U.S. companies engaging in investment in the industrialized countries of the world, primarily in Western Europe and Canada and Japan as compared to investment in the United States, and one was because these countries granted investment credits to their taxpayers, and granted very liberal depreciation.

So we looked at our tax laws and Secretary Dillon gave data to the Congress, showing that with our 7-percent investment credit and liberalized depreciation the return to the investor under the tax systems of Western Europe and the United States would be the same, and that this would put investment in the United States on a par with these countries.

But I think this was primarily only looking at the question of spurring American investment here at home, making it attractive for our capital to stay at home rather than to go abroad to the industrialized nations of the world.

But we do have a policy, I believe, under all our balance-of-payments rules and under our tax law, and certainly it is a policy under the Foreign Assistance Act, that private investment in the less developed countries of the world should be encouraged. We have investment guarantees, for example, for less developed country investment.

We do not extend the interest equalization tax to the less developed world.

The Commerce Department's voluntary program on balance of payments does not apply to the less developed countries. Banks under the Federal Reserve voluntary program are to give a priority to bank commitments to less developed countries.

Now the magnitudes are pretty small. The amount of investment we are talking about, nonoil investment, manufacturing, the whole manufacturing investment in the whole less developed world was only \$178 million in 1964. The investment credit in the United States came to about a billion and a half dollars of tax.

We are talking in this Thai treaty about \$150,000, or \$100,000 of investment credit.

Senator PELL. But the thing that is important is the pattern for other treaties in the future. This is what concerns me.

Mr. SURREY. But it is only for really less developed countries. It wouldn't apply, for example, to a territory like Hong Kong. Also, the magnitudes are very small.

Senator PELL. Didn't you just say India was under consideration for a treaty?

Mr. SURREY. Yes, sir. But the magnitude of investment in any of these countries is very small.

Senator PELL. I come from a State where the competition that we face in one of our major industries comes from Pakistan, India, and other developing nations.

Mr. SURREY. From imports into the United States.

Senator PELL. Yes; cotton textiles.

Mr. SURREY. In the Thailand treaty, I don't think that is so. In Thailand, the manufacturing activities there seem to be quite limited. They are primarily, I think, in machinery and for local consumption and matters of that nature.

Senator PELL. I would agree with you about the general idea of increasing investment in undeveloped nations. The point you have cited, like the interest equalization arrangement and the voluntary curtailment of bank loans and short-term bank loans, are basically projections of our foreign economic policy, concerned with our balance of payments. To my mind, a tax treaty should only be concerned with the interests of the citizens of the two countries involved, and it is not a question of projecting the Nation's economic policy. That is why I personally object to this idea of a 7-percent credit in this treaty.

#### REASON FOR 7-PERCENT TAX CREDIT

Let me come to another point. Why do you pick the magic figure 7, because 7 is like a red rag to those of us who suggested it to upgrade our machinery to compete with these nations.

If you had chosen six or eight it might have been easier for us.

Mr. SURREY. It is curious, that reaction. We had looked at it the other way. In fact when other countries requested 10 percent we did not go to 10 percent because we thought that would be a departure, a significant departure, from U.S. policy. In other words, we felt that it would be in keeping with U.S. policy to say that insofar as investment is concerned we will not leave the less developed countries under a handicap as compared to investment in the United States

and therefore we would use the same 7 percent but we would not go beyond 7 percent. So that is the way we approached it. In other words, from their standpoint it was saying to Thailand, "In return for all your concessions, we will see, that investment in Thailand is not under a handicap as compared with investment in the United States," and that was the way we approached this treaty. We did not go as far as the other industrialized countries had gone, which was to say that "We will in addition give our investors in Thailand a positive advantage," which is what the other industrialized nations have done.

And there are important things to take account of, Senator Pell. When all is said and done, the United States gains heavily from the development of the less developed world. It gains through exports to these countries, and that has been the pattern.

What we find is that the rest of the industrialized world begins to see that, and is beginning to extend its network of tax treaties because they think that this aids their political and economic interests.

Unless we find an appropriate way of negotiating with less developed countries, we will be left behind in this parade, and if the rest of the industrialized world believes that tax treaties are to their advantage, I think we should pay attention to that feeling. We believe we have found in this approach a mechanism that does not prejudice the United States domestically but at the same time is acceptable to the less developed world in the sense that they will enter into tax treaties which are helpful to American export trade, American investments and American cultural relations.

Senator PELL. We are really talking in two different areas. I am not arguing with you one bit about our objectives and the importance of encouraging the industrialization of underdeveloped nations. We are both tilting at the same windmill from different sides. I am saying it should not be done through tax treaties, and if you do do it, don't use the figure 7 percent.

#### PROPOSED TAX TREATY WITH INDIA

One further query in connection with India: Are you considering such a treaty with India?

Mr. SURREY. Yes.

Senator PELL. Will the figure 7 be used in that?

Mr. SURREY. Yes.

Senator PELL. Again we would find in the textile producing parts of the country considerable concern because that is the very percentage that was used to upgrade our own machinery. You will find Indian textile products coming into our country now.

Mr. SURREY. That may be a special problem in connection with India; that is not a special problem in Thailand as I understand.

Senator PELL. I understand.

Mr. SURREY. I say the magnitudes involved here have to be taken into account.

When you say it can be done other than by tax treaties the answer there basically is no. You cannot, except through a tax treaty, have Thailand restrict the scope of its taxes. So that you start with the necessity of operating through a tax treaty because that is the essence

of what we are doing here, in that Thailand is restricting the scope of its tax.

Now, the question is—under what conditions will Thailand or Israel or India enter into a tax treaty with the United States? They have refused to enter into tax treaties unless there is some recognition, some encouragement in their light, of capital inflow. We think this extension of the investment credit is the encouragement that is least harmful to the political policies and tax policies of the United States. Thailand has entered into treaties with, I think, four countries by now, and in each of those treaties the other country has made concessions which we think go beyond the concessions the United States is making in this treaty.

Senator PELL. I would defer this to the chairman of the subcommittee, but it is very difficult for me as an individual, when the treaty has already been concluded and signed and it is given to us for ratification, to vote against it. I would then be pulling the rug out from under you but I wonder if, by the same token, those things which bother us here, such as this figure 7, could not perhaps be taken into consideration in the future.

Mr. SURREY. I think it is quite appropriate, Senator. Let me say this: We have explicitly limited this clause, the investment credit, to 5 years. We also, after negotiating two or three of these treaties, brought them here, and attempted to bring them here as a group so we could get your general reaction. For example, if this committee were to authorize us to write an 8 or 9 or 10 percent investment credit that would be one thing, if it felt that was appropriate.

We do view these hearings as giving us the insights of this committee into this process of treaties with less developed countries and for that reason we have been quite cautious in putting time periods on the innovations in these treaties, time periods which will go just to these particular clauses and not the entire treaty.

Senator GORE. Would the Senator yield?

Senator PELL. Absolutely.

#### POSSIBLE BENEFIT OF STATUTE OVER TREATY

Senator GORE. For the sake of clarification as we go along, before you leave the question of the advisability of granting investment credit for the development of manufacturing abroad, in this case in Thailand, I think a few questions may be posed here. First, consider the advisability from the standpoint of our own interests and the interests of Thailand of giving an investment credit against taxes owed to the Treasury in the United States on profits earned in the United States for, one, investment in Thailand and, two, the accumulation of assets in Thailand. The advisability of it is one thing. If it is advisable, if it is in the national interest, then I think a second question which comes to this time element to which you were addressing your remarks is important. Could this be more advisedly accomplished through a statute which would be more temporary in nature than through a treaty which certainly becomes a supreme law, and a rather rigid thing? True, we could abrogate the treaty by legislation or by renunciation, but this is something we are reluctant to do. So I think this second element, the time element, is a part of the decision of the Senate as to

whether we wish to do this, and if we wish to do it, whether we think it is advisable to do it by treaty rather than legislation.

Excuse me for interrupting.

Mr. SURREY. Could I respond to that for a minute, Senator?

Senator GORE. With Senator Pell's consent.

Mr. SURREY. I will respond by stating that we were directed by the Foreign Assistance Act of 1961 to explore the possibility of using tax treaties to promote private foreign investment. In other words, the Congress asked the executive branch to enter into tax treaties with less developed countries if at all possible. So that is one reason why the treaty approach is used.

Secondly, as I indicated before, these clauses in this treaty are temporary. They are all to be reexamined after 5 years. The United States has the unilateral right under this treaty to reexamine the investment credit extension after 5 years, and that does not go to the withdrawal of the entire treaty. So there is a temporary period for that provision, just as there is for the deferral provision, Senator.

Thirdly, I do not think it would be wise to do this unilaterally by statute. I think there is something basic to the treaty approach: There may be some countries you do not want to extend this credit to. We did not think it desirable in the case of the Philippines to extend the 7 percent credit because of the general contours—

Senator PELL. The Philippines did not want it either.

Mr. SURREY. Well, that is part of the thing. Under legislation, under a legislative approach, the Philippines would have it because it would be unilaterally extended by the United States to the Philippines.

Senator GORE. That might not necessarily be the case. This comes to the point on which I first questioned you today, and that is the possibility of building up resentment to U.S. equity involvement in the capital structure of other countries, the economy of other countries. We are having a kickback on that now, a rather severe one, from our neighbors Canada and Mexico, and from the Philippines to which you just referred.

Mr. SURREY. But that is just the very reason, I think, that the approach that is being used of negotiating bilaterally with countries that are interested and receptive—

Senator GORE. It would be fine except we have such a treaty with Canada.

Mr. SURREY. Yes; but not an investment credit, Senator.

Senator GORE. I did not mean investment credit. But we have a tax convention.

Mr. SURREY. Yes; but we do not have investment credit. I think we have given a lot of thought to this, and the treaty approach—

Senator GORE. You have provoked a lot of thought on the part of the Senate, too.

Mr. SURREY. The treaty approach enables us to engage in bilateral negotiations and suit the particular extension of investment credit to those countries which are receptive to U.S. investments and which will agree to nondiscriminatory clauses and which will enter into all these tax provisions. If you do something unilaterally, we have found, you give away all your bargaining weapons at the tax treaty table and there is nothing left to talk about.

## POSSIBLE EXCLUSION OF CERTAIN MANUFACTURED GOODS

Senator PELL. I wonder if I could leave with you one thought in connection with the treaty you are now in the process of working out with India. Perhaps you could have this credit apply only to investment in heavy industry, where there is no competition. We want to encourage capital to go into the steel industry, nuclear installations, and industry of that sort, but perhaps it would be better not to include consumer goods. I obviously have a parochial interest in this, but we are being flooded with textile imports, many of them produced from plants with machinery made in my own State. To encourage production by the same devices that we took to get new machines, and then encourage the manufacture of the same product abroad which then comes back in is not very popular.

Mr. SURREY. I see the point you are making.

Senator PELL. I am wondering if you could exclude consumer goods in the working out of your treaty? Does this make any sense to you?

Mr. SURREY. Consumer goods imported into the United States.

Senator PELL. Certainly.

Mr. SURREY. I do not think you would be concerned about consumer goods remaining in India.

Senator PELL. Absolutely not.

Mr. SURREY. It is consumer goods imported into the United States.

Senator PELL. This would make life a little easier for my intellect.

Mr. SURREY. I think I can understand that problem.

## PAST SENATE ACTION ON TAX TREATIES

Senator PELL. I hope you would take that thought into consideration in perhaps negotiating this and, as I say, make this less difficult to accept. I would like to ask my chairman if it would be very unseemly to reject a treaty which has been signed even though we do not like it. We do not have much alternative, do we?

Senator GORE. Well, we in effect rejected the Indian treaty in 1958 which had the elements of tax sparing and the most eloquent witness against that was the distinguished witness before us now.

He testified specifically against tax sparing in the Pakistan treaty hearings.

Senator PELL. For ratification?

Senator GORE. No, opposed to ratification.

Senator PELL. The Assistant Secretary of the Treasury.

Senator GORE. He was not the Assistant Secretary of the Treasury at that time.

I hope this is not going to be disconcerting to you, Mr. Secretary.

Secretary Surrey called the Pakistan treaty a "radical departure," he called it "the first tax treaty which directly reduces the U.S. income taxes applicable to American corporations." He condemned using the treaty process "to reduce directly U.S. taxes on Americans."

That is exactly what this treaty does.

Senator PELL. This is just what we have been saying about this treaty.

Senator GORE. Of course, he had the distinction then of being a lofty professor and now he is in the operating end of our Government in a very high position and different principles are involved, tax sparing then, and here we have the investment credit.

Mr. SURREY. I do think that is a fundamental difference, Senator.

Senator GORE. I only cite this—it is a fundamental difference, and I recognize it. I only cite the refusal of the Senate to ratify the treaty, and Mr. Surrey's opposition to it, in answer to your question, Senator Pell, that the bottom doesn't fall out of the world if the Senate does not ratify this treaty. The importance of the pending treaty, as I see it, is not its intrinsic importance vis-a-vis the United States and Thailand, but the fact that this is more or less a prototype, to use a current word, and that if this one is ratified, then we will have 25 to 30 others. That does assume a magnitude of some importance. Secretary Surrey has two or three times referred to the paucity of commodities and taxes involved here, and I agree. But if this is a good idea, then, of course, it is something we hope will grow.

I supported the foreign aid programs, in fact, I have supported them all. I particularly supported them to rehabilitate the economy in Japan, and we find in certain industries now that with American aid Japan has a newer plant and in some respects a more efficient productive plant than the United States. This was one of the most compelling arguments used by Senator Pell in advocating investment credit in the United States. I opposed investment credit. I was unable to persuade the Senate against the eloquent arguments of Senator Pell that we needed to improve our own plant with investment credit.

#### NEED FOR A SELECTIVE APPROACH TO TAX TREATIES

There comes a time when I think all good things may be becoming surplus. In other words, you can overdo the best of things. Just how far we can go in subsidizing the development of industry abroad, I do not know, and this comes to the question of selectivity. By this treaty giving investment credit for development of manufacturing abroad, we have no power of selection. It is a broad coverage. It does not matter whether the investment is in textiles, in shoes, in bubble gum, or whatever. The subsidy from the Treasury goes, and if it is wise policy for the United States to subsidize the development of foreign economies, should we do it with this scatter-gun approach of a treaty which gives such a benefit to all kinds of investment, except in oil and mineral extraction, or would it be more advisedly approached on a selective basis? It seems to me that that is the second important question involved here. Do you agree with that?

Senator PELL. I do.

Mr. SURREY. I think the treaty approach does permit you to be selective, and if this committee thought we ought to be more selective than we have been, we thought we had some degree of selectivity here, obviously, that would be something to be taken into account.

I do want to reemphasize the fact, and it goes to your question, Senator, that these are all temporary clauses and they are deliberately temporary and they are deliberately put in that way so that they have to be reexamined at the point of 5 years because you will get countries that will be changing perhaps their pattern of industrialization, and this will give us, this limitation to 5 years, the opportunity to examine these matters, perhaps to engage in more selectivity as you indicate, as we gain experience with this.

In other words, we have tried to pattern the approach here as far as possible to your general objectives by keeping it sufficiently flexible

and sufficiently within our control rather than have it a long enduring matter never to be reexamined without having to reexamine the entire treaty.

Senator GORE. I can see that the 5-year limitation has merit. But so far as promoting selectivity, it promotes nothing at all. Within that 5-year period the benefits, subsidy by way of investment credit, will flow to any type of investment which any American, any interests, may wish to make in Thailand.

Mr. SURREY. Yes; with the exceptions set forth in the treaty.

Senator GORE. Except the prohibited ones of oil and mineral extraction.

Mr. SURREY. And, of course, except as Thailand itself puts limitations upon the process.

Senator GORE. But that is not within our control.

Mr. SURREY. No; that is not within our control.

Now, I think our general thought was that the investment levels are so low, and likely to be so low, that this was not yet a problem in Thailand.

Senator GORE. I think I would agree with you. But when you extended this to 27 countries I am not sure that that is true.

Mr. SURREY. No. What may be a selective problem in one country may not be a selective problem in another country.

Senator PELL. I wonder if you could agree in principle, or would this be pressing you too hard, that in the further negotiation of these treaties with India and with other countries, that goods being produced for export or investment in plants producing goods for export to the United States could be exempted from any 7 percent credit—I would prefer  $7\frac{1}{4}$  or  $6\frac{7}{8}$  percent credit, if we could agree in principle on that, I would agree more enthusiastically.

Mr. SURREY. I would not, if you don't mind, Senator, like to make a commitment on that today. But I do want to say to you I do think your suggestion requires our very careful consideration. I can see a good deal of merit in the suggestion.

Senator PELL. I would be interested in the reaction of my colleague, the chairman, to the same thought, that this investment credit might or might not apply to plants producing goods for export to the United States in competition with our own goods.

Senator GORE. I do not know how you could administer that.

Mr. SURREY. Well, I think we could. I would like to think about it.

Senator GORE. This would certainly ease some of the difficulties involved.

Senator PELL. Not just me, but I think other Senators, would feel this way, too, when the question is thought through.

Senator LAUSCHE. Senator Pell, your thought is that if you give them a tax benefit, on the one hand, and then allow them to make inroads on our own business by exporting to us, you are giving them a double benefit and harming us twice.

#### POSSIBLE HARM TO DOMESTIC INDUSTRY

Senator PELL. That is right. The only person who benefits then is the individual American investor, who can make a killing to the harm of our domestic industry. It can be china, rubber tires, or tex-

tiles in my case, whatever it is that is made. My point is that while the objective is to have investment in heavy production, particularly in the developing nations, and the productivity of the free world is a good thing, couldn't we exempt from it investment in plants that are going to be in direct competition with American plants. Would that idea have merit?

Senator LAUSCHE. It would not only be of harm to our industry, but to all segments of the economy that are in any way related to it.

Senator GORE. Of course, this would become another restriction to trade, and I think the Department would want to examine that rather broadly from both standpoints.

Senator PELL. Excuse me, not to trade, just to the investment credit.

Senator GORE. Well, I mean when you set up certain estoppels for particular categories of goods manufactured through or as a result of or affected by this investment credit, you might affect a wide scope of international trade when you extend it to all the underdeveloped countries.

Mr. SURREY. In the treaties that we have signed, Thailand and Israel, we did not think this was a problem because I do not think they have goods that enter competitively with the United States. India we would have to look at, Senator Pell, and we would have to look at it to see whether your observation there had a practical content, but we would be glad to look at it.

Senator GORE. This was true with respect to Hong Kong a few years ago, and now some of the most devastating competition comes from the territory of Hong Kong.

Mr. SURREY. As I say, we would not enter into a treaty of this kind with Hong Kong. We do not even treat Hong Kong as a less developed country.

Senator GORE. I think the point that Senator Pell is making is that there are numerous other countries which have a very low wage scale and mass unemployment, and yet dexterity of hand and industrious people that, if given the proper and sufficient stimulus of subsidized American investments such competitive factors might easily be erected in other countries.

Thailand might be one of the possibilities. I am not sure that the Thai people are as industrious as the Chinese, but they are certainly highly skilled in the type of work that requires dexterity of hand.

It is in this area, it seems to me, the area where the particular type of labor that requires dexterity is involved or maximized in a product. Our devastating competition in international trade does not come from the mass machine production, the assembly line production. It is in those products where hand labor is maximized and, particularly adept and dexterous hand labor. Is this not generally true?

Mr. SURREY. In the exports of Thailand, for example, to the United States, the vast proportion is rubber from Thailand, tapioca is next in proportion, then kapok.

Senator GORE. I wish they could send us some of their pineapples. They have the most delicious pineapples in the world.

Mr. SURREY. They don't come to 1 percent in the export figures. Gum and teak are others. In other words, Thailand is a raw materials exporter. It is not a finished goods exporter.

Senator PELL. And certain luxury textiles. I happen to be the proud possessor of a Thai necktie, and it is really a remarkably nice one indeed.

Mr. SURREY. Our figures show silk 1 percent.

Senator GORE. Incidentally, I know the gentleman who developed Thai silk; it is called under the trade name of Thai Bok. His name is Thompson. His home is very near Washington.

He was there as a soldier on the Burma Road, and discovered up in the mountains the Thai weaving or spinning an unusual quality of silk, so after the war he secured some good American and German and Swiss dyes, and went back and selected some talented people, and he has succeeded in making a world market for Thai silk.

Senator PELL. Without a 7-percent credit.

Mr. SURREY. I would suppose in a sense some of the Rhode Island manufacturers succeeded without the 7-percent credit. The important thing is what happens on the average, and at the margin.

Senator PELL. I not only hope but urge that in your negotiations with India and any other undeveloped nations, you give thought to this idea that I propose.

Mr. SURREY. We will, Senator.

#### STATUS OF INDIAN TREATY

Senator GORE. The Indian treaty, Senator Pell, is under active negotiation. In fact, it is pretty near to the signing stage, is it not?

Senator PELL. Are we that near already?

Mr. SURREY. I do not think that it's that far. We have a tentative text, but it is not yet a final text.

Senator PELL. Does it include this provision for the exclusion of goods destined to the United States?

Mr. SURREY. No, it does not.

Senator PELL. Would it upset the negotiation to stick it in?

Mr. SURREY. That is something I would have to explore, Senator.

Senator PELL. I hope you will be able to do it.

Mr. SURREY. Yes.

Senator PELL. But it does have this magic 7.

Mr. SURREY. Yes, because, you see, in our light that would be in keeping with the way we view it. If it were 8, 9, or 10, I think we would have been moving in the direction of a positive inducement, as against the United States, and that is why, I think without direction from this committee, we did not think it was advisable.

When you get down to less than 7—and this is one of the interesting things, a number of these countries made us engage in calculations as to whether from their standpoint they were getting the equivalent of tax sparing. Remember, this is a treaty, and this is a bargain, and the other country has to sign it. The signature of the United States alone is not enough.

Seven percent gives them nearly the amount of benefit that they think a tax-sparing credit would give them when you look at the whole thing. So that, consequently, at 7 percent they could enter into these treaties, although I think they would have preferred 10 percent, but I do not think it would have been appropriate to negotiate 10 percent. Below 7 percent we therefore would have problems.

## FEW BENEFITS FOR THE UNITED STATES

Senator GORE. I must say, as I have studied these treaties, Mr. Secretary, I have not been particularly impressed with the national benefits which might be anticipated for the United States.

It is true, as Senator Pell says, that it might benefit some investors, American investors, in Thailand. The real benefit, if any, it seems to me, must be drawn from the overall policy of encouraging economic development in underdeveloped countries.

I agree with you that as these economies develop they are better customers for the United States. I think experience shows that, and insofar as benefits to our country are to be found, I think they must be found in this, at least this is my view.

Now then, the second question is whether this is the best way to do it. I would like to see the United States promote economic development in underdeveloped countries. I have supported bills for that purpose, the Alliance for Progress, for instance.

But I must say I have the gravest of doubts as to whether we should do it by treaty, providing investment credit on a nonselective basis for any sort of economic development; and, secondly, I doubt that as a price for doing that we should give to Thailand or concede to Thailand or accord to Thailand, an interest in, and thereby by treaty reduce, taxes on our own people here at home. It just does not seem to me that this is exactly the proper thing to do.

When you combine the investment credit for, let me repeat, both investments and accumulation of assets abroad with deferral of taxation, and deferral is in many respects forgiveness of taxation, on the sale of properties by American corporations to a foreign subsidiary or foreign affiliate, it amounts to or could amount to a heavy subsidy for such investment in Thailand.

Mr. SURREY. Senator, let me just repeat—

Senator GORE. Before you go to that, let me quote what you said with respect to subsidies of this sort:

I think I would tend to say—and this is in part the experience of tax history—that tax concessions are probably not the most effective way to do it.

You impressed me very much when you said that.

Mr. SURREY. I was hoping I would impress you even more today.

Senator GORE. I must say you are increasingly impressive, Mr. Secretary.

## FOREIGN ASSISTANCE ACT PROVISION RELATING TO TAX TREATIES

Mr. SURREY. We start with this background, Senator. The Foreign Assistance Act of 1961 directed the President to accelerate a program of negotiating treaties of commerce and trade, including tax treaties, which shall include provisions to encourage and facilitate the flow of private investment to and its equitable treatment in friendly countries and areas participating in programs under this act. This was the congressional direction.

Senator GORE. That was under the Eisenhower administration.

Mr. SURREY. This is 1961.

Mr. GORE. Oh, well, it was largely a repetition of what was in the 1954 act.

Mr. SURREY. Well, but it is a direction in 1961. This is a tax treaty.

Senator GORE. I must say that also this was contained in language submitted to the Congress by the executive branch, so I am not sure that this was a mandate that originated in the legislative branch. We sort of concurred in it, and maybe we should do less of that.

Mr. SURREY. Yes. But I take my—I read the statutes of Congress—

Senator GORE. I understand we passed it, and you are right.

Mr. SURREY. That is right, and there it is.

This is a tax treaty with Thailand which does obtain for the United States important tax concessions of a kind which the United States has been seeking to obtain generally in a tax treaty program which this committee has approved time after time.

We have said that without some recognition of encouragement to investment in Thailand, in keeping with the directive in that act, I do not think we can sign this treaty with Thailand or these other countries.

Insofar as the policy of the United States is concerned, the 7-percent credit is a device which it has sanctioned. That is national policy. Consequently, this does not adopt any new national policy such as tax sparing, which was a positive additional benefit to the investor as against investment at home. Tax sparing was a lowering of the tax to the investor in the foreign country as against investment at home and, therefore, quite a different concession and quite a different thing. This treaty involves the extension to a less developed country of a policy that is already ingrained in our tax laws and, therefore, is of a quite different nature.

I generally agree with you, Senator, that we should be very careful in changing the U.S. tax laws on U.S. investors. This committee, however, has approved this effect in the past. I was in error when I testified earlier. In the treaties with Japan and Great Britain, we do reduce the U.S. tax on U.S. investors. The treaty with Japan has since been changed because of changes in their law, but basically their treaty did so, and thus such a policy has been used at times, sparingly, in the past.

With respect to this problem of deferral, again that is limited for 5 years. It is an experiment.

The suggestion came to us with respect to and from those groups of companies in the United States, construction companies, architectural firms, companies that are interested in exporting machinery.

In many cases their activity is to produce a plant in the other country. They either take part architecturally or from a construction aspect or as the exporters of machinery produced in the United States.

The foreign country sometimes desires that they take minority stock. There can be other reasons for taking minority stock. We thought generally that is the kind of thing that is in the interests of the United States to encourage. We thought deferral would be in keeping with U.S. policy in that deferral is permitted when there is an 80-percent interest in most of these situations. This would be permitted under the treaty when there is a minority interest, which is also, we think, in keeping with encouragement of joint ventures. It is a policy to be tried for 5 years.

If the committee thinks it is not working well, if the committee thinks it is disadvantageous to the United States, then obviously it

can be studied. But again, we attempted to carefully circumscribe it and keep it within those limits so that this would not be something that is so ingrained that the whole treaty has to be destroyed if we later decide that this was not a sensible departure.

#### MEANS OF ENCOURAGING DEVELOPMENT

It looked to us to be a sensible way of encouraging the development of these countries through these kinds of services and through this export of machinery and equipment. Now, we may be wrong in that. We do not think so. But that is the underlying basis for the policy.

It had to be done bilaterally because unless the other country agrees to a similar deferral there is no point to the exercise, since a tax would have to be paid to the other country.

Senator GORE. Of course, as a matter of tax equity, I think this would be a wrong policy. What you have is the sale of patents and architectural designs, know-how, other property from the United States to a foreign affiliate, in which they have a minority ownership. This property is exchanged for the assets of this foreign affiliate. If those assets are of value, then they have made a sale, and then they have income. They sold a patent, they have sold know-how, and they have sold other property.

Mr. SURREY. The word "sale" bothers me because they look at it as a contribution for stock.

Senator GORE. Well, if you contribute \$1 million for stock, you get the stock. Now, whatever you call it, that is an acquisition of assets. If you do not want to call it that, call it an exchange of patent rights for stock.

Mr. SURREY. Yes.

Senator GORE. In any event, to the extent that this stock in the foreign affiliate is of value, then the domestic corporation has acquired a value in the foreign assets for property which is owned in this country. This is income by whatever devious way you describe it, whether devious or not devious, whether direct or indirect, and from the standpoint of tax equity it is income on which they should be taxed, whether by normal or capital gains rates would depend upon the circumstances.

So what you do here is you defer. You just do not treat this as income for tax purposes. Without the consideration of promoting the developing of the underdeveloped country, I would say it would be indefensible. It may be defensible because it is done for this purpose.

Now, this is my view on it, and whether you agree with this or whether you do not, the question is, so far as I see it, whether the development, the character of the development to be promoted, justifies both the tax credit and the tax deferral.

#### POINT OF DEFERRAL

Mr. SURREY. What I was trying to do was to indicate, one might say, that the risk to the United States in changes in U.S. tax policy was not so great. For example, on this deferral point, Senator, if there is 80 percent ownership, then for most of these cases there is deferral unilaterally under our law.

In these particular cases we are dealing with, where it is less than 80 percent ownership, in most situations, I think there would be a tax in the foreign country for which we would grant a tax credit in the United States.

Senator GORE. It would not be a tax on income earned in the United States on the sale of a U.S. asset.

Mr. SURREY. Oh, no. You see, the foreign country would look at it your way, Senator. It would say there is an exchange of stock for a patent, and Thailand, for example, could tax this very transaction because Thailand would regard that as income originating in Thailand. Consequently the U.S. investor would plan the transaction so that he would get a credit for the Thailand tax when we, in turn, taxed this transaction.

All we are doing here essentially and basically is saying they will defer their tax, and we will defer our tax in lieu of their taxing and our giving the tax credit so as to make this kind of investment or this kind of contribution more feasible. But there is not any basic harm to the United States in this transaction because in many cases if properly conducted and properly planned, you can get a foreign tax credit for this, and our tax is reduced anyway. We defer to the foreign country. There may be a difference in rates, of course, but basically these are transactions which are taxed in both countries.

#### PROBLEM OF TAX JURISDICTION

Senator GORE. Mr. Surrey, I do not know how Thailand would tax X corporation, a U.S. corporation.

Mr. SURREY. That is the problem, Senator, of tax treaties, and that is why we get into these difficulties because Thailand considers the transaction as taking place in Thailand. There has been an exchange in Thailand under your terms, I mean the way you approach it is the way a good, hard-boiled Thailand tax inspector would approach it. He would say there has been a sale in Thailand of assets for Thailand stock. That is the reason this provision, to make sense, has to be bilateral. It would not do us any good to defer our tax unilaterally in these cases because in many cases, without some special concessions in the other country, there will be a tax in that country. Sometimes our people can work out these concessions, but something has to be done to eliminate the tax in the foreign country.

Now, sometimes they may plan it so that the sale technically occurs here and does not occur in the foreign country. But we do not have control over those rules. Thailand has controls over what Thailand wants to tax, subject to a tax treaty. If Thailand says—

Senator GORE. Something within their own sovereignty.

Mr. SURREY. That is correct. Thailand can say this transaction takes place for tax purposes in Thailand, and there is nothing the United States can do about it except through a tax treaty, and that is why these tax treaties are important, because some countries have different views of tax jurisdiction.

Senator GORE. You make a good point, and it illustrates, of course, that this is by no means a one-sided question. There are many considerations involved in the decision to ratify or to reject the pending treaty.

I do not quite understand the mechanism. I do not challenge the accuracy of your statement at all, but I do not quite understand how Thailand would reach X corporation, a U.S. corporation, that does not have a so-called permanent establishment in Thailand, but which, for the exchange of patents, receives 10 percent of the stock of Y corporation, which is a Thai corporation.

The stock is shipped to X corporation in the United States; the patent material is shipped to Y corporation in Thailand. How would Thailand ever reach the assets of X corporation?

Mr. SURREY. Well, there are two questions in this.

Senator GORE. Unless they wish to confiscate the 10-percent stock.

Mr. SURREY. Yes; there are assets. There are always two questions, Senator, as you point out. One is, is there a tax to be levied and, two, has the foreign country got practical ways of collecting the tax?

Senator GORE. Yes.

Mr. SURREY. Now, for example, one of the reasons why the permanent establishment rule is so important in this treaty is that Thailand imposes taxes on U.S. corporations that sell through people in Thailand, even though the U.S. corporation may have nobody in Thailand, and it enforces that by a withholding tax of 2 percent of the gross receipts. So there are ways by which—

Senator GORE. Two percent of the receipts of such—

Mr. SURREY. Sales.

Senator GORE (continuing). Such sales agencies?

Mr. SURREY. Sales that the U.S. exporter makes to Thailand through an independent commission agent or broker in Thailand.

Now, most companies, I mean American corporations, have not been in Thailand, they are right here in the United States sending their goods to Thailand, they have nobody in Thailand.

Senator GORE. So the tax would really be not on X corporation but upon whatever corporation or whatever agent—

Mr. SURREY. It is 2 percent of the gross receipts which would otherwise be remitted to the United States which are withheld in Thailand. The commission agent has to withhold.

Senator GORE. So that in order to alleviate such an arbitrary treatment—

Mr. SURREY. We write this treaty.

Senator GORE (continuing). You propose this treaty.

#### PERSONAL AND NATIONAL BENEFITS OF TAX TREATIES

Mr. SURREY. We write this tax treaty with Thailand under which that tax will not be withheld.

Senator GORE. This has been of benefit primarily, as Senator Pell stated, to those few Americans who are investors over there.

The question is where is the national benefit?

Mr. SURREY. These are people who are exporting into Thailand. These are American corporations exporting into Thailand.

Senator GORE. They may not be exporting. They may be engaged in manufacturing in Thailand.

Mr. SURREY. No. If they are engaged in manufacturing in Thailand—

Senator GORE. I mean they may have stock in a corporation that is purely a Thai corporation.

Mr. SURREY. Then we have a different set of problems. Then we would have the subsidiary in Thailand. But these are American corporations with no interest in Thailand other than to export to Thailand.

Senator GORE. The example I gave you did not assume that X corporation would export to Thailand except they were exporting their patents and gaining in exchange therefor a 10-percent ownership in Y corporation, a Thai corporation.

Mr. SURREY. What I wanted to indicate, Senator, was that Thailand jurisdictional tax rules are very broad and, therefore, in the case you have indicated, Thailand could say, "we have jurisdiction to tax here," because a Thai corporation is, in your language, selling stock and getting something for it.

Now, under that view a taxable transaction has occurred in Thailand. The American person engaged in that transaction has income from Thailand, and the question is how Thailand would collect that tax. They could levy on the stock or if there are other assets of the corporation they could levy on those.

But this is not unusual. There are other countries that will say, "As long as their stock is involved any transactions with respect to that stock no matter where occurring in the world are taxable." For example, Germany, says that if an American owns stock in a German corporation and sells that German stock to another American at a profit, Germany taxes that profit if there is, I think, 25 percent ownership.

Now, we would not, the United States would not, do that. In other words, if a German held a 25-percent interest in an American corporation and sold that to another German, we would not tax that transaction.

Well, now, here is a difference in tax rules which only a treaty can deal with, and the German treaty, which we hope to have before you, will deal with this situation and restrict the scope of German tax. That is what these tax treaties are all about, and these are just instances of where you get a jurisdictional rule in one country that is much broader than our jurisdictional rule, and in these cases the foreign tax credit mechanism breaks down, our taxpayers get subjected to taxes they do not know about and later have to pay, or which economically are harmful.

Now, sometimes they can plan to have other income from these countries so that the United States picks up the tab through our foreign tax credit. In other words, this would be a German tax, and it would be creditable to the extent that there was worldwide income, and we would pick up the tab.

When we enter into a tax treaty, what we are really doing in the German case is that the U.S. Treasury will benefit in large part and the German Treasury will give up the tax. That is exactly what this German treaty before you will involve.

This Thai Treaty involves in the deferral example a similar thing. The U.S. Treasury is unilaterally committed to crediting foreign taxes. When we ask Thailand to restrict the scope of its jurisdiction, as in this permanent establishment case or in this deferral case, our Treasury, in effect, does not have to credit this foreign tax in Thailand, and the U.S. Treasury in dollars and cents benefits from this Thai tax treaty.

## BENEFITS FOR THE UNITED STATES

I would say that with respect to a good deal of this Thai tax treaty the U.S. Treasury is one of the beneficiaries.

For example, when the dividend tax in Thailand is reduced from 25 to 20 percent, we thereby gain some tax as a result of that very transaction because the Thailand rate falls below the U.S. rate, and we pick up tax.

Senator GORE. Just as you say the volume of trade is small, the magnitude of this is quite small.

Mr. SURREY. Yes. We happen to be dealing in small figures.

Senator GORE. That is right.

Mr. SURREY. The German example I gave you, I know of one transaction that involves over \$2 million.

Senator GORE. Yes. That would be much larger.

Mr. SURREY. Yes.

Senator GORE. So the real importance of this pending treaty with Thailand, and the reason I have called for a hearing on this particular one, is not its magnitude either in revenue, in exports, trade, or import volume, it is because of the fundamental principles involved, which I have already stated.

It is a matter of importance, and one on which you have made an excellent case from your standpoint, and is one which the Senate must consider not just from the parochial point of view but from the national point of view.

As Senator Pell has said, we need tax conventions with many countries, the more countries the better if they are advisable conventions.

Whether or not the overall public interest is served by the concessions which you propose in order to obtain the agreement of our foreign contracting parties is something the Senate must look at with the greatest of care.

Mr. SURREY. I would fully subscribe to that. We would not have sent this treaty to the Senate of the United States unless we thought it was in the national interest of the United States. But we certainly believe this is a matter which should be examined, and we fully understand it.

Senator GORE. I think that I may have addressed a letter to you or to the Secretary of the Treasury some year or so ago admonishing you to tread carefully in this area. I would wish to concur in the suggestions of Senator Pell that further negotiations be had with the greatest of caution until the Congress reaches some decision on the pending treaty.

Now, the pending treaty, as you well know, let the record show, is not a 100-percent prototype, because, as you have said, a treaty between the United States and any other country may vary in some degree from a treaty between the United States and any other country. But, in general, this is a prototype. Therefore, the Senate will want to consider it carefully, and is considering it carefully.

I have talked with numbers of Senators about it. I am not sure that those who are not in the club realize the importance of the luncheon discussions in the dining rooms that are positively only for Senators. There at a round table yesterday, I believe, as I looked around the table there were nine Senators, and we were discussing just this subject, and I observed as an aside to someone on my left

that a more meaningful debate and discussion was underway there than was underway on the floor of the Senate. So this is being discussed, it is being considered. No speeches have been made on the floor yet. There are some requests from the public for an opportunity to testify on the treaty.

I think I will just fix now Wednesday of next week at 10 o'clock for the appearance of public witnesses, and then this subcommittee, to which Senator Fulbright has referred this treaty for consideration, if it can in the rush of events here in these last few weeks of this session, will make a recommendation to the full committee.

I believe that concludes my questions on it. If you would like to make a concluding statement the committee would be pleased to hear you.

Mr. SURREY. No. I think that concludes my statement, Senator. I fully understand the importance of this issue. We have not in any way attempted to keep secret what we are doing.

As a matter of fact, I very deliberately last year announced in a speech in Montreal, that the Treasury was engaged in this policy so that there could be public discussion and consideration of the matter.

#### SUGGESTIONS FROM LEGISLATIVE BRANCH WELCOMED

We are cognizant of the fact that this is a new matter, several new matters, and that there can come out of these discussions suggestions such as that which Senator Pell has made, for use to consider.

I do want to emphasize though that I am certain that the Senate is aware that this is a prototype in the sense that we feel some provision of this nature—the 7% investment credit is necessary in order to obtain tax treaties at all with the less developed countries.

I do not regard the Philippine treaty as illustrative. I think that was unusual, and I do not think it would be repeated with other less developed countries.

Senator GORE. Likewise I did not consider, as you know you had three here, I did not consider the proposed treaty with Israel as much of a prototype as the Thai treaty. That is why I suggested we have a hearing on the Thai treaty.

Mr. SURREY. We wanted to proceed with negotiations with a number of these countries before we had full discussions with you, and I think that is helpful. Having had discussions with Israel, and some with India, and with the Philippines and Thailand, these are four countries, and it has given us a background. That is what I have been trying to do, to give the committee a sense of what we think the string of negotiations with other countries will look like. It has been our experience, in talking with most of the countries, that they invariably open their negotiations by asking for a tax sparing clause. That is the way every discussion starts with a less developed country. We say "No." Then if it is appropriate we suggest the extension of the 7-percent credit, and they think about it. My guess is that it would be an acceptable device to most countries. It would have to be handled carefully, as we did in the Philippine case.

We also, I think, should consider Senator Pell's suggestion because some of the countries that may be coming up may be involved in that situation.

Senator GORE. India certainly would be.

Mr. SURREY. India might be, and I would have to look at their export picture.

Senator GORE. I think it is reasonable to say that the Congress would not likely have approved investment credit for foreign investment at the time the investment credit for domestic investment was passed, because the very arguments so eloquently put forward by Senator Pell and others in favor of enacting the investment credit was to improve our productive plant in order to meet competition from increasingly modern and effective foreign plants. That, however, should not prejudice the consideration of this.

One of the questions is whether we do by treaty what is essentially a legislative matter, to wit, the taxation of our own nationals.

Mr. SURREY. I do think that is important. I would say that my experience in having negotiated a number of treaties, we have a large number now both with industrialized and less industrialized under consideration, leads me to emphasize the great importance of giving the U.S. representatives sufficient cards to play at the bargaining table. The very act of extending the foreign tax credit unilaterally handicaps us today when we are negotiating with other countries. Unless you give us sufficient cards to use at a bargaining table we are just simply at a disadvantage. I do want to emphasize, Senator, that these are difficult bargains whether you are dealing with developed or less developed countries.

I think treaties properly serve the United States in many areas, such as the tax area. After having had some experience with it and having worked on it, I think the experimental approach of handling the 7-percent credit at this time in tax treaties would be more advisable than the unilateral act of extending the credit.

Senator GORE. I do not expect to raise the question here, but a constitutional lawyer would have quite a time with these two constitutional provisions. One is the treaty process, and the other one is the provision that all revenue measures originate in the House of Representatives.

Mr. SURREY. We defer to the treaty process and to the Senate of the United States on that.

Senator GORE. Thank you, Mr. Surrey.

It may be that the subcommittee will want to meet with you informally for further consideration.

Mr. SURREY. At any time, sir.

Senator GORE. We will recess until 10 o'clock Wednesday, August 25, 1965.

Thank you.

(Whereupon, at 11:35 a.m., the subcommittee was in recess, to reconvene at 10 a.m., Wednesday, August 25, 1965.)

THE UNIVERSITY OF CHICAGO  
DEPARTMENT OF THE HISTORY OF ARTS  
AND ARCHITECTURE

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AND ARCHITECTURE

## TAX CONVENTION WITH THAILAND

WEDNESDAY, AUGUST 25, 1965

UNITED STATES SENATE,  
SUBCOMMITTEE OF THE  
COMMITTEE ON FOREIGN RELATIONS,  
*Washington, D.C.*

The subcommittee met, pursuant to recess, at 10:05 a.m., in room 4221, New Senate Office Building, Senator Albert Gore presiding.

Present: Senators Gore and Williams.

Senator GORE. The Subcommittee on Tax Conventions has now held four hearings on the income tax convention with Thailand. We have heard spokesmen for the Departments of State and Treasury, and Dr. Woodworth, staff director of the Joint Committee on Internal Revenue Taxation.

Today has been set aside for hearing public witnesses. We will hear several witnesses from the business community. I do not know the tenor of their views. I am aware that there is some dissatisfaction with the permanent establishment provisions and perhaps with some of the source rules set out in the treaty. It may be that in trying to combine foreign aid objectives with the objectives we normally pursue in tax conventions that we have perhaps gone too far in encouraging foreign equity investment at the expense of our regular foreign commerce. It may well be that the regular U.S. exporting concerns would be victims instead of beneficiaries of the pending treaty. This we must examine. If this is the case, it could have serious repercussions when this type treaty shall have been extended to 25 or 30 countries.

We shall now let the witnesses speak for themselves and their respective interests.

I regret, gentlemen, that due to time limitations, we will have to ask you to limit your oral presentation to 10 minutes. It may well be, of course, that there will be questions and discussions that will go beyond this time limit. At any rate, let me assure you that your full statements will be printed in the hearings, and it is my firm belief that each member of this subcommittee is going to study these hearings closely before any action is taken on this treaty.

We will now proceed with the witnesses. The first witness is Mr. Raphael Sherfy.

### STATEMENT OF RAPHAEL SHERFY, MANUFACTURING CHEMISTS' ASSOCIATION, INC., WASHINGTON, D.C.

Mr. SHERFY. Mr. Chairman, my name is Raphael Sherfy, and I am appearing today on behalf of the Manufacturing Chemists' Association, Inc. (MCA) in my capacity as special tax counsel for the associa-

tion. I am a partner in the law firm of Turney, Major, Markham & Sherfy located in Washington, D.C. Prior to joining this firm in 1959 I was associate tax legislative counsel in the Treasury Department for 7 years.

The Manufacturing Chemists' Association is a nonprofit trade association with 194 U.S. member corporations, large and small, which account for more than 90 percent of the productive capacity of the chemical industry in this country. With the committee's indulgence I would like to confine my comments today to one of the definitions in article 3 of the income tax convention with Thailand.

#### CONCERN OVER PERMANENT ESTABLISHMENT PROVISION

The definition of a permanent establishment embodied in article 3 departs significantly from the definition generally found in most of the income tax conventions to which the United States is a party. Prior conventions have defined a permanent establishment generally as a branch, an office, factory, mine, or other fixed place of business. In addition, it has been generally provided that a foreign subsidiary corporation would not in itself constitute a permanent establishment of its parent. Furthermore, except for the convention with India to which the Senate has never given its advice and consent, the established U.S. policy has been to provide for the exclusion from the concept of a permanent establishment of (1) a bona fide commission agent or broker acting in the ordinary course of his business, and (2) an agency unless the agent has general authority to negotiate and conclude contracts or has a stock of merchandise from which he regularly fills orders. The following treaties define this term along the foregoing lines: Australia, Austria, Belgium, Canada, Denmark, Finland, Germany, Greece, Honduras, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Pakistan, Sweden, Switzerland, the Union of South Africa, and the United Kingdom.

The Manufacturing Chemists' Association wishes to invite your attention to the expanded definition of a permanent establishment in the Thailand income tax convention. Subparagraph (b) of paragraph 4 of article 3 of the convention provides that a permanent establishment of a U.S. corporation will include an agent who regularly secures orders in Thailand for a U.S. corporation. Paragraph 5 makes this principle also applicable to a bona fide broker, general commission agent, forwarding agent, custodian or other independent agent who acts almost exclusively for and regularly secures orders for a U.S. corporation.

The association objects to this extension of the coverage of permanent establishment from the previous policy reflected in most of our prior conventions. This new policy is also embodied in the convention with the Philippines which is before your committee.

The Manufacturing Chemists' Association does not believe that the United States should agree that these circumstances constitute a sufficient basis for Thailand to tax.

Senator GORE. Must the United States agree?

Mr. SHERFY. No, sir.

Senator GORE. In other words, Thailand is free to levy such a tax without agreement of the United States, and does she not now do so?

Mr. SHERFY. Let me take the first question I think you asked me. It is true that Thailand could levy a tax without the treaty provisions, because it is her own jurisdiction.

Senator GORE. Yes.

Mr. SHERFY. Her own tax. As to whether she does it today or not, I do not know.

Senator GORE. I think as a matter of fact they levy a 2-percent tax.

Mr. SHERFY. I understand in one of the treaty countries that this principle has been extended so it is possible that the tax is not actually levied. Yet the new principle has been extended to this particular country.

Senator GORE. You object, whether Thailand does or does not.

Mr. SHERFY. We object to the principle.

Senator GORE. You object.

Mr. SHERFY. We object to the practical application of the new principle, but we also object to getting this principle established.

Senator GORE. Thank you very much.

#### PERMANENT ESTABLISHMENT PROVISION AS A PRECEDENT

Mr. SHERFY. There is not a reasonable nexus for Thailand jurisdiction. The association is concerned that once jurisdiction is claimed under this expanded concept, a selling or marketing subsidiary corporation of a U.S. enterprise will generally be considered a permanent establishment of such enterprise. Under our past treaties this parent-subsidiary relationship was considered generally not to set up a permanent establishment.

This new policy has been justified on the basis that it does not confer any greater taxing jurisdiction than is already exercised by the other country. In addition, it is alleged that less developed countries should not be denied an opportunity to obtain revenue from the taxation of import sales.

The Manufacturing Chemists' Association submits, however, that in many cases where the statutory authority to tax import sales exists it is dormant and is rarely used except against agencies owned by the exporting company. The failure to exercise this authority may be explained by the lack of personal jurisdiction over the exporter. We believe that the use of an income tax convention to establish this jurisdiction is undesirable.

It should be kept in mind that the convention permits exchange of information between the tax authorities of each government to the extent pertinent to the carrying out of the provisions of the convention. This exchange of information should only be permitted where a prima facie case is made out that the taxpayer is subject to the Thailand tax under the terms of the convention. Presumably, where the broadened definition of permanent establishment is applicable, information with respect to U.S. corporations could be transmitted to the tax authorities of Thailand when such corporations are not really in business there.

The Manufacturing Chemists' Association requests your subcommittee, if it should approve this convention, to provide a reservation as to the expanded definition of permanent establishment.

I wish to thank the members of the subcommittee for the opportunity of presenting the views of the Manufacturing Chemists' Association on this matter.

Senator GORE. Do any of the companies you represent engage in manufacturing abroad?

Mr. SHERFY. Definitely.

Senator GORE. What is their reaction, and what is your reaction as their representative, to the investment credit proposed in the pending treaty?

Mr. SHERFY. I can only answer that question this way: representing the Manufacturing Chemists' Association, that we take no position.

Senator GORE. On balance do you advocate the ratification or the rejection of the pending treaty?

Mr. SHERFY. The rejection of the Thailand Treaty unless we get this reservation on permanent establishment.

Senator GORE. Thank you very much.

The next witness is Mr. D. H. Gleason, of Corn Products Co., New York City.

#### STATEMENT OF D. H. GLEASON, CORN PRODUCTS CO., NEW YORK CITY, N.Y.

Mr. GLEASON. My name is Donald H. Gleason. I am comptroller of Corn Products Co., New York, N.Y.

While I am chairman of the Subcommittee on the Taxation of Foreign Source Income of the National Association of Manufacturers, I am not appearing in behalf of the association today because time has not permitted policy study of the Thai Convention as its text was only recently released.

I would add that Corn Products Co. does not have at this time any investment in Thailand. Our sales in that country through arrangements with local importers are not important and prospects for the future as far as Thailand is concerned are problematical.

#### TECHNICAL ASPECTS OF TAX TREATY

We are, as are many members of the NAM, however, very much interested in the Thai Convention because it embodies new concepts not contained in presently effective tax treaties with other nations. Further, and of considerable importance, is its improved treatment of certain technical problems. These are substantial improvements over their counterparts in earlier treaties.

The innovations, and the new concepts, are not only significant for our economic and business relations with Thailand, important as these are considering our stake in southeast Asia, but have broader implications because they may well become a pattern for other conventions with other countries in the future.

While some may criticize some specific points as to detail in some of these, these may be corrected in later treaties.

Why are tax treaties important? One might just as well ask: Are U.S. business operations abroad good or bad? The record, I think, shows that they have been very good, not only for our balance-of-payments positions, and for the economy of the country as a whole,

but also for our country's posture in the political and economic affairs of the world.

Each country of the world has two income-tax jurisdictions. The first is over all of the income earned within its borders, and the second is over all the income of its citizens or residents wherever earned. There are consequently many overlaps where the income of citizens or entities of one country is earned in another. Were the same income to be taxed by two jurisdictions and by both at the comparatively high tax rates which have become popular throughout the world since late 1920's, little or none would be left, and many businesses producing the income would tend to atrophy and die.

The simple solution adopted by some countries is that of territoriality. Under this system, some countries forego in part at least their secondary jurisdiction over income earned abroad, and tax income earned only within their borders at full rates.

Our solution has been the development of the foreign tax credit system, imperfect and complicated though it may be, under which the foreign income tax paid on the income of U.S. entities is permitted within limitations to reduce the U.S. tax on such income that would otherwise be payable. This solution is sometimes referred to as tax neutrality; for under it, in theory, income taxes do not affect the direction of the flow of the capital which produces the income.

The simple solution, territorially, has recently gained in advocacy and has much to recommend it. The revenue impact would be light because U.S. tax collected on foreign business income after foreign tax credits is of comparatively minor importance. While there may not be much chance of the adoption of taxation on the basis of territoriality in the near future, I hope to see it sometime.

Whether or not we continue with the foreign tax credit system, or adopt territoriality, tax treaties will continue to serve a vital basic function. Where income is subject to the jurisdiction of two nations, its function in simplest terms is to set forth who taxes what income, how, where, when, and at what rates, and to coordinate these factors.

The record before you already describes in detail the technical improvements in the Thai convention. I will merely mention the areas involved—

(1) Detailed and more precise definitions of the "permanent establishment" concept.

(2) More detailed and precise source of income rules.

(3) A broad nondiscrimination rule.

Perhaps more controversial, but certainly of equal importance with the technical improvements is the new concept introduced by this treaty. This involves the allowance of a direct tax credit of 7 percent to qualified U.S. investors in Thailand for new investments and the allowance of a 7-percent credit to such investors for certain reinvested profits of their Thai investments. The concept is simply an extension of the theory upon which the domestic investment credit is grounded.

It differs, however, very markedly in its scope and its operation. First of all, the domestic investment credit is based on new investment in plant facilities and equipment. It is rollover credit, so to speak, in that where assets are replaced, a new credit is obtained in a comparatively few years.

The investment credit in the Thai convention is a "one shot" proposition measured, perhaps to oversimplify, by increases in net balances

held within limitations in the investment in Thailand. Both investment credits are grounded on the theory that they are intended to stimulate economic activities which are desirable.

Another new concept of lesser importance is the tax deferral in respect of the exchange of certain intangibles for stock in an eligible corporation.

#### NEGOTIATION OF TAX TREATIES

Earlier, I discussed briefly the duality of tax jurisdictions in foreign business operations, the theory of neutrality and our tax credit system. As I also indicated, tax treaties are much needed if these very complicated, independent, interdependent, and frequently conflicting factors are to be coordinated.

In signing the treaty, Thailand is very definitely giving up some of its primary and secondary tax jurisdiction and consequently its right to tax. Thailand, from a practical standpoint, does not have any reciprocal gain in the ordinary sense from the United States giving up some of its primary and secondary jurisdiction to tax for it has little or no U.S. source income, other than raw material exports. The tax credit is the only thing that our negotiators, the Treasury Department, have to bargain with and they need that tool.

Other questions may be raised. Is it proper; for example, for the Treasury Department by the treaty mechanism to introduce what amount to be changes in our tax laws? This question is grounded on the general rule that tax legislation should start in the House and be corrected and confirmed in the Senate. To answer this, I would submit, it is obviously impractical for the House of Representatives to negotiate a tax treaty.

The system which we now have, that of treaties negotiated and concluded by the executive branch and ratified by you, the Senate, seems eminently practical. Certainly, where an undesirable treaty has been negotiated, it will fail of ratification.

This treaty, all things considered, is an improvement on prior treaties and I trust that you will view it with favor. I greatly appreciate the opportunity of appearing before you and presenting these comments.

Senator GORE. In how many countries does your company operate through subsidiaries?

Mr. GLEASON. About 30 or 32. I have not got an exact count, sir. I can supply that. It is generally all over Western Europe and Latin America. Our investments in the Far East now are not important.

Senator GORE. What is the proportion of the exports of your company from the United States to your own subsidiary companies abroad and to other customers abroad?

Mr. GLEASON. Because of the nature of the business, it is very small, sir. Our export sales in 1964 were about \$15.5 million. Our domestic sales were \$511 million, and the sales of our international subsidiaries were \$382 million.

Senator GORE. Of this \$15 million, what portion went to your subsidiaries?

Mr. GLEASON. Very little. Sir, might I explain. A box of corn starch is a pretty small thing. If it is made let us say in Argo, Ill., and then shipped to we will say Paris, why the transportation costs

and the packaging costs would be too large; it is that kind of business, sir.

Senator GORE. You heard the previous testimony with respect to the permanent establishment.

Mr. GLEASON. I did, sir.

Senator GORE. What is your attitude toward the provisions of the treaty in that regard?

Mr. GLEASON. I think that the thing that can be said in its favor is that the ground rules are specifically spelled out, more so than in prior treaties, so that a businessman setting up some arrangement knows where he stands. That is the basic improvement.

I would disagree perhaps with the provision which would make one individual or corporation doing business only for one company a permanent establishment. I think that is the valid criticism to this point. I am sure that in treaty negotiations in the future, why the Treasury Department will well recognize this, particularly after hearings such as this, that people are unhappy about it.

#### FUTURE TAX TREATIES

The future treaties that are going to be negotiated, of necessity, all of them cannot be exactly the same as this for a number of reasons. First, it is a different bargaining with each country. Second, their tax laws are different as among each other, and a treaty for one might not be appropriate for another.

Senator GORE. I recognize that no one treaty could be an exact model for others, but generally speaking some new concepts and broad principles will be laid down upon the ratification of the pending treaty. These new concepts would, to a greater or lesser degree, perhaps greater, be followed in the negotiation of further treaties.

But, as you say, the Treasury Department and the State Department will undoubtedly review the present hearing and take the points of view expressed into consideration.

Mr. GLEASON. Exactly, sir.

Senator GORE. To what extent would your company and its subsidiaries expect to benefit from the investment credit provision of the pending treaty?

Mr. GLEASON. I could not answer that now. Sure we would benefit some. The less developed countries are those generally speaking where the exchange risk to the American investor is high. The direct tax credit is small as compared to what one might lose say in a business which runs a net current asset position in declining foreign exchange. Investors tend to borrow as much money in local currencies as they can. I think perhaps in the sense of giving something to companies, the investment credit has been overemphasized. I think perhaps its most important point is that it does give the Treasury Department a tool to bargain with.

Senator GORE. A tool with which to obtain treaty—

Mr. GLEASON. Obtain concessions in the treaty, in a future treaty, from the government with which they are negotiating; trying to get them to agree to limit their primary or secondary jurisdiction to tax and perhaps put withholding tax rates down, or say, "We will not tax this kind of a transaction."

Senator GORE. Just what concessions would Thailand make in the pending treaty that would be beneficial to the United States generally?

Mr. GLEASON. Well, the proposed reductions in withholding taxes and the exemption for certain transactions which do not involve a permanent establishment.

Senator GORE. These are beneficial to—

Mr. GLEASON. These are beneficial to, first, the American investor, and second, indirectly beneficial to the collection of the revenue, because if this income is earned there and not taxed, when it is repatriated it does not carry a foreign tax credit, and when it is reported for taxes here, Uncle Sam gets his full bite.

Senator GORE. Do you have in mind in what countries you may be investing or retaining earnings from investment as a result of other treaties of this type?

#### EFFECT OF TREATY ON INVESTMENT POLICIES

Mr. GLEASON. In the usual sense I do not think that this treaty, if it were fully applied, would tend to change our investment policy very much. It would, however, make such investments as we have from a tax and financial standpoint easier to manage. It would tend to make them more successful from our standpoint, and that of itself would tend to encourage them.

Senator GORE. Well, if the proposed investment credit would not significantly change the pattern of your investment, then the U.S. Government would be subsidizing your investment, it seems to me, without a compensating benefit.

Mr. GLEASON. I do not think that is so, sir, for this reason. The investment credit on accumulated profits is something that we probably would not get very much benefit of, for two reasons. First, we have to repatriate earnings as fast as we can for U.S. debt service to pay our own dividends.

Second, we want to get these earnings out of exposure to the foreign exchange risk of these underdeveloped countries as fast as we can.

Sure, when some of these retained earnings may go into bricks and mortar, and that in a sense is one way of eliminating the foreign exchange risk. But we are in business to make money and to bring it home and to pay it to our stockholders.

Senator GORE. Well, that is very good, but still the basic question is if, as you say, the investment credit would not significantly affect your business operations, that is your pattern of investment, then it would seem incontrovertible that your tax liability to the U.S. Government would be reduced by the investment credit without any particular compensating effect.

Mr. GLEASON. Well, my company may not be typical in this respect. I am trying to be honest. I hear how these business judgments are made. They do have an effect, sir, certainly, but I do not think the effect is as important as some people have stated or some people feel. It is a terribly hard thing to measure.

Senator GORE. Please understand I am not, by asking these questions, in any way attempting to be critical.

Mr. GLEASON. I understand, sir.

Senator GORE. One must go by example, I suppose.

Mr. GLEASON. Absolutely.

Senator GORE. For the purposes of discussion, how would the deferral of taxation on income from sale of patents, know-how, and other property to foreign subsidiaries or to foreign corporations affect your company?

Mr. GLEASON. Not much at all, and this is another policy matter. As a policy matter, my company likes to have the parent company own these intangible assets, itself, and then collect royalties or fees for the licensing of the use thereof of this know-how, these patents, and so on. This is a policy matter. We think in the long run it works out better that way.

Senator GORE. You do not think you would receive any tax benefit from the deferral provisions of the pending treaty.

Mr. GLEASON. I doubt it, and here again I am guessing. I doubt if we will, for example, exchange the right to use know-how or what have you in exchange for an equity interest in either one of our presently owned companies or in others. I think the chances of my company's doing that are small.

Now, this will be different in other businesses.

Senator GORE. Yes.

Mr. GLEASON. And from business to industry, and so forth.

Senator GORE. And if approved, your company would consider alterations of policy as a result. Whether you do so is something else.

Mr. GLEASON. That, of course, is so. I am just guessing, knowing a good deal about the nature of the way we operate and expect to operate and how the foreign tax credit works and one thing and another.

For example, the royalties for the use of know-how frequently for foreign exchange controls have a priority for repatriation here over ordinary earnings and profits. For example, if you put the permanent license to use the know-how down in exchange for stock, why that will downgrade that segment of earnings for repatriation.

Senator GORE. Well, you have been very helpful and very forthright, and I thank you, sir.

Mr. GLEASON. Thank you, sir.

Senator GORE. The next witness is Mr. Herbert J. Erlanger, general tax counsel, Motion Picture Export Association, New York, N.Y.

**STATEMENT OF HERBERT J. ERLANGER, GENERAL TAX COUNSEL,  
MOTION PICTURE EXPORT ASSOCIATION, NEW YORK, N.Y.**

Mr. ERLANGER. Mr. Chairman, my name is Herbert J. Erlanger. I am tax counsel of the Motion Picture Export Association of America, Inc. My address is 522 Fifth Avenue, New York, N.Y.

Our member companies are the export companies of the main producing companies who in turn are the members of the Motion Picture Association of America.

I want to thank the committee for the privilege of testifying today in the matter of the ratification of the proposed income tax convention with Thailand. Our present tax situation in Thailand is an unhappy one.

**PRESENT TAXATION ON TWO LEVELS**

As in all countries with which the United States has no income tax convention and in which our member companies distribute their

product through subsidiaries, income tax is at present imposed in Thailand on two levels.

The local subsidiary which has a permanent establishment in Thailand, is taxed on its balance sheet profit like anyone else doing business in Thailand, and the tax treaty does not in any way affect the method in which this subsidiary is taxed or is meant or designed to do so.

In addition the New York supplier—i.e., the member company—who does not have a permanent establishment in Thailand, is taxed on the share he receives, which is commonly denominated the "New York share" and is computed as a percentage of the film rental the local distributing company receives from the motion picture theaters. In Thailand the method of taxation of the New York supplier has been all along extremely onerous and the Motion Picture Export Association of America, Inc., has been carrying on negotiations for the last 5 years with the Thai tax authorities in this matter to obtain relief.

The Thai Tax Code is committed to the basic principle of taxation of net profits and the problem is the rather usual one of determining what is the net taxable profit contained in the income received by the New York supplier. Generally speaking the Thai Tax Code in the case of income earned by foreign taxpayers without permanent establishment in Thailand leans very heavily on a system of determining by law the percentage that may be deducted from gross receipts in order to arrive at net taxable profits.

Unfortunately, however, the code does not contain any such specific provision in the case of income from film distribution, and thus the authorities have arbitrarily and by analogy been applying the provisions for income derived from the leasing of real estate which leads to the result that the tax base in the case of our member companies is equal to 90 percent of the gross New York share which is the presumed net profit, such presumption not being subject to rebuttal.

I believe it will not be necessary for me to elaborate on the fact that the net profit of the American motion picture industry is not equal to 90 percent of the gross rentals received either within the United States or from any foreign country, and in the several discussions which I have had during the last 5 years with officials of the Thai Finance Ministry and Internal Revenue Bureau including the Finance Minister himself and the Director General of Internal Revenue, these officials have at all times conceded that the present method of taxation is excessively burdensome and inequitable and have always promised that a very substantial change would be made when the Tax Code is revised. They have at times even given me figures which while unofficial and confidential have always represented a mere fraction of 90 percent. Unfortunately, however, they also told me each time that this revision could only be made when the Tax Code undergoes a general overhaul, and while I was assured each time that the Finance Ministry and the Internal Revenue Bureau were working hard on this, its completion has seemed to recede further and further into the future whenever I had an opportunity to see the officials in Bangkok.

Thus while the proposed income tax convention does not deal directly with the tax base on which our member companies would be taxed, it does limit itself in its article 11 to a mutual imposition of a maximum tax rate that can be applied in certain cases including the

ease of our member companies and sets this maximum tax rate at 15 percent of the gross.

TREATY WOULD BE ADVANTAGEOUS TO FILM INDUSTRY

By law the tax rates presently applicable to corporations in Thailand are progressive and range from 15 percent on the first 500,000 baht to 20 percent on the next 500,000 baht and 25 percent on all amounts exceeding 1 million baht. In exchange, 500,000 baht are roughly equal to \$25,000 and 1 million baht to \$50,000. Thus the bulk of the income of our member companies is taxed at the top rate of 25 percent and the provision of article 11 of the treaty presents a clear advantage over the status quo.

For this reason I should like to urge the ratification of the treaty.

For the information of the committee I would finally like to say that our member companies are the following:

Allied Artists International Corp., Columbia Pictures International Corp., Metro-Goldwyn-Mayer, Inc., Paramount International Films, Inc., Twentieth Century-Fox International Corp., United Artists Corp., Universal International Films, Inc., and Warner Brothers Pictures International Corp.

Senator GORE. Is the tax which you have outlined now actually collected in full by the Thai Government?

Mr. ERLANGER. Yes, Mr. Chairman, it is.

Senator GORE. Then why do your companies continue to do business there?

Mr. ERLANGER. Well, I mean even a tax of 25 percent is not 90 percent, is not prohibitive. I mean we can still exist, but it is very onerous.

Senator GORE. Thank you very much.

The next witness is Mr. Fred W. Peel, chairman, Tax Committee, American Mining Congress.

STATEMENT OF FRED W. PEEL, CHAIRMAN, TAX COMMITTEE,  
AMERICAN MINING CONGRESS, WASHINGTON, D.C.

Mr. PEEL. Mr. Chairman, my name is Fred W. Peel. I am appearing today in my capacity as chairman of the Tax Committee of the American Mining Congress.

With your permission, I would like to have our statement inserted in the record, and then I will just briefly summarize it.

Senator GORE. Without objection.

(Mr. Peel's statement in full follows:)

STATEMENT OF FRED W. PEEL, CHAIRMAN, TAX COMMITTEE, AMERICAN  
MINING CONGRESS

Mr. Chairman, my name is Fred W. Peel. I am presenting this statement as chairman of the Tax Committee of the American Mining Congress. The Mining Congress includes among its members producers accounting for the major part of the production by the various branches of the mining industry, including coal, ferrous and nonferrous metals, and industrial minerals. We appreciate having this opportunity to present our views on the pending income tax convention with Thailand.

The American Mining Congress wishes to protest the treatment proposed to be accorded the extractive industries by the provisions of article 5 of the Thai treaty, relating to the investment credit.

Article 5 of the Thai treaty provides a 7-percent credit against tax liability for investments by U.S. residents or corporations in eligible Thai or U.S. corporations. To be eligible to receive an investment that qualifies for the 7-percent credit a corporation must derive at least 80 percent of its gross income from the active conduct of certain described businesses. In describing these businesses article 5(3)(a) specifically excludes "the extraction, refining, or similar processing of any mineral, ore, oil or gas." Thus, the investment credit would be denied for investments in corporations that engage to a substantial extent in mining or certain subsequent processing of minerals.

Our concern is not merely with the Thai treaty but with the precedent it would create by discriminating against the extractive industries. It is clear that the administration proposes to follow a policy of excluding mining corporations from the definition of corporations eligible for investment credit under the treaties it negotiates with less developed countries. A similar provision is contained in the pending income-tax convention with Israel. The legislative proposal for a 30-percent investment credit for investments in less developed countries also would have barred mining corporations from eligibility. When Mr. Surrey, Assistant Secretary of the Treasury for Tax Policy, discussed treaty negotiations for extension of the 7-percent credit in his speech in Montreal last fall, he indicated that in its technical details it would follow the provisions that had been worked out for the legislative proposal for a 30-percent investment credit. From this background it appears unlikely that mining corporations are being barred from eligibility under these treaties because of the wishes of the less developed countries with whom the treaties are being negotiated.

There is no basis for discriminating against mining, refining, and similar processing in granting the 7-percent credit. Availability of the credit would influence investment decisions in the extractive industries the same as in other industries. The decision of whether or not to engage in a mining venture, or the choice between a mining venture in one country or another, is influenced by marginal factors such as the after-tax rate of return, as are investment decisions in other businesses.

It is not safe to assume that the prospects for a mining venture are always so attractive that the investment will be made regardless of tax consequences. Also, it cannot be assumed that the extent and the grade of a mineral deposit will be fully known when the initial investment decisions are made. In some instances even the existence of a mineral deposit may not have been determined; the first investment decision may be whether or not to undertake a mineral exploration program.

Furthermore, refining and similar processing can be, and frequently are, carried on outside the country where the mineral deposit is located. Such processing may be done independently of ownership or operation of mines. Thus, availability of a 7-percent investment credit may be crucial to the choice of the location of a refining or similar facility or to the decision as to whether or not to invest in the facility at all.

For many less developed countries their mineral resources represent their best hope for economic development. It would be unfortunate for the United States, in a treaty program that has as one of its purposes encouragement of development of these countries, to exclude mineral development from the investment credit.

Undesirable inferences might be drawn from discrimination against mining in income-tax treaties with less developed countries. Such discrimination might imply that the United States feels these countries should not emphasize development of their mineral resources, or that the United States feels it is not advisable for our investors to participate in such development.

To place the 7-percent investment credit provision in the Thai treaty in proper perspective: to the extent it parallels the 7-percent credit for domestic investment it does not provide an incentive for foreign investment; it merely removes an existing discrimination against foreign investment that was created when the 1962 Revenue Act limited the investment credit to the United States. We object to continuing this discrimination in the case of the mining industry.

Mr. PEEL. Our interest is in one specific provision of the Thai Treaty, which is the definition of eligible corporations under article 5 dealing with the investment credit. To qualify for the investment credit under the treaty, it is necessary to make an investment in an eligible corporation. An eligible corporation is defined as a corpora-

tion that receives at least 80 percent of its gross income from the active conduct of certain described businesses. In describing those businesses, the treaty specifically excludes "the extraction, refining, or similar processing of any mineral, ore, oil, or gas." It is to that provision that my testimony is addressed.

#### CREDITS TO MINING INDUSTRIES OMITTED

We object strongly to this proposed treatment of the mining industry. We think it is detrimental to the interests of the less developed countries, because in the case of many of these countries, their best hope, or possibly even their only hope, of developing economically is through development of their mineral resources.

Senator GORE. Do you know why this provision is in the treaty, some of the reasons for it? Was it sought by our Government or was it sought by Thailand?

Mr. PEEL. I understand that Mr. Solomon, who was the witness on behalf of the State Department, was questioned on that. I was not present, but I understand that he indicated that there were several possible reasons. One was that the country itself might not want to include the extractive industries.

I am rather skeptical as to whether that is the reason mining has been excluded from this treaty. Similar language is contained in the Israeli treaty. The extractive industries were excluded from the administration recommendations for the 30-percent credit by legislation for less developed countries, and when Assistant Secretary of the Treasury Surrey gave a speech last fall in Montreal on Treasury policy with respect to treaties with underdeveloped countries, he, in describing this 7-percent investment credit by treaty concept, said that they intended to use the technical basis that they had developed for the 30-percent credit. So all the indications seem to point to the fact that it is U.S. policy that has excluded the extractive industries.

As to why that should be, Mr. Woodworth in his statement to your subcommittee surmised that it might have been because they felt that the mineral resources were in the ground where nature put them, and that no investment credit would be necessary for their development.

If that is the thinking of the State Department and the Treasury, I think it does not make sense from an economic standpoint or from a business standpoint, because as a matter of fact the choice of where to invest in the development of mineral resources, or whether or not to invest in their development at all, depends on after-tax return the same as any other business decision.

Mineral deposits vary in size, and they vary in grade. They vary in accessibility. In many instances the decision as to whether or not to go into an area and develop deposits might be marginal, so that the existence of a 7-percent credit might make the difference, just as with the decision to go into a country and engage in retail merchandising or manufacturing. It makes very little sense from an economic standpoint to think that these marginal factors are not significant in the extractive industries.

#### POSSIBLE REASON FOR OMISSION OF EXTRACTIVE INDUSTRIES

Now, possibly—and I think there was some indication, I understand, in Mr. Solomon's testimony—the thinking was that the extrac-

tive industries should be excluded because they have the benefit of percentage depletion. But I think that is beside the point if you are focusing on the question of what you can do to get these less developed countries started on a sound economic basis toward their own economic development.

Furthermore, some of the corporations that would be denied eligibility under this treaty provision might not even be eligible for percentage depletion. For example, if they were Thai corporations, there would be no percentage depletion under our law, because the percentage depletion deduction does not apply to dividend payments to the U.S. taxpayer. Or, if they were engaged in refining activities and not engaged in extraction of minerals, since refining is beyond the cutoff point depletion would not be relevant.

Senator GORE. Do the companies you represent which do business abroad generally do so by way of branch or by way of subsidiary?

Mr. PEEL. I do not know that you can generalize. Occasionally they do business through branches, sometimes through domestic subsidiaries, and sometimes through foreign subsidiaries. Sometimes the choice is determined by whether they go into the mining venture on their own or whether they go into it jointly with other investors. The mining industry has developed a pattern, both domestically and abroad, of going in with partners—I use that term loosely—on a joint venture basis. So frequently the form of organization is determined by the fact that several companies are sharing the risk.

Senator GORE. Would the provisions of this treaty have a bearing upon these relationships?

Mr. PEEL. I should have emphasized at the beginning I do not personally know of any mining concern that is concerned at this time with investments in Thailand. We are concerned about the precedent effect of this treaty.

Senator GORE. Yes. As a matter of fact, there are not too many mineral resources in Thailand.

Mr. PEEL. I really do not know.

Senator GORE. Well, I do not really know either. I have not learned of any. Well, thank you very much.

Mr. PEEL. Thank you, sir.

Senator GORE. Before you leave, Mr. Peel, I take it that you oppose ratification of the treaty in its present form.

Mr. PEEL. Yes, sir; we would oppose it with this present treatment of the extractive industries.

Senator GORE. Thank you.

The next witness is Mr. Hearne, vice president, taxes, United States Steel Corp.

I received your letter a few days ago, Mr. Hearne, and that will be made a part of the record.

(The letter referred to follows:)

UNITED STATES STEEL CORP.,  
New York, N.Y., August 29, 1965.

Re proposed treaty with Thailand.

Senator ALBERT GORE,  
Senate Office Building,  
Washington, D.C.

DEAR SENATOR GORE: You have stated that a public hearing is to be held on the proposed treaty with Thailand on Wednesday, August 25. Government witnesses on this treaty have appeared over the last few days.

Assistant Secretary of the Treasury Stanley S. Surrey testified before your subcommittee that the treaty with Thailand would "indicate the general procedure and standards being followed with respect to the negotiation of tax treaties with less developed countries."

We had been under the impression that the proposed treaty with the Philippines was to be the first of this type of treaty to come before your subcommittee and we sent you a protest dated August 5 against certain features of the proposed Philippine treaty dealing with "permanent establishments." The same objectionable features are contained in article 3 of the proposed treaty with Thailand. We object particularly to article 3, paragraph (4) (b), (c) and the last sentence of paragraph (5). Our reasons are explained in copy of our letter of August 5, attached, which as above indicated we sent to you with respect to the Philippine treaty.<sup>1</sup>

While the particular treaty with Thailand does not bother us substantially, we do object strenuously to the further proliferation of this principle with other undeveloped countries as proposed by Mr. Surrey.

We respectfully request that our protest be made a part of the record of the hearings.

Respectfully submitted.

W. L. HEARNE,  
Vice President, Taxes.

UNITED STATES STEEL CORP.,  
New York, N.Y., August 5, 1965.

Re proposed income tax treaty with Philippines.

HON. J. W. FULBRIGHT,  
Chairman and the Honorable Members of the Senate Foreign Relations Committee,  
Senate Office Building, Washington, D.C.

DEAR SIR: We wish to raise serious question as to the effect on American business of parts of article 8 of the proposed income tax treaty with the Philippines which has been negotiated by our Government and has come before your committee and the Senate for approval. The particular provisions that concern us are article 8, paragraph (4) (b) and (c), the last sentence of paragraph (5), and paragraph (8). These provisions say, in effect, that if a U.S. corporation has an agent in the Philippines who "exclusively or almost exclusively" secures orders in the Philippines for the U.S. corporation, the U.S. corporation and all affiliated corporations shall be deemed to have a permanent establishment in the Philippines. They shall be deemed to have a permanent establishment for the entire year if there is such a permanent establishment at any time during the year. This provision would allow the Philippines to tax any U.S. corporation and its affiliates if any one of them employed such an independent agent or had a selling subsidiary in the Philippines.

Mr. Stanley Surrey, Assistant Secretary of the Treasury, in his speech of September 21, 1964, before a meeting of the Tax Executives Institute in Montreal, is quoted on page 24 of the Treasury release of this speech as saying respecting "permanent establishments:"

"\* \* \*, in a situation in which a less developed country feels that these issues are important, where otherwise appropriate we have explored adding to the definition of 'permanent establishment' such factors as an agent who regularly secures orders in the less developed country, or maintains a stock of goods from which he regularly makes deliveries. Also, the use of an agent of independent status could constitute a permanent establishment if the agent acted almost exclusively for the exporter and engaged in these activities. In addition, it may not always be appropriate to eliminate the force of attraction principle."

The writer has been in correspondence with and has talked to Mr. Surrey about this speech and about the Philippine treaty and if we interpret Mr. Surrey's last letter correctly, he claims that the "treaty \* \* \* with the Philippines does not expand the taxing jurisdiction of either country \* \* \*." This may be so because many countries have what might be called a global taxation orbit and they are limited in what they will tax only by what they can lay their hands upon, but it seems to the writer that two things can be said about the answer of the Treasury Department. In the first place, if it is not necessary to expand the taxing jurisdiction of the Philippines, then why do we put it in the treaty, and why does Mr. Surrey refer to it in his speech as "adding to the definition of permanent establishment"?

<sup>1</sup> Photocopy with enclosure sent to the Honorable J. W. Fulbright, chairman, and the honorable members of the Senate Foreign Relations Committee.

Secondly, and more importantly, the fact is that so far as we can determine none of the less developed countries at the present time exerts a power to tax an independent agent acting for a U.S. corporation based upon the profits of the U.S. corporation, nor do they seek to tax the U.S. corporation or its affiliates on account of the activities of such an independent agent.

Thus, if the objectionable provisions in this treaty are enacted it gives complete sanction to the Philippines to tax U.S. corporations in accordance with the terms of the treaty. Mr. Surrey's speech, above referred to, indicates that the United States will cooperate with other countries in enforcing their tax laws.

For corporations with substantial assets the proposal of the treaty with respect to permanent establishments is a most serious matter and would be a major deterrent to any effort to make sales in countries that have such a treaty with the United States.

It should be mentioned that the proposed definition of a "permanent establishment" is contrary to that proposed by the OECD. In their draft treaty in paragraphs 5 and 6 on page 44 of article 5 on permanent establishments the OECD specifically rejects any idea that a subsidiary or an agent can give rise to the claim that such subsidiary or agent is a permanent establishment of the parent or seller.

The Congress has provided in Public Law 86-272 that States may not impose an income tax upon a corporation which has employees or agents within a State if the only activity of the corporation is to solicit orders in such State. This is so even though the selling personnel live in the State. (*Smith, Kline and French Laboratories v. State Tax Commission*, Oregon Supreme Court, June 16, 1965, Commerce Clearing House Oregon Tax Service, pars. 201-591.) Nevertheless, the Philippine Treaty provides that the Philippines may tax a U.S. corporation and all affiliated corporations if one of them has an "exclusive or almost exclusive" agent who "regularly secures orders in the \* \* \* State (the Philippines) for the (U.S.) corporation." (Par. (4)(b).) Thus, the Senate is by this treaty called upon to approve for foreign countries the taxation which the Congress has forbidden to each of our own United States. It is submitted that the same reasons which caused the enactment of Public Law 86-272 are present with respect to foreign nation taxation of U.S. business.

Several additional problems arise in connection with this new approach in the Philippine Treaty. Incidentally, we understand this same problem is in the proposed treaty with Thailand and is urgently desired by other countries. In the manner of foreign trade it is necessary for selling agents to assert great efforts to break into any new territory. For a long time the selling efforts do not return sufficient income to adequately compensate a selling agent. Either the selling agent must be subsidized irrespective of commissions, or a subsidiary of the parent must be established with sufficient funds to pay its salesmen over the early lean years. It seems clear from the proposed treaty, and Mr. Surrey agrees, that a subsidiary company would stand in the same light as an independent agent under article 8 of the proposed treaty and thus if the subsidiary acted "exclusively or almost exclusively" for the U.S. parent it would subject the U.S. parent and all affiliates to tax in the Philippines. Thus the provisions of article 8 of the treaty would limit any effort to sell U.S. goods merely to such efforts as could be put forth by an agent who had substantial other activities. We do not believe it is in the best interests of selling U.S. goods to limit the scope of the sales activities abroad.

Secondly, we do not believe this principle can be limited to selling agents or subsidiaries but would quickly be demanded by underdeveloped countries for application to all other subsidiaries such as raw material producers and any manufacturing subsidiaries that use goods produced by the parent.

Question can be raised as to what exactly constitutes "an agent acting exclusively or almost exclusively" for the U.S. corporation. For instance, if an independent agent had two employees, one of whom spent all of his time selling for the U.S. corporation, presumably the agent would not be operating exclusively or almost exclusively. But if one person alone was an independent agent and had no employees, and he spent all of his time selling for the same U.S. corporation, he would be deemed an exclusive agent under article 8, paragraph (4). Then it can be imagined that a U.S. corporation thought it had an agent that was not devoting substantially all of its time to selling for that corporation, but because business for that corporation increased or because the agent lost some other accounts he might become the exclusive agent for the U.S. corporation without any knowledge of the U.S. corporation and thus unwittingly subject the U.S. corporation to substantial taxes.

Such a proposal would subject a corporation such as ours to tremendous and perhaps overwhelming costs of administration in satisfying foreign government as to its taxable income. How is taxable income to be determined? Certainly it is to be determined under the laws of the underdeveloped country. These countries have different laws from those of the United States so that an entirely different tax return must be prepared and filed. What income and what percentage of that income shall be deemed earned in the less developed countries? Shall it be only on the products which are sold? No such breakdown of profits is now compiled or required under U.S. tax laws and can at best only be approximated. Is the income from other products and other business, and dividends and interest to be lumped together and subjected to a percentage allocation? What if such other income has already been taxed after having been earned by branches or affiliated corporations in other jurisdictions? If, for example, we sell pumps through an agent in the Philippines, is our steel business or our ore mining business to be also taxed there? How can these matters be audited reasonably? Our U.S. tax return is a large book of hundreds of pages. The laws of most foreign countries require that all books and records be produced in the foreign jurisdiction. Some underdeveloped countries, for example Venezuela, require the audit and verification of all invoices before any deduction for cost of goods sold or expenses is allowed. Some foreign jurisdictions also impose severe penalties, up to 200 percent, for any disallowances which the taxpayer has not presented before audit.

The Treasury has cited the India Tax Treaty of 1959 as precedent for this concept of permanent establishment. However, the Treasury assured the Senate the treaty with India would not be used as a precedent. (Hearings of Senate Committee on Foreign Relations on India Tax Convention, 86th Cong., 2d sess., pp. 27-29, 43-45, June 28, 1960.)

The administrative problem and costs involved would be sufficient to shut off all our sales effort in the Philippines as soon as this treaty is approved and this would apply to every other country where a similar provision is negotiated. We suggest this would not be in the interest of the U.S. balance of payments nor U.S. employment and we respectfully suggest that the treaty be revised to eliminate paragraph (4), the last sentence of paragraph (5), and all of paragraph (8), of article 8.

Respectfully submitted.

W. L. HEARNE,  
*Vice President, Taxes.*

**STATEMENT OF WILLIAM L. HEARNE, VICE PRESIDENT, TAXES,  
UNITED STATES STEEL CORP., NEW YORK, N.Y.**

Mr. HEARNE. Thank you, sir. That letter is perhaps what might be called the formalized testimony. I have put down some thoughts here to come within your 10-minute limitation which follow along the general ideas of that letter.

**EFFECT OF TAX TREATY ON AMERICAN BUSINESS ABROAD**

I am the operating head of the tax department of United States Steel Corp. Along with others who seek to sell U.S. products in foreign countries we are seriously concerned at the effect the principle set out respecting "permanent establishments" in the Income Tax Convention With Thailand will have if this principle is carried into treaties with other developing nations, as has been proposed by Assistant Secretary of the Treasury Surrey in his testimony before this committee and as he stated in a speech before the Tax Executives Institute on September 21, 1964, in Montreal. I should first explain that I have submitted for the record a letter dated August 5, 1965, under the heading "Proposed Income Tax Treaty with the Philippines." This letter was written under the impression that the tax treaty with the Philippines would be the first one considered by this honorable

committee and thus it refers to article 8 of the proposed Philippine Treaty. The same comments apply with equal force to the proposed treaty with Thailand, only it is article 3 in the Thailand Treaty whereas it is article 8 in the Philippine Treaty.

I should also make clear that we are objecting to the principle which the Treasury hopes to establish by securing the approval of the Senate to the treaty with Thailand. At the moment we do not sell very much to Thailand but if this principle to which we respectfully call your attention is to be carried on into other treaties with developing nations then we do face the definite prospect of being unable to compete in these developing countries for business. Assistant Secretary Surrey has mentioned that the treaty with India, for example, is currently being negotiated and contains this principle.

I will try to explain simply the provisions in article 3 of the proposed Thailand treaty which would cause us to withdraw any sales effort in Thailand. Article 3 has to do with the definition of a permanent establishment. It is generally recognized in tax law that if you have a permanent establishment in a State or in a country then you are subject to their tax laws. Paragraph (4) of article 3 provides that a U.S. corporation shall be deemed to have a permanent establishment in Thailand if it engages in trade or business in Thailand through an agent who regularly secures orders in Thailand or maintains in Thailand a stock of goods or merchandise belonging to the U.S. corporation from which the agent regularly makes deliveries. Paragraph (5), particularly in the last sentence, says that even if the U.S. corporation uses a wholly independent agent, such an agent shall not be considered as an independent agent but shall be considered to have established a permanent establishment of the U.S. corporation if the independent agent acts exclusively or almost exclusively for the U.S. corporation or for any affiliated corporation of the U.S. corporation. Then in paragraph (8) of article 3 it is provided that if a U.S. corporation has any kind of a permanent establishment in Thailand at any time during the taxable year it shall be considered to have a permanent establishment in Thailand for the entire taxable year.

#### TAX BURDEN ON PERMANENT ESTABLISHMENT

In plain language this seems to us to say that if we have any kind of a salesman who devotes his principal efforts to selling our goods in Thailand at any time during the year, then the U.S. corporation and all of its affiliates must file a tax return for that year in Thailand in accordance with the tax laws of Thailand, and must pay whatever tax Thailand deems to be due.

The very burden of filing a tax return for United States Steel Corp. and its affiliated companies in Thailand or the Philippines or India would be such a costly burden as to keep us from trying to sell our products in any country where we were unsure of securing enough business to offset the probable costs of compliance.

It should perhaps first be noted that this treaty says we cannot solicit business with any one of our salesmen without thereby establishing a permanent establishment and subjecting ourselves to full taxation in Thailand. In contrast to this, this committee will remember that by the enactment of Public Law 86-272 the Congress said that a State of the United States could not tax a U.S. corporation merely

because the U.S. corporation solicited business in that State. Thus the Senate is by this treaty called upon to approve taxation by foreign countries which the Congress has already forbidden to each of our own United States.

We have many problems with respect to the status of a salesman or an independent agent. With respect to an independent agent, as above noted, it is provided that if he acts exclusively or almost exclusively for the U.S. corporation, then he shall not be considered as of independent status but shall be considered to have established a permanent establishment. Presumably if one independent agent spent all his time selling for us, he would under this treaty not be considered an agent of independent status, but if he had a helper and the helper spent all of his time for other clients, then the two-man agency would not be acting exclusively or almost exclusively for the U.S. corporation. We might believe we had an agency which was not operating almost exclusively for us but if it lost other clients or if our business turned out to be particularly good, or if the second salesman quit, then without our knowledge and without our will he might become an agent operating almost exclusively for us and we would be subject to taxation in Thailand.

Then it seems under this treaty that if we wished to sell something complicated such as steel for a bridge or a building, and if we sent one of our technicians to Thailand, we would merely by this sales effort, have established a permanent establishment in Thailand for a day, a few days, a week or some time in accordance with paragraph (8) and thus would be deemed to have a permanent establishment in Thailand for the entire year.

#### PROBLEM OF DEFINING TAXABLE INCOME IN A DEVELOPING COUNTRY

I have heretofore referred to some of the problems we would encounter through having to file a tax return. Our U.S. tax return is a sizable document. The tax return for Thailand would of course be an entirely different document and would be in accordance with their law. There was some discussion during the testimony of Dr. Woodworth before your committee as to what would constitute taxable income in the developing country. Dr. Woodworth thought the tax could not exceed the gross receipts from the products sold. I would agree that this seems logical. However, some developing countries with which I am familiar have fines and penalties that go to 200 percent of the tax. Most countries do not allow any deductions for cost of goods sold or expenses of operation unless the books of the corporation are kept in the particular country. We have had bitter experience with this principle. Some developing countries impose fines if every possible disallowance with respect to the tax return is not set out before the audit of the return. In a word, it seems to us that there is no reasonable limit to what tax and administrative expense may be required once a U.S. corporation has become subject to taxation by having a permanent establishment. Heretofore it has been possible to insulate the U.S. operation by having an independent agent or a separate subsidiary.

Question can be raised as to what it is Thailand or the Philippines hope to tax by their desire to have such a provision included in the treaty. Certainly if an independent agent does the selling he is going

to secure the full worth of his services or he is not going to take on the job. His job is selling, and he is adequately compensated for the selling job. Any other profit is the manufacturing profit and is certainly fully taxable under U.S. laws if the manufacturing operation is in the United States. Thus it would seem that Thailand or the Philippines or India can only hope by this treaty provision to tax some of the manufacturing profit. Thus we get into a battle as to who can tax what profit, with the taxpayer being asked to pay tax on more than 100 percent of his profit, and that was the problem that caused the public law with respect to each of the United States.

Finally we believe that the best sales results are secured by the greatest selling effort and that if U.S. corporations are to be limited in their efforts to sell in less developed countries to independent agents who have several other customers, this is going to be a serious deterrent to U.S. sales and employment. Furthermore, it will eliminate the selling of complicated products such as data processing machines, trucks, bridges, buildings, and anything that requires intensive effort or high skill in selling.

We respectfully request therefore that the principle enunciated by article 3, paragraph (4), subparagraphs (b) and (c), the last sentence of paragraph (5), and all of paragraph (8) be rejected by this committee and the Senate.

Senator GORE. Would it be reasonable for one to conclude from your statement that, insofar as United States Steel is concerned, ratification of the pending treaty and similar treaties with other underdeveloped countries would operate to discourage your activities in those countries rather than to encourage commerce and trade?

Mr. HEARNE. By and large, sir—

Senator GORE. Would it encourage or discourage investment, commerce, and trade?

#### EFFECT OF TREATY ON UNITED STATES STEEL SALES EFFORT

Mr. HEARNE. Yes, sir. As a matter of fact, I talked this morning to the head of our foreign sales effort, and he said that wherever this treaty went in, we would have to withdraw all of our sales effort.

Senator GORE. Do you know if such a decision as you have just described on the part of your company pertains to any other U.S. concern?

Mr. HEARNE. I do not know, sir. The difficulty, if I may say so, with many of these treaties is that they do not receive great publicity in their native states as it were, so this provision I think is not very well understood generally in business.

With those to whom I have talked, they have all felt that this would eliminate their sales effort, if, as I have indicated, it is required to file a tax return wherever you have an agent, or of course it would include a subsidiary.

Once you had a subsidiary in one of these foreign countries that was doing a sales effort, this treaty provides that subsidiary and an agent are the same thing.

Senator GORE. Do you think that this is too big a price to pay for the concessions received from Thailand in this treaty?

Mr. HEARNE. Yes, sir.

Senator GORE. And you would ask that, unless this correction be made, the Senate not ratify the treaty.

Mr. HEARNE. Yes, sir.

Senator GORE. Senator Williams.

## ADVANTAGES OF LEGISLATIVE ACTION

Senator WILLIAMS. Mr. Hearne, if there were going to be the decision of the Congress to approve such a proposal, do you think it would be better to do it legislatively than to do in the form of a treaty? Legislatively all of the Congress could consider it, both the House and the Senate. In addition, the public would know more about what was going on.

Mr. HEARNE. I certainly agree with you, sir.

Senator GORE. It was partly because of the precedential importance of the treaty and partly because of the lack of public knowledge of the terms of the treaty that this subcommittee determined to go into it rather thoroughly and to invite public witnesses. After receipt of your letter with respect to the Philippine Treaty, you were advised that the hearings on this treaty were underway and you have appeared and have been very helpful in your analysis of the treaty.

Are there other provisions of the treaty to which you wish to refer?

Mr. HEARNE. Well, we, as you are well aware, Senator Gore, are in the steel business, and our principal activity in helping less developed countries is in mineral extraction. We do not have any steel plants as such in foreign countries. Generally the first thing that happens in foreign countries is to develop their mineral resources out of which they earn foreign exchange to develop their manufacturing. So the exclusion of mineral extraction and further processing of course eliminates us from any 7-percent credit. Naturally we are not happy about that. We think that if credits are to be passed around, that in a democratic country they should be passed rather widely.

Senator WILLIAMS. Do you consider the 7-percent investment credit really a present to industry?

Mr. HEARNE. I suppose, Senator Williams, that any deduction is a present or any credit, if we go on the theory that the Constitution allows taxation of gross income.

Senator GORE. If the provisions to which you object with respect to permanent establishment were stricken from the treaty, do you think the existence of the 7-percent credit would significantly affect the operations of your company or your plans to operate and develop or export abroad?

Mr. HEARNE. I do not think that the 7-percent credit would make much difference either way.

Senator GORE. To the extent that it served to reduce your tax liabilities, it would be, as Senator Williams has described it, a gift.

Mr. HEARNE. Certainly.

Senator GORE. Any further questions?

(No response.)

Senator GORE. Thank you very much.

Mr. HEARNE. Thank you, sir.

Senator GORE. The next witness is Mr. Leslie Mills.

**STATEMENT OF LESLIE MILLS, U.S. COUNCIL OF INTERNATIONAL  
CHAMBER OF COMMERCE, NEW YORK, N.Y.**

Mr. MILLS. Mr. Chairman, I am Leslie Mills representing the Committee on Taxation of the U.S. Council of the International Chamber of Commerce. The U.S. council is a separate organization to U.S. business entities which along with councils in other countries are members of the International Chamber of Commerce.

I have a prepared statement which with your permission I would like to submit for the record, particularly since it includes an appendix which I shall not cover in my brief comments.

Senator GORE. Thank you. Your full statement will appear in the record.

(Mr. Mills' statement in full follows:)

**STATEMENT OF LESLIE MILLS, REPRESENTING THE COMMITTEE ON TAXATION, U.S.  
COUNCIL OF THE INTERNATIONAL CHAMBER OF COMMERCE, INC.**

The committee on taxation of the U.S. council has not had an opportunity to consider all provisions of the income-tax convention with Thailand, since the convention was not available to the committee in time for review. However, we submit herewith comments on the two articles, the substance of which was previously considered by the committee; these concern (1) the definition of permanent establishment (art. 3) and the investment credit (art. 5).

**DEFINITION OF PERMANENT ESTABLISHMENT**

Article 3 of the convention provides useful rules for determining when a permanent establishment exists in one of the contracting countries. Paragraph 4 states in substance that a corporation or resident of one of the contracting states shall be deemed to have a permanent establishment in the other contracting state if the resident or corporation engages in a trade or business in the latter state through an agent who regularly secures orders in the latter state for that resident or corporation. Paragraph 5 provides an exception that an agent will not be independent, regardless of status, if it acts exclusively or almost exclusively, for its U.S. principal.

Promotion by the Treasury Department of this provision was forecast in a speech last September by the Assistant Secretary of the Treasury, in which he suggested that this provision might be necessary so that a less-developed country should not be deprived of the revenues that may result from taxation of proceeds derived from the sale of goods by U.S. exporters to a customer in that country. The Assistant Secretary's statement to this committee explained that the provision reflects the position of Thailand that a nominally independent broker operating in Thailand is not really independent if his business depends on a single firm, and therefore when it acts through a dependent agent, the firm should be considered to have a permanent establishment in Thailand.

The U.S. council submitted a statement to Senator Fulbright earlier this month, commenting on the earlier public statement by the Assistant Secretary. A copy of the portion of the statement commenting on the proposed broadening of the definition of "permanent establishment" is attached hereto for reference.

The U.S. council considers this part of article 3 entirely inappropriate, and as stated in more detail in the attached excerpt from our earlier statement, acceptance of this provision would be an undue burden on U.S. exporters largely because of impossible problems in administration.

There may be many reasons why an organization in Thailand would represent a U.S. exporter exclusively or almost exclusively. It may be that the U.S. corporation for business reasons uses a controlled local corporation for that purpose. It may merely reflect the fact that a U.S. corporation's business is of sufficient importance to make it desirable for an independent local organization to concentrate exclusively in its representation. In either case, the Thailand organization is fully subject to Thailand tax and other laws, including the obligation to pay taxes on income derived from its services. But what the provision does is make the U.S. corporation in effect responsible for the Thailand taxes, and thus subject to inquiry by the Government of Thailand on the amount

of profit allocable to Thailand operations. The U.S. corporation is subject to U.S. tax rules, as well as general business considerations, to insure that the prices it charges for its products or services sold through its Thailand agent are fair and reasonable. It can only be a burden on the exporter if the tax authorities of Thailand are invited to second guess these export arrangements. The difficulty, of course, is not merely a possible difference of opinion between the taxing authorities of the two Governments as to the proper export price.

Aside from the probability that double taxation is almost sure to occur under these circumstances, the fact is that in almost every case it is virtually impossible for the taxing authorities of Thailand to determine the actual profit made by a foreign exporter on particular sales transactions. What they will surely do is adopt an arbitrary formula, possibly based on sales, and thus the burden of possible additional tax will fall on the resident agent. If the exporter has no interest in the agent's problems, he can disassociate himself from the problem. However, to keep the business going he is likely to seek a way to revise the export arrangements to minimize the difficulty. Or he may be forced to seek other and less efficient means of representation. In any event the provision is an invitation to disruption of trade arrangements, frequently developed on an arms length basis. The provision should be excluded from the treaty.

#### INVESTMENT CREDIT

The U.S. council's consideration of the investment credit provision in the proposed treaty is based on the understanding that such a provision will be incorporated in future new or revised treaties with less developed countries. This seems clear from the statement to this committee by the Assistant Secretary of the Treasury, and by other published statements. Thus our consideration goes beyond the relative importance of the proposed Thailand treaty, because of the limited opportunity for investment by U.S. enterprises in that country.

Also the U.S. council gave long and careful consideration last year to the proposed Less Developed Country Investment Credit Act, H.R. 11524, met with representatives of the Department of Commerce, and submitted two reports to the Secretary of Commerce, with information copies to the chairman of the Committee on Ways and Means of the House, which had the bill under consideration. Our views thus developed on the general concept of a credit on investments in less developed countries are generally applicable to article 5 of the Thailand convention, although the provisions of the bill considered last year and the convention article differ in some respects.

The International Chamber of Commerce is devoted to the principle that encouragement of private initiative in the United States and in all free countries including the developing countries is the best way to promote economic development and peace. The U.S. council has long felt that private enterprise can and must play a major role in this development process. It is clear that large amounts of capital will be required by the developing countries for many years to come and it is equally clear that available public capital may not be sufficient for this purpose. Furthermore we believe that our general policy should be to promote the flow of private capital to the developing countries and that the use of Government capital should not be confined to circumstances when political or other considerations make the use of private capital inappropriate.

Thus we have repeatedly urged that the governments of both capital importing and capital exporting countries take every measure possible to reduce the obstacles to private investment, foreign and domestic, and to encourage the free flow of capital goods and technology across international boundaries. In adopting this position we have recognized that one of the principal areas in which governments can assist in this process is through tax policy.

Our basic long-term position has been that the country in which income arises should have the sole right of taxation, and the International Chamber of Commerce continues to urge that this principle be adopted by governments unilaterally, as well as bilaterally through the conclusion of treaties or through the ratification of multilateral conventions.

However, we recognize that universal acceptance of this principle has yet to be attained and, therefore, we devoted considerable time to consideration of the desirability of adopting the provision before the last Congress for an amendment to the Internal Revenue Code to provide a 30-percent credit for U.S. investment in less developed countries.

While wholeheartedly commending the concern of the proponents of the proposal with the role of private enterprise in the economic growth of the less developed countries, we were unable to endorse the bill as introduced.

Our objections, transmitted to the Secretary of Commerce covered three basic points.

The first was possible conflict with the rules of the GATT. We felt that the legislative proposal could be considered to create an export subsidy which would conflict with article XIV of GATT. We were later informed by the Secretary of Commerce that his Department did not consider this objection to be valid, and we, therefore, do not pursue it.

Our second objection was on the limitations on industries which would be allowed the credit. We noted that the legislative proposal excluded the most significant source for the establishment and continuance of enterprises basic to economic development in the developing countries—the industries dealing with development and processing of raw materials. We felt that the credit, if one was to be allowed, should cover all investments.

Our third objection was that the procedure suggested raised a basic question concerning continued U.S. efforts to establish sound business thinking in the developing nations. We felt that the proposal would stimulate the unfortunate trend in many less developed countries to seek a government approach to their economic development, rather than the promotion of private enterprise which has been the foundation of the economic success of the United States and other capital exporting countries.

In these discussions of the previous similar proposal, we also express concern that the apparent subsidizing of U.S. enterprises in the less developed countries would inevitably cause resentment in the private sector of these countries, since the businessmen on whom so much responsibility rests for developing the economies could well feel that their U.S.-owned competitors were being unfairly subsidized. Also, and most important, it was and still is our opinion, based on our experience in foreign trade and taxation, and in particular with the enormous complexities of the 1962 revisions of the Internal Revenue Code affecting foreign investment and trade, that the investment credit provision would lead to such administrative difficulties, and later litigation that the advantages to be gained would be outweighed by these complications.

Despite our objections in principle and in concept to an investment credit of the type under discussion, we recognize that under present circumstances the use of the tax system, and perhaps even the investment credit concept, may well be the most readily available means for effectuating our national policy to promote private investment abroad and in particular in the less developed countries. However, we do not believe that the tax convention structure is the appropriate means for implementing such a policy.

Tax conventions are basically agreements between two countries to avoid double taxation, and to prevent undue burdens on the citizens of one not imposed on the citizens of the other. Thus in general there is a quid pro quo in the agreements. It is recognized, by us as well as by the Treasury, that in conventions between the United States and less developed countries we may have to give up more protection than we receive, since the position of the less developed country may be such that its citizens cannot receive benefits equal to what is given up. However, in dealing with the important problem of promoting investment from this country to these less developed countries, we submit that, from the viewpoint of both the countries, the problem is greater than merely considering their intercountry business relationships and problems. The health of our position in foreign trade and investments continues to be of national concern, and it is our opinion, that the 3 years' experience with the foreign provisions in these areas, enacted in the 1962 Revenue Act, merit a complete new review by the Congress based on present circumstances.

Specifically, we believe that a study should be made of the entire field of U.S. tax legislation as it affects foreign operations, with a view to the revision of existing legislation and, if necessary, preparation of new legislation to obtain a unified approach to the maintenance of our position on international trade and the encouragement of increased participation of U.S. private enterprise in the development of the economies of the developing countries in the free world. This is a common objective, since the health of our international trade position is essential to the development of other countries, and their economic development is essential to our position. We believe this should be done through a major reconsideration and revision of the provisions of the pertinent Internal Revenue Code, and not through the haphazard procedure of new conventions with individual countries, and the even slower process of revision of existing treaties.

EXCERPT FROM STATEMENT BY COMMITTEE ON TAXATION OF THE U.S. COUNCIL OF THE INTERNATIONAL CHAMBER OF COMMERCE SUBMITTED TO SENATOR FULBRIGHT JUNE 30, 1965

2. *The proposed broadening of the definition of "permanent establishment" in tax treaties*

In order to negotiate treaties, it is proposed to allow less developed countries to tax U.S.-based enterprises more. This is to be done by allowing the less developed country to tax affiliated enterprises in the United States on an unknown portion of their U.S. earnings. This would be done by treating as a permanent establishment of a U.S. enterprise any agent that "regularly secures orders in the less developed country, or maintains a stock of goods from which he regularly makes deliveries" (p. 24 of speech). It is stated that this principle has already been negotiated in the Philippine treaty which is to come before the Senate for ratification early in 1965.

While there are a number of changes in the proposed Philippine treaty in the definition of the term "permanent establishment" as generally used in U.S. treaties, the principal change is found in article 8, subsection 4(b). This provision states that a corporation or resident of one of the contracting states shall be deemed to have a permanent establishment in the other contracting state if the resident or corporation engages in a trade or business in the latter state through an agent who "regularly secures orders in the latter state for that resident or corporation." Mr. Surrey justifies the inclusion of such a provision in the proposed Philippine treaty on the ground that a less developed country should not be deprived of the revenues that may result from the taxation of proceeds derived from the sale of goods by a U.S. exporter to a customer in that country.

The proposed provision is not new. It was contained in the proposed treaty with India in 1960, which, incidentally, the Treasury assured the Senate was not going to be used as a precedent for future treaties (hearings of Senate Committee on Foreign Relations on India Tax Convention, 86th Cong., 2d sess., pp. 27-29, 43-45, June 28, 1960). It was also contained in a different form in the Mexico Draft Tax Convention in 1945, but this draft convention was rejected in favor of the London draft prepared by the Fiscal Committee of the League of Nations when it met in 1946. At that time and at the 1927 and 1928 meetings of the Fiscal Committee, full consideration was given to including such a provision, since the laws of many nations recognize that solicitation of orders alone gives sufficient basis for taxation. Thus both the earlier and later drafts of the league committees rejected the proposal and more recently the OEEC and OECD draft conventions relied on basically the same concepts in this respect as the earlier treaties.

The various committees of experts which have rejected the proposal have done so on several grounds. First, residence or nationality is deemed by some countries including the United States to provide a firmer ground for the imposition of tax than some legislative notion of source of income. Second, in almost every case it is virtually impossible for the country of source to determine the actual profit made by a foreign exporter on a particular sales transaction which may be deemed subject to taxation. Third, it is recognized that the omission of this provision from tax treaties and the reliance on a more restricted definition of permanent establishment has greatly contributed to the flow of trade to both developed and less developed countries. In fact, it is clear that many less developed countries having a similar provision in their present tax laws do not, in fact, enforce the provision because they recognize to do so would impede the flow of goods into their countries; this would appear to throw some doubt on the assertion that less developed countries would be deprived of revenue if this provision were not included in treaties with them.

If the provision is enacted, in many cases the destination country will have to content itself with taxing the agent of the seller on some assumed profit from the total transactions. It may be true that many large American exporters will abandon their agent to the tender mercies of his own taxing authority. The consequent disruption of American export trade flowing from this situation is apparent and seems contrary to our policy of encouraging exports by companies of all sizes.

The direct effect on exporters must also be taken into account if this provision is included in the treaties. Our current national export program is aimed at increasing the number of smaller companies engaged in exporting, but smaller

companies do not have the staffs to handle the myriad foreign taxes they may encounter if the less developed countries exert a right to tax sales profits. Smaller companies, in particular, may not have either the talents or the resources to ascertain the nature and extent of taxability in every country and to arrange transactions to qualify for the foreign tax credit under the Internal Revenue Code. Compliance with U.S. and foreign tax laws by companies large and small will be made much more difficult at a time when the complexities and burdens of compliance are already enormous.

Qualifying for the foreign tax credit in particular introduces several difficulties. Taxpayers will be faced with the necessity of having to revise long-established terms for trade to provide, in accordance with case law now prevailing in this country, for title and risk of loss to pass outside the United States in order to qualify the income as foreign source income for credit purposes. This would introduce an additional complication in normal trade transactions and lead to confusion for buyer and seller alike in the preparation of documents, collection of payments, and adjustment of claims. Moreover, a reversal of the terms of trade under which the exporter must retain risk until the goods are outside the United States may result in additional costs incurred because of increased insurance and financing costs.

It is also stated that it may be wise to retain the "force of attraction" theory with those less developed countries which enter into tax treaties with the United States. Thus, not only would the exporter be subjected to taxes on the sales profits because of this broader notion of taxability, but he would also be denied whatever reductions in taxes may be otherwise available on licensing and divided income.

It would appear from the facts set forth above that the benefits obtainable from the treaties would be far less than the burdens which would be imposed on the established system of exporting as it presently exists in the free world.

Mr. MILLS. The committee on taxation of the U.S. council has not had an opportunity to consider all of the provisions of the income tax convention with Thailand since the convention was not available to the committee in time for review. However, we submit herewith comments on two articles, the substance of which was previously considered by our committee. These concern the definition of permanent establishment and the investment credit.

#### EFFECT OF PERMANENT ESTABLISHMENT PROVISION

Mr. Chairman, of the two articles I was going to discuss, I find that article 3, the permanent establishment, has been quite fully covered by previous witnesses, and if I may, I think I might leave my statement to speak on that, adding only that the committee which I represent has represented a great many international corporations and other international organizations and they feel quite strongly that the matter discussed before of creating a permanent establishment merely by having an exclusive or almost exclusive agent is not in the best interests of the United States and should not be included in the treaty.

Senator GORE. You have heard the testimony of Mr. Hearne who just preceded you, with respect to the permanent establishment rule.

Mr. MILLS. Yes, sir.

Senator GORE. Do you find yourself in concurrence with his views?

Mr. MILLS. I do, sir; and I find, as I mentioned, the committee which I represent has members from other large international organizations, and it is their position that this permanent establishment, this part of the permanent establishment rule is entirely inappropriate and should not be included in the treaty.

Senator GORE. Proceed.

Mr. MILLS. The second point I wish to discuss is the investment credit.

The U.S. council's consideration of the investment credit provision in the proposed treaty is based on the understanding that such a provision will be incorporated in future new or revised treaties with less developed countries. This seems clear from the statement to this committee by the Assistant Secretary of the Treasury and by other published statements. Thus our consideration goes beyond the relative importance of the proposed Thailand Treaty, where there is only a limited opportunity for investment by U.S. enterprise.

Also the U.S. council gave long and careful consideration last year to the proposed less developed country Investment Credit Act. They met with representatives of the Department of Commerce and submitted two reports to the Secretary of Commerce with information copies to the chairman of the Committee on Ways and Means, which was then considered in the bill. Our views thus developed on the general concept of a credit on investments in less developed countries are generally applicable to article 5 of the Thailand convention, although the provisions of the bill considered last year and the convention article differ in some respects.

#### ROLE OF PRIVATE INVESTMENT IN THE DEVELOPING PROCESS

The International Chamber of Commerce is devoted to the principle that encouragement of private initiative in the United States and in all free countries including the developing countries is the best way to promote economic development and peace. We have also long felt that private enterprise can and must play a major role in this development process. It is clear that large amounts of capital will be required by the developing countries for many years to come and it is equally clear that available public capital may not be sufficient for this purpose. Furthermore we believe that our general policy should be to promote the flow of private capital to the developing countries and that the use of government capital should be confined to circumstances when political or other considerations make the use of private capital inappropriate.

Thus we have repeatedly urged that the governments of both capital importing and capital exporting countries take every measure possible to reduce the obstacles to private investment, foreign and domestic, and to encourage the free flow of capital goods and technology across international boundaries. In adopting this position we have recognized that one of the principal areas in which governments can assist in this process is through tax policy.

Our basic long-term position has been that the country in which income arises should have the sole right of taxation, and the International Chamber of Commerce continues to urge that this principle be adopted by governments unilaterally, as well as bilaterally through the conclusion of treaties or through the ratification of multilateral conventions.

However, we recognize that universal acceptance of this principle has yet to be attained and, therefore, we devoted considerable time to consideration of the desirability of adopting the provision before the last Congress for an amendment to the Internal Revenue Code to provide a 30-percent credit for U.S. investment in less developed countries.

While wholeheartedly commending the concern of the proponents of the proposal with the role of private enterprise in the economic growth of the less developed countries, we were unable to endorse the bill as introduced.

#### POINTS OF OBJECTION

Our objections, transmitted to the Secretary of Commerce, covered three basic points.

The first was possible conflict with the rules of the GATT.

Senator GORE. Suppose we skip over your reference to the 30-percent legislative proposal because that is not before this committee.

Mr. MILLS. My point, Mr. Chairman, is that my committee did consider this 30-percent proposal at great length, and did not approve it, and as far as I can see, while there may be some language difficulties, what is now before your committee is a proposal for an investment credit of the same form with a lower rate, and we do not approve it.

Senator GORE. You think the same principle is involved?

Mr. MILLS. Yes, sir.

Senator GORE. Well then, proceed.

Mr. MILLS. The second objection we have to the 30-percent credit, and therefore to the provision in this treaty, was on the limitation of industries which would be allowed the credit. We noted that the legislative proposal excluded the most significant source for the establishment and continuance of enterprises basic to economic development in the developing countries—the industries dealing with development and processing of raw materials, which felt that the credit if one was to be allowed should cover all investments.

Our third objection was that the procedure suggested raised a basic question concerning continued U.S. efforts to establish sound business thinking in the developing nations. We felt that the proposal would stimulate the unfortunate trend in many less developed countries to seek a government approach to their economic development, rather than the promotion of private enterprise which has been the foundation of the economic success of the United States and other capital exporting countries.

In our discussions with representatives of the Department of Commerce on the investment credit, we also expressed concern that the apparent subsidizing of U.S. enterprises in the less developed countries would inevitably cause resentment in the private sector of these countries, since the businessmen on whom so much responsibility rests for developing the economies could well feel that their U.S.-owned competitors were being unfairly subsidized. Also, and most important, it was and still is our opinion, based on our experience in foreign trade and taxation, and in particular with the enormous complexities of the 1962 revisions of the Internal Revenue Code affecting foreign investment and trade, that the investment credit provision would lead to such administrative difficulties, and later litigation that the advantages to be gained would be outweighed by these complications.

Despite our objections in principle and in concept to an investment credit of the type under discussion, we recognize that under present circumstances the use of the tax system, and perhaps even the investment credit concept, may well be the most readily available means for

effectuating our national policy to promote private investment abroad and in particular in the less developed countries. However, we do not believe that the tax convention structure is the appropriate means for implementing such a policy.

#### REVIEW OF REVENUE CODE REQUIRED

Tax conventions are basically agreements between two countries to avoid double taxation, and to prevent undue burdens on the citizens of one not imposed on the citizens of the other. Thus, in general, there is a quid pro quo in the agreements. It is recognized, by us as well as by the Treasury, that in conventions between the United States and less developed countries we may have to give up more protection than we receive, since the position of the less developed country may be such that its citizens cannot receive benefits equal to what is given up. However, in dealing with the important problem of promoting investment from this country to these less developed countries, we submit that, from the viewpoint of both these countries, the problem is greater than merely considering their country business relationships and problems. The health of our position in foreign trade and investments continues to be of national concern, and it is our opinion that the 3 years' experience with the foreign provisions in these areas, enacted in the 1962 Revenue Act, merit a complete new review by the Congress based on present circumstances. Specifically, we believe that a study should be made of the entire field of U.S. tax legislation as it affects foreign operations, with a view to the revision of existing legislation and, if necessary, preparation of new legislation to obtain a unified approach to the maintenance of our position on international trade and the encouragement of increased participation of U.S. private enterprise in the development of the economies of the developing countries in the free world. This is a common objective since the health of our international trade position is essential to the development of other countries, and their economic development is essential to our position. We believe this should be done through a major reconsideration and revision of the provisions of the pertinent Internal Revenue Code, and not through the haphazard procedure of new conventions with individual countries, and the even slower process of revision of existing treaties.

Thank you, Mr. Chairman.

Senator GORE. Senator Williams.

Senator WILLIAMS. Mr. Mills, I gather you feel that if there is going to be a change in the tax form as it relieves investors in foreign countries that it may be better to proceed legislatively than to do it through a treaty, is that correct?

Mr. MILLS. Yes, sir, that is our position.

Senator WILLIAMS. And I notice that you suggest that the time may be arriving when we should have a general study of taxation in this whole area, and I want to say that I agree with you fully.

I understand that in Panama they have enacted a new law, or are in the process of doing it, where their tax on foreign investments will be exactly equal to the tax credit that the respective countries may get in their own countries.

Mr. MILLS. Yes, I have heard that.

Senator WILLIAMS. In our instance that would mean that a corporation would be paying, under our new tax formula, 48 percent tax in Panama, which would completely offset their tax here in this country, is that correct?

Mr. MILLS. Yes, sir; in effect a country would revise its tax laws so that it would go into its treasury at the expense of the U.S. Treasury.

Senator WILLIAMS. In a case involving some European country where the corporate tax may be lower, we will say 30 percent, you would have the net effect of two companies operating in those areas, one paying a 30-percent rate and one a 48-percent rate, would you not, both in the same country?

Mr. MILLS. Well, the net effect would be that, looked at from the U.S. point of view; yes, sir.

#### NEED FOR STUDY OF TAX STRUCTURE

Senator WILLIAMS. I agree with you. I think that our whole tax structure as it relates to both the foreign tax credits and all of this has got to be studied, and I think it would be better to study it legislatively.

Mr. MILLS. Sir, one reason that I think we need a study, and in particular such a matter as the credit for foreign investments should be in the basic code, is, as has been previously indicated, these treaties are negotiated by representatives of the two governments, and they give and take, so it seems to follow that even if we have a treaty, there can be changes in the particular provisions.

Now, I am engaged in tax practice. I have enough trouble with the present code. I would hate to have 30 or 40 countries each with possible different provisions in dealing with foreign credits. I am close enough to retirement that it would not be a personal problem, but I do not like to wish that on my successor.

Senator WILLIAMS. And if we do it legislatively, the Congress decides to make a change, and we can do it without entering into consultation with all these respective countries then.

Mr. MILLS. Yes, sir.

Senator GORE. To offset that we are urged by the Treasury Department and the State Department to approve the treaty because they maintain that the benefits which flow to U.S. taxpayers doing business in the underdeveloped countries would offset the concessions we make and the additional burdens which the U.S. concerns doing business abroad might incur as a result of the permanent establishment rules.

Have you weighed this in balance to reach your conclusion?

Mr. MILLS. I have considered it, sir, and I respect their position. But the discussion of my committee came to the conclusion that they would not endorse the credit principle, even as a single basic change in the Internal Revenue Code and certainly not as a treaty provision.

Senator GORE. Were you present to hear the testimony of Mr. Gleason of the Corn Products Co.?

Mr. MILLS. I heard part of it.

Senator GORE. He rather strongly urged approval of the treaty, and one of the benefits which he outlined to the committee was the certainty of tax treatment which a series of treaties would bring about.

What is your reaction to that?

## OPPOSED TO TREATY IN PRESENT FORM

MR. MILLS. There is no doubt that that is a very valuable and very important matter for U.S. business people abroad. I still have a personal doubt, Senator, that one could not negotiate a treaty with Thailand without this provision in it, because even without this provision, there is much to Thailand's advantage in having an arrangement with the United States which gives some assurance to U.S. investors. They will not go into a country in any volume at all if they are subject to the haphazard tax administration in that country. But then I was not one of the negotiators of the treaty.

SENATOR GORE. On balance and after consideration, you recommend the rejection of the treaty, do you?

MR. MILLS. Yes, sir; if the treaty cannot be amended as we would like it amended, that it not be approved by the Senate.

SENATOR GORE. And do you know what proportion of your clients, your member firms, agree with this position?

MR. MILLS. No, I do not. I am reporting for the committee on taxation of the U.S. council, and this is the position of that committee, which has representatives of many large U.S. national organizations.

SENATOR GORE. Has the position of your committee been made known to the members of the organization for which you speak?

MR. MILLS. Oh, yes, because our discussion has led to this letter to the Department of Commerce. I have it here. I think it was last fall. At least it was early this year, possibly in March.

SENATOR GORE. What I am trying to ascertain is whether this is your opinion as a tax lawyer, whether it is the opinion of the committee on taxation, or whether this is the position which has been considered by the businesses whom you serve, and that this is a reasoned judgment on their part. I do not expect you to say whether it is unanimous or not, but can you give us some indication as to the extent of concurrence in your views?

MR. MILLS. Let me clarify it in this way. The committee for which I am speaking has not considered this in relation to a treaty, so that if I have left the impression before that they are equating the advantages of a treaty in other areas with this, I was wrong. The committee was considering the propriety of having investment credit for foreign investment in the Internal Revenue Code, and the committee, which has representatives of many organizations, decided that they would not approve the proposal. That position was discussed again with representatives of the Department of Commerce, and the decision not to approve was affirmed.

That decision went beyond the tax committee. It went to the higher echelon, I would say that, in the U.S. Council of the International Chamber of Commerce, and that is their official position, that they do not think it would be appropriate to have a credit for foreign investment in the Internal Revenue Code.

SENATOR GORE. And from that you deduce that it would not be sound and in the public interest or in the interests of the concerns you represent to have it contained in a treaty.

MR. MILLS. Yes. I am following through. I am making that statement now, since I became involved in this 2 days ago, and I obviously did not consult with my committee. It is entirely possible that some

companies represented there would feel that the net balance of having certainty in other areas would outweigh their disagreement with the principle.

Senator GORE. Well, that clarifies it.

Senator Williams?

POSSIBLE WAYS OF ALTERING THE TREATY

Senator WILLIAMS. Mr. Mills, assuming that these treaties were to be ratified by the Senate, and after the ratification the Congress decided to repeal the so-called investment credit or enact in lieu thereof a more accelerated depreciation formula, as has been advocated, what would be the effect of our treaties? Could we do that without consultation in reopening the treaties, or would we be locked in?

Mr. MILLS. You mean repeal the investment credit thing here?

Senator WILLIAMS. Suppose the Congress, after this was done, decided to change the whole formula of investment credit. You know it was suggested at one time. Some felt that rather than investment credit it would be better to just have a more rapid accelerating form of depreciation or something. Suppose that idea came around again and Congress decided to do that. For domestic industry would we be locked in on the investment credit formula internationally, or would we have to renegotiate or could we just repeal that investment credit?

Mr. MILLS. Senator Williams, Senator Gore referred to me as a lawyer. I am only an accountant, so to the extent you are asking me for a legal opinion, I am out of order. But I understand from testimony before this subcommittee last week, and I was not here, that the question was raised as to whether this could be removed from the treaties, and I understand the answer to be that it can be denounced after 5 years, but that it could not be touched in the 5-year period.

Senator WILLIAMS. I have no further questions.

Senator GORE. Thank you very much.

Are there other citizens who wish to testify on this subject?

(No response.)

Senator GORE. This concludes the hearings on the proposed tax convention with Thailand.

(Whereupon, at 11:35 a.m., the committee was adjourned.)

(The following letters and statements were received for inclusion in the record:)

NATIONAL FOREIGN TRADE COUNCIL, INC.,  
New York, N.Y., August 23, 1965.

HON. ALBERT GORE,  
*Chairman, Subcommittee on Tax Conventions, Committee on Foreign Relations,  
U.S. Senate, Washington, D.C.*

DEAR SIR: The National Foreign Trade Council, which was founded in 1914, is a national organization composed of U.S. corporations engaged in all aspects of foreign trade and business. Its purpose is to promote U.S. foreign trade and business.

The income tax treaty program long has been regarded as a most important method of promoting U.S. foreign trade and business. Testimony, on behalf of the National Foreign Trade Council, has been presented to the Foreign Relations Committee concerning each of the income tax treaties to which the United States is a party. At each annual convention of the National Foreign Trade Council since the initiation of the tax treaty program, there has been included in its recommendations, a statement that the tax treaty program be extended and improved.

Despite its concern with reference to several provisions in the treaty, which are discussed below, the National Foreign Trade Council urges that the Senate give its advice and consent to the ratification of the tax treaty between the United States and Thailand (Senate Executive E, 89th Cong., 1st sess.).

In addition to the basic advantages of a tax treaty, such as making more certain the limits beyond which tax liabilities cannot be asserted by the two countries and alleviation of double taxation, the treaty contains several provisions which will encourage some companies engaged in trade or business in Thailand. These include—

- (1) The 7-percent investment credit (art. 5) ;
  - (2) Deferral of taxation by both countries on the transfer of property, services, and know-how by a U.S. company in exchange for stock to a Thai company of which it owns 25 or more percent (art. 6) ;
  - (3) The provisions that the taxpayer should not be taxed twice on the same item of income (arts. 22 and 24) ;
  - (4) The assurance that the taxpayer may have a more effective method of resolving the settlement of double taxation situations (art. 28). If the provisions concerning resolution of double tax situations prove to be effective, they will solve a most troublesome problem of companies engaged in foreign trade and business. This arises in the event that they are taxed by both the United States and a foreign country on the same item of income.
- The new provision (art. 27) concerning the exchange of information with reference to new tax laws, regulations, judicial decisions, etc., would seem to be most helpful.

The provisions in the treaty with Thailand which cause us concern are the following:

(1) The provision that a U.S. company will be deemed to have a permanent establishment in Thailand if it uses the services of an exclusive agent there. We believe this to be undesirable and a departure from acceptable definitions of "permanent establishment."

While we recognize that the situation may be mitigated by the allowance of a credit for Thai tax against U.S. tax in certain instances, we believe that the provision that an exclusive agent may constitute a permanent establishment is undesirable because it could well be invoked to subject to a foreign tax regime American corporations whose activities abroad are minimal, and also even the American exporter in the usual course of foreign trade.

In no event should this provision, or its anticipated interpretation, be accepted as a precedent for other treaties.

(2) The foreign tax credit mentioned in the previous paragraph appears to be granted to U.S. taxpayers who produce goods in the United States and sell them to buyers in Thailand even if title passes to the Thai purchaser in the United States. However, it is not clear that any such credit can be given to U.S. taxpayers who do not qualify as producers in the United States.

(3) That the 7-percent tax incentive credit is not extended to investments in the growth or cultivation of agricultural products, or the extraction, refining or processing of minerals, ore, oil, or gas seems to us undesirable. We believe that the credit should be allowed with respect to all investments in Thailand in connection with the active conduct of a trade or business.

The council urges that the treaty with Thailand should not be regarded as an acceptable prototype or model for treaties with less developed nations, because of the undesirable provisions referred to above.

Despite these undesirable provisions, however, the National Foreign Trade Council again urges that the Senate give its advice and consent to ratification of the income tax convention between the United States and Thailand.

It is requested that this letter be made part of the record of the hearings.

Very truly yours,

JOSEPH B. BRADY, *Vice President.*

KEARNS INTERNATIONAL,  
Pasadena, Calif., August 24, 1965.

AD HOC SUBCOMMITTEE ON TAX CONVENTIONS,  
*Foreign Relations Committee,*  
U.S. Senate, Washington, D.C.

GENTLEMEN: I am most grateful for the invitation to testify on the proposed tax convention with the Kingdom of Thailand. Unfortunately, it is impossible for me to be in Washington on this date and I take this opportunity to respectfully submit the following comments.

The Kingdom of Thailand is unique in all of the countries of southeast Asia. It has been completely independent and self-governing for several hundred years. The fiscal policies of Thailand have, historically, resulted in sound currency and internal fiscal integrity. The Government of Thailand has been, historically, friendly and cooperative with the United States. In the most recent period, leaders of Thailand's Government have irrevocably placed themselves beside the United States in foreign policy as relating to southeast Asia.

We have recently had the opportunity to make a detailed study of the economy of Thailand, past, present and future. The purpose of this study was to determine the needs of that country for industrial development. The entire study can be made available to your committee for examination but, in essence, it is undeniably evident that Thailand must increase its industrial activity if it is to maintain an improvement in its standard of living and opportunity for its rapidly growing population.

Your committee is undoubtedly aware that Thailand has, historically, been an agricultural nation and it is only recently that industry has become an important factor. As a result, it is necessary to enlist the support of industrialized countries for both financial and technical assistance. It has been my good fortune in the past 5 years to work closely with some of the Thai Government and private entities to develop useful industrial enterprises. As a result, I am acutely aware of the difficulties that are experienced in the absence of mutually beneficial tax conventions.

In our considered opinion, the proposed convention that is now under consideration by your committee will make a very substantial contribution to the economic growth of Thailand and, ultimately, to the foreign earnings of American companies who can participate more fully in this economic development as a result of the removal of the present inequities.

Thank you for giving us the opportunity to express these views.

Sincerely yours,

HENRY KEARNS.

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CHAMBER OF COMMERCE OF THE UNITED STATES,  
Washington, D.C., August 27, 1965.

HON. ALBERT GORE,  
*Chairman, Subcommittee on Tax Conventions, Committee on Foreign Relations,  
U.S. Senate, Washington, D.C.*

DEAR SENATOR GORE: This letter is to state the views of the Chamber of Commerce of the United States with respect to the Thailand Income Tax Convention and other similar treaties now pending before your Subcommittee on Tax Conventions of the Senate Foreign Relations Committee.

The national chamber supports such conventions, and urges their ratification. To begin with, we believe that it is in the national interest to conclude conventions for the avoidance of double taxation with all countries of the free world, both developed and less developed. We believe this general proposition is supported by both the Government and the U.S. business community. To date, the United States has entered into treaties for the avoidance of double taxation with 22 foreign nations. For the most part, the United States has been successful in concluding conventions only with developed countries.

From the point of view of U.S. business, our treaties endeavor to reduce the overall foreign rate of tax on foreign investment to a rate not exceeding the U.S. rate, through the reduction of the tax rates in the foreign country on dividends and royalties.

Our treaties not only tend to eliminate double taxation of income, but in many instances help to avoid the double reporting and payment of taxes, even in situations where actual double taxation of income would not otherwise occur. Through the use of the concept of permanent establishment, which is incorporated in all of our treaties, the treaties uniformly exempt U.S. exporters from the reporting and payment of foreign taxes in the normal course of an export transaction. To this extent, our treaty network substantially assists and fosters the U.S. policy regarding encouragement of exports. Through the use of normal treaty provisions, the convention with Thailand accomplishes both of these objectives.

Most of the provisions of the pending conventions are, in some form or another, included in U.S. treaties currently in force with other countries. We will not review these standard treaty provisions, since they have been approved by the Senate in other conventions many times. There are, however, two significant innovations in the pending treaty with Thailand, which have not heretofore

been included in any U.S. treaty: a credit for investment in Thailand, and a reciprocal tax deferral on the transfer of intangible industrial property and technical services in exchange for stock.

First, it should be recognized that in dealing with a less developed country, our normal treaty provisions will not usually result in reciprocal revenue benefits to that country. Since tax treaties will not arise unless both parties to the treaty can realistically expect some benefit, our normal treaty pattern had to be improved in some respect to provide reciprocal benefits to less developed countries. We believe the two modifications adopted by the United States in the Thai convention for this purpose are to be recommended.

The credit for investment in Thailand merely endeavors to place investment in Thailand on a tax parity with investment in the United States, which is now favored over foreign investment as a result of the investment credit adopted as part of the Revenue Act of 1962.

Article 6 of the convention, which relates to the reciprocal deferral accorded the transfer of intangible industrial property and technical services in exchange for stock, defers not only current taxation on the transfer of technical services for stock, but also eliminates the otherwise complicated mechanical problems under sections 351 and 367 of the Internal Revenue Code in establishing tax-free patent and know-how transfers to jointly owned Thai corporations. The chamber believes the merits of this provision go beyond treaties with less developed countries and that it should be included in all of our treaties with both developed and less developed countries. The provision does nothing more than defer the taxation of certain property transfers and services rendered until such time as stock received therefor is sold or exchanged.

Finally, to the extent the pending convention with Thailand deviates from our standard tax treaty pattern, it contains features which should foster another major interest of the United States, investment in less developed countries, and provides norms which, hopefully, will be used in successfully negotiating other treaties with less developed countries.

Foreign investment in the developing countries is essential to economic development in the host country, and in the United States as well. Increased U.S. investment, stimulated by equitable tax treatment, benefits the U.S. balance-of-payments position through expansion of our export trade.

The ability of their private sectors to earn foreign exchange is the crucial element needed to sustain the development of emerging countries. The chamber has testified on numerous occasions to its support for U.S. private investment in less developed countries.

A large market for export expansion awaits development in such emerging countries as Thailand. However, continually increased levels of foreign investment by American business can be expected only when, and to the extent that, the commercial opportunities available abroad exceed the commercial and non-commercial dangers attendant upon it. The relative insecurity of an investment—the danger that it will be discriminated against in favor of local capital; that it will be expropriated without due process of law and reasonable compensation; that its worth will be reduced by inflationary trends; that it will be hamstrung by arbitrary regulation—provides a backdrop against which commercial attractiveness must constantly be measured by the potential investor.

The current U.S. reexamination of existing income tax conventions continues to move in the direction of lessening taxation by the country of the source of income. This trend is desirable. It is a step in the right direction toward removal of disincentives to vital private investment in the less developed countries.

In addition to stimulating the U.S. economy, U.S. private investment abroad increases the international trade growth rate of developing countries and provides foreign exchange which can accelerate development through the efforts of individual less developed countries.

Disincentives to private investment must be removed in order to increase substantially the investment of U.S. capital and know-how in developing countries.

Apropos this point, the national chamber regards the 7-percent investment credit provided in this and other pending tax conventions as just such a removal of a disincentive. To deny this credit to the U.S. investor who is implementing his country's foreign policy by helping to stimulate mutually beneficial economic growth abroad and at home—when the credit is available to a domestic investor in the United States—is to discriminate against the investor abroad at a time when his own Government is seeking in the national interest to encourage him.

It should be obvious that an American corporation investing in foreign countries with tax rates lower than our own does not benefit from the lower tax rates, because its total tax will always be at least as great as if the U.S. rates were applied initially.

Double taxation can only serve as a disincentive to new foreign investment. The Chamber of Commerce of the United States therefore urges your subcommittee to support the pending United States-Thailand tax convention and other such treaties with friendly countries for the avoidance of double taxation.

Sincerely,

DON A. GOODALL,  
*Legislative Director, Legislative Department.*

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STATEMENT BY P. F. CORNELSEN, VICE PRESIDENT AND PRESIDENT OF THE  
INTERNATIONAL DIVISION, RALSTON PURINA CO., ST. LOUIS, MO.

Mr. Chairman, you have received statements and testimony from various departments of the Government, and from industry spokesmen, on the advisability of ratifying the proposed income tax convention with Thailand. As we have under consideration at the present time a recommendation to invest in a joint venture for the purpose of constructing and operating a grain export facility in Thailand, we would like to submit our business views of the proposed treaty.

After studying the provisions of the treaty in depth we would like to recommend its ratification. We believe the relief it provides to business in general is essential to enable business to invest in Thai enterprises.

While the permanent establishment rules could be clarified to avoid any possibility that Thailand might treat a manufacturing subsidiary which purchases for its use goods produced by its U.S. parent as a permanent establishment of the parent company, thereby subjecting the parent company to Thai taxes, we do not believe this ambiguity is material when compared with the relief provisions of the treaty. Two of these beneficial provisions are the 7-percent investment tax credit and the deferment of tax on the transfer of property and know-how for stock in a Thai company. We strongly favor these two incentives, and because they are new the following is limited to their consideration.

As you may know, Ralston Purina Co. is a worldwide supplier of commercial feeds for animals and poultry. We have worked closely with agriculture since 1894 to develop the nutrients necessary to provide this Nation with the finest quality of meats, poultry, and dairy products at the lowest possible cost. Food is our business. Since 1957 we have been sharing this know-how with many of the less developed countries of the world. These countries rely heavily upon agriculture to support their economy and to raise the level of nutrition of their population.

We have feed manufacturing plants and food processing facilities in Latin America, Europe, and the Middle East. We are now looking to the Far East where food shortages are critical. Thailand is a suitable base of operations for that area. The country has proven its loyalty to the United States. Its people are industrious and progressive, and its Government, though military, is stable and efficient. Moreover, its currency is relatively firm.

Thailand agriculture has made dramatic improvements in recent years, enough to feed its people and to have a surplus which it can export to neighboring countries to relieve their food shortages. Among its exportable commodities are corn, grain sorghums, rice, tapioca meal and flakes, soybeans, castor beans, red beans, kenaf, and jute. The three largest export items are rice, rubber, and corn, in that order. Even with this number of exportable commodities Thailand still utilizes only about 60 percent of its available productive land. The remaining 40 percent constitutes the only surplus land immediately available in the entire area of southeast Asia which can be used to alleviate the present food shortages in this area. However, until the necessary facilities are constructed to handle an increased volume of export trade, there is no reason to increase its production.

This is the area in which our company may provide assistance. Through the use of our technical skill and know-how, we would organize a company in Thailand to construct and operate a modern grain export facility near

Bangkok. The grain would be stored in silos, conditioned, segregated, and grade controlled to insure a uniform quality. The absence of a satisfactory grading system has hampered Thailand in its export trade with other countries, primarily Japan. Our more than 70 years of experience in the handling and merchandising of grain would enable us to lend assistance in eliminating this existing bottleneck to agricultural development.

Studies of the Thai economy indicate that the rate of return on an investment in a grain storage facility would be nominal. Attached are two schedules, marked "Exhibit A," showing the profit projection of such a venture based on the investments shown. The best rate of return that could be expected on the total assets assigned to the project is only 3.6 percent before taxes, which is substantially less than our normal rate of approximately 13 percent.

Hence an investment of this size is not practical for us except as a means of benefiting from the future growth and expansion of the industry. We are willing to invest in Thailand because we are confident that it has the potential to become an agricultural leader in southeast Asia. Our business consists primarily of the manufacture and sale of commercial feed, not grain storage. We look upon this investment as an initial step to greater investment in the commercial feed industry. When proper marketing channels are established to move the products from the farmer to the export market, whole new fields of investment opportunities will be opened to U.S. businesses. When this happens the 7 percent investment tax credit will become immensely important in stimulating the flow of capital into the country and facilitating exports of American-made products.

Our studies indicate that a grain storage facility of the size and nature needed in Thailand will require 30 months for construction and will cost over \$5 million. Approximately four-fifths of this cost would consist of concrete grain storage silos and the remaining one-fifth of machinery and equipment. The grain elevators would be constructed in Thailand from Thai materials. The machinery and equipment would be supplied from the United States. Since no income would be generated during the period of construction the investment tax credit would serve to defray interest costs during this period.

We feel that our situation is a concrete example of the need for an investment tax credit. An immediate return on our investment would make it easier for us to finance the project, as it would reduce our risk and enable us to increase the amount of our capital investment. Again may it be emphasized that this is only a starting point for future investments in Thailand.

Without the immediate tax credit we would be hesitant to make even an initial investment, as there would be little incentive to purchase machinery and equipment here and export it to Thailand when we can receive a 7 percent credit by using it here. The current tax preference of domestic investment over foreign investment impedes the economic growth of less developed countries. Unless the rate of return in foreign countries is significantly higher to offset the added risk involved, the effect is to reduce private capital investments in favor of the immediate 7 percent tax credit in the United States. Extension of the investment tax credit to Thailand would eliminate this impediment.

In our opinion, the investment tax credit is the best financing device yet conceived to encourage investment of U.S. capital in underdeveloped areas. Because of the extreme risk involved, business must have some incentive to assign its capital to these areas rather than to the industrialized nations. Tax exemptions of income is helpful but not of immediate benefit in financing. Often these ventures operate for years without any significant profit, not to mention the startup costs and interest expenses that must be met in the meantime. Tax sparing, besides being complex and inequitable fails for the same reasons. Such incentives are based on income whereas the investment credit is based on investment. The businessman always knows the amount of his investment, but he does not know what his profit will be. From experience in these underdeveloped areas he knows that his profit may be nil.

The same reasons advanced for the investment tax credit apply to the tax deferral provision in regard to the contribution of property and technological information for stock of a Thai company. The payment of a tax at the time stock is acquired for technical information and services makes financing of such a corporation even more difficult. Contrast this with the payment of a tax at the time such stock is sold, when the investor has the funds to pay a tax.

From the foregoing we think it is clear that business needs the investment tax credit and the other relief provisions contained in the convention if capital investment in less-developed countries is to be encouraged. This is especially true in Thailand. In order for Thailand to become self-sufficient it must increase its export trade. If the United States does not lend assistance other governments undoubtedly will. For this reason we strongly urge the prompt ratification of this convention by the Senate.

If you should desire, we would be glad to appear before the committee for the purpose of answering questions concerning this statement.

*Profit projection*

	1st	2d	3d
Gross Income.....	\$937,500	\$1,112,500	\$1,112,500
Less:			
Operating expenses.....	-190,000	-225,000	-225,000
Interest expenses.....	-325,000	-355,000	-354,800
Depreciation.....	-281,600	-281,600	-281,600
Preliminary cost amortization.....	-6,000	-6,000	-6,000
Insurance.....	-12,500	-12,500	-12,500
Net profit.....	122,400	232,400	232,600
Percent return on assets.....	1.9	3.5	3.6

*Cash flow—Construction years (2½)*

	1st	2d	3d	Total
Buildings.....	\$1,845,000	\$1,247,000	\$492,000	\$3,584,000
Construction expenses.....	48,000	54,000	50,000	152,000
Pre-start up interest costs.....	19,900	152,100	128,000	300,000
Total to be capitalized.....	1,912,900	1,453,100	670,000	4,036,000
Machinery and equipment.....		1,162,000	40,000	1,202,000
Land.....	200,000			200,000
Preliminary costs.....	30,000			30,000
Cash needs.....	2,142,900	2,615,100	710,000	5,468,000
Cumulative cash needs.....	2,142,900	4,758,000	5,468,000	5,468,000

TRANS WORLD AIRLINES, INC.,  
Washington, D.C., August 20, 1965.

HON. J. W. FULBRIGHT,  
Chairman, Senate Foreign Relations Committee,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In connection with your consideration of the United States-Thailand Income Tax Convention, we should like to indicate our views in support of its ratification and in particular with respect to article 7, which provides for the reciprocal exemption of income from the operation of aircraft in international traffic, since TWA plans to resume flying operations to Bangkok in May 1966.

The United States has, during the years, entered into many treaties to avoid double taxation. As a general rule treaties contain a clause exempting shipping or airline profits, except in the home country, which usually takes one of two forms, both very similar, which are as follows:

"Income which an enterprise of one of the contracting States derives from the operation of ships or aircraft registered in that State shall be exempt from taxation in the other contracting State."

or

"Profits derived by an enterprise of one of the contracting States from the operation of ships or aircraft shall be exempt from tax by the other State."

Such exemption of profits except in the home country is intended to facilitate the operation of international transportation enterprises and avoids the numerous difficulties involved in the taxation of international transportation enterprise outside the home country of the operating enterprises. The International Civil Aviation Organization recognizing the desirability of such an exemption, on April 13, and October 4, 1951, adopted the following resolution:

"(1) Each Contracting State should, to the fullest possible extent grant reciprocally to air transport enterprises of other Contracting States—

"(a) exemption from taxation on the income and gross receipts derived in that States from the operation of aircraft in international air transportation; and

"(b) exemption from property taxes, capital levies, increment of wealth or other similar taxes on aircraft engaged in international air transportation.

"(2) Each Contracting State should endeavour to give effect to paragraph (1) above, in bilateral agreements relating to double taxation generally, or by such other methods as the inclusion of appropriate provisions in bilateral agreements for the exchange of commercial air transport rights, or by legislation granting such exemption on a reciprocal basis;"

Prior to adopting this resolution the North American members of the Financial Committee of International Air Transport Association prepared a paper endorsing the principal of reciprocal exemption of income from the operation of aircraft in international air transportation and the reasons indicated may be summarized as follows:

(1) The exemption of such income, except in the home country is not dependent upon a uniform method of allocation and the consequential necessity of multilateral action. The impossibility of achieving multilateral uniformity is demonstrated by the experience of U.S. carriers with several States of the United States and by abortive attempts in the international field. Fundamental differences between jurisdictions in tax structure, revenue needs, and economic conditions preclude the general acceptance of any uniform allocation formula.

Moreover, in international practices, fiscal and commercial legislation, make hazardous any attempt to evaluate the profits of a particular establishment on the basis of the central accounts of the enterprise to which it belongs. See study by Paul Deperon, member of the Secretariat of the League of Nations and secretary of the Fiscal Committee, prepared for the Advisory Committee on Economics to the Committee on International Economics Policy February 21, 1945.

(2) It has the advantage of simplicity of application, since there is no need to allocate the taxable base. This precludes (a) the developing of an acceptable formula, which, in the case of international air transportation is extremely difficult, and (b) the making of complicated computations necessary to apply that formula as required.

(3) It insures the automatic elimination of much tax reporting by the carriers and of the necessity to compile and keep current, complex and detailed statistics useful for tax purposes only.

(4) The wide acceptance of the theory, of exemption of such income except in the home country, supports the application of this theory to international air transportation.

(5) Since this theory removes the uncertainty of the application of foreign taxes it would encourage the development of foreign trade and promote and foster international air transportation.

As a U.S. international air carrier TWA strongly supports the concept of reciprocal tax exemption for income of international air carriers outside of their home country whether by tax treaty, bilateral contract, or legislation granting such exemption on a reciprocal basis. Since we are presently attempting to expand our operations to less developed parts of the world, specifically Africa, we are particularly desirous of establishing this concept with respect to less-developed countries.

Notwithstanding the fact that any income taxes paid by TWA to foreign jurisdictions on its foreign source income would generally be available as a credit against its U.S. income tax liability under section 901 of the Internal Revenue Code of 1954, there is always the possibility, as was pointed out to the committee by Assistant Secretary Surrey, that such credit may be lost using the "per country" limitation method where a foreign jurisdiction uses different concepts to define "source of income" than the United States. While this possibility would be more remote using the "overall" limitation method there are obviously circumstances which would discourage a company from making an election to use the "overall" limitation method, which may only be revoked with permission of the Secretary of the Treasury or his delegate.

Although the only detriment to TWA, other than the numerous difficulties involved in foreign tax administration, if there were no such tax exemption, would be the possible loss of credit for foreign income taxes as indicated above, there is the U.S. balance-of-payments problem which results from payment of income tax by a U.S. corporation to a foreign jurisdiction. TWA has been taking vigorous steps to cooperate with the Government in its fight against the dollar drain. When any U.S. corporation pays income taxes to a foreign jurisdiction where exemption might have been possible, the result is a dollar loss to the extent of the credit for foreign income taxes which will subsequently be claimed against the company's U.S. income tax liability.

We believe that the exemption of international transportation enterprise profits is highly desirable both from the standpoint of our company's financial interests and with respect to the U.S. balance-of-payments problem. We respectfully urge your committee to report favorably recommending ratification by the Senate.

Sincerely,

J. WOODROW THOMAS, *Vice President.*

## APPENDIX

89TH CONGRESS }  
1st Session }

SENATE

{ EXECUTIVE  
E

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### INCOME-TAX CONVENTION WITH THAILAND

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### MESSAGE

FROM

### THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THAILAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME, SIGNED AT BANGKOK ON MARCH 1, 1965

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JULY 29, 1965.—Convention was read the first time and, together with the message and accompanying papers, was referred to the Committee on Foreign Relations and was ordered to be printed for use of the Senate

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THE WHITE HOUSE,  
July 29, 1965.

*To the Senate of the United States:*

With a view to receiving the advice and consent of the Senate to ratification, I transmit herewith the convention between the United States of America and Thailand for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Bangkok on March 1, 1965.

I transmit also, for the information of the Senate, the report of the Secretary of State with respect to the convention.

In view of the desirability of concluding tax conventions with various developing countries, technical discussions have been in progress with the authorities of a number of such countries for this purpose. Although such conventions are expected to follow, in general, the pattern of tax conventions presently in force between the United States and a considerable number of other countries, attention is being

given in the discussions with authorities of the developing countries to the possibility of including in the contemplated conventions special provisions aimed at facilitating trade and investment and encouraging joint ventures. The United States will benefit in each case by having a convention containing desirable provisions relating to business and investment income and the equitable treatment of U.S. citizens, residents, and corporations in the matter of income taxation.

The convention with Thailand is one of the contemplated series of such conventions with developing countries. The convention contains provisions similar to provisions in existing U.S. income tax conventions. It contains some provisions, however, for which there is no parallel in such existing conventions. One of the principal provisions of this kind is that under which U.S. residents and corporations investing in qualifying Thai enterprises would be allowed to claim as a credit against their U.S. income tax 7 percent of their investment in such enterprises as an incentive to private investment in Thailand. Likewise, U.S. residents and corporations would be granted an election to defer tax on income resulting from the transfer of property, technical services, or information concerning industrial, commercial, or scientific knowledge, experience, or skill to a Thai corporation in exchange for its stock. The application of all such provisions is subject to prescribed conditions and limitations.

The convention contains provisions relating to exemptions or credits with respect to taxes on various types of income, including commercial and industrial profits and income derived from the operation of aircraft and ships. It contains a limited reciprocal provision with respect to the rate of tax on dividends. It provides for exemption from tax of interest received by the Government of one of the contracting states or any of its wholly owned agencies or instrumentalities. It contains provisions relating to cultural and industrial royalties, income from real property, natural resource royalties, income from personal services, remuneration received by teachers, remittances or certain other payments to students and trainees, and governmental salaries, wages, pensions, annuities, or similar benefits. It contains provisions relating to deductions for charitable contributions made by U.S. citizens, residents, and corporations to qualifying Thai organizations.

In addition to the provisions regarding tax exemptions and credits, the convention contains provisions substantially similar to provisions in existing U.S. tax conventions with respect to cooperation between the officials of the two countries for the exchange of information and for limited assistance in collection.

The convention has the approval of the Department of State and the Department of the Treasury.

LYNDON B. JOHNSON.

(Enclosures: (1) Report of the Secretary of State; and (2) income tax convention with Thailand, signed March 1, 1965.)

DEPARTMENT OF STATE,  
*Washington, July 17, 1965.*

THE PRESIDENT,  
*The White House.*

I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the convention between the United States of America and Thailand for the avoidance

of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Bangkok on March 1, 1965.

This convention, the purposes of which are to avoid double taxation, of income, prevent fiscal evasion, facilitate trade and investment, and encourage joint ventures, is one of a contemplated series of income tax conventions with developing countries. The convention follows, in general, the pattern of income tax conventions now in force between the United States and numerous other countries in that it contains provisions dealing with such matters as (1) the taxation of business income, (2) items of investment income, (3) the allocation of expenses to income-producing activities in both countries, (4) reciprocal allowances of a foreign tax credit to afford relief from double taxation of the citizens, residents, and corporations of one country deriving income from sources within the other country, (5) exchange of information and consultative procedures to give effect to the convention with a view to assuring the benefits thereof to those entitled to such benefits, and (6) a national treatment provision to preclude discriminatory tax treatment of the citizens of one country residing in the other country and of the enterprises of one country engaged in business in, or controlled by citizens, residents, or corporations of, the other country. The convention provides rules for determining net income for purposes of the imposition of tax by each country; for example, it provides that a resident or corporation of one country engaged in business within the other country may deduct expenses incurred within or without such other country which are directly related to the business so conducted. In these and various other respects, the convention affords a measure of certainty to business enterprises of both countries.

Apart from provisions similar to those found in other tax conventions of the United States, the convention with Thailand includes some exceptional provisions designed specifically to encourage investment in Thailand by U.S. residents and corporations (art. 5). U.S. residents and corporations investing in qualifying Thai enterprises would be allowed to claim as a credit against their U.S. income tax 7 percent of their investment in such enterprises. Such investment may include not only original investment, but also in certain circumstances, earnings accumulated by the Thai enterprise. Under present U.S. tax laws, there is allowed a 7-percent credit for investment by U.S. taxpayers in certain types of business property located in this country. The treaty provision is intended to extend this principle in order to allow a similar incentive to private investment in Thailand. There is also a provision for recapture of the credit in certain circumstances. There is no similar provision in any existing tax convention of the United States.

Unlike existing tax conventions of the United States, the convention with Thailand contains a provision whereby U.S. residents and corporations would be granted an election to defer tax on income resulting from the transfer of property, technical services, or know-how to a Thai corporation in exchange for its stock (art. 6). This is intended to enable U.S. investors to furnish property, services, or know-how to a Thai corporation without being required, in either of the two countries, to pay tax at the time of such transfer. The tax thus deferred may be imposed when the stock which is received tax free is eventually disposed of.

The convention would allow U.S. citizens, residents, or corporations to deduct from their taxable income subject to U.S. tax amounts donated to a qualifying Thai charitable organization (art. 18). Similar provisions are included in the existing income tax conventions with Canada and Honduras and in the income tax convention with the Philippines recently signed but not in force.

In view of the fact that a less developed country derives limited amounts of income from sources in developed countries and that the usual restrictions on taxation at the source would tend to benefit the developed country without compensating benefits to the less developed country, the convention with Thailand does not include all of the limitations on tax at the source which are usually included in such conventions between developed countries. Consequently, the convention provides for only a limited mutual restriction with respect to withholding tax rates on dividends, provides a narrow reciprocal exclusion from tax on interest, and provides only a limited reduction of tax on income from international shipping. The convention provides, however, for a reciprocal exemption from tax on the operations of aircraft in international traffic and a general limitation on the taxation of royalty income.

Article 1 describes the taxes which are the subject of the convention. For the United States, the convention applies so the Federal income tax, including surtax, not including the tax on improperly accumulated earnings or the personal holding company tax. The convention does not apply to State income taxes except insofar as discriminatory taxes are concerned and treated in article 23. For Thailand, the convention applies to its income tax.

Articles 2 and 3 define various terms used in the convention. The comprehensive definition of "permanent establishment" is set forth in article 3.

Article 4 provides a reciprocal exemption from tax in one country with respect to industrial or commercial profits of a resident or corporation of the other country, subject to prescribed conditions.

Article 5 contains the provisions regarding investment credit whereby, subject to prescribed terms and requirements, a U.S. resident or corporation shall be entitled to a 7-percent investment credit against his U.S. income tax for investment in Thailand. The credits allowed under this article may not exceed the amount of U.S. property, as defined in paragraph (5)(a), invested by the resident or corporation in the eligible corporation. If more than one U.S. resident or corporation qualifies for the benefits of the article with respect to a single eligible corporation, the limitation is determined separately for each such resident or corporation.

Article 6 contains the provisions relating tax deferral for technical assistance. It provides a reciprocal deferral of tax on gain otherwise recognized by either of the two countries on the receipt of stock by a resident or corporation of one country from a corporation of the other country. The benefits of the article apply only where the resident or corporation of one country receives stock, or rights to acquire stock, of a corporation of the other country in consideration for specified types of property, services, or information supplied by such recipient resident or corporation to the corporation of the other country. A U.S. resident or corporation making the election under this article may defer the recognition of gain on the transfer of the specified

property, services, or information without regard to the provisions of sections 351 and 367 of the Internal Revenue Code of 1954.

Article 7 provides, in paragraph (1), a reciprocal exemption from tax in one country with respect to income of a resident or corporation of the other country derived from the operation of aircraft in international traffic and provides, in paragraph (2), a reciprocal 50-percent reduction in tax in one country with respect to income of a resident or corporation of the other country derived from the operation of ships in international traffic.

Article 8 deals with related enterprises and provides that where an enterprise of one country and any other enterprise are related, within the meaning of paragraph (3), and such related enterprises make arrangements or impose conditions between themselves which are different from those which would be made between independent persons, then any income which would, except for those arrangements or conditions, have accrued to one of the enterprises but, by reason of those arrangements or conditions, has not so accrued, may be included in the income of such enterprise and taxed accordingly.

Article 9 relates to the taxation of dividends and provides, subject to prescribed conditions, for a maximum tax rate of 20 percent of the gross amount of dividends paid by a corporation of one country to a corporation of the other country. The provisions in this article are more narrow than corresponding provisions in most U.S. tax conventions in that the reduction in tax rate applies only in the case of dividends paid by a corporation in one country to a corporation in the other country which does not have a permanent establishment in the country of the paying corporation, and then only if the recipient corporation has owned for at least 6 months 25 percent or more of the voting stock of the corporation paying the dividends.

Article 10 provides that interest received by the Government of one country, or by any agency or instrumentality wholly owned by it, shall be exempt from tax by the other country.

Article 11 provides, subject to prescribed conditions, that the rate of tax imposed by one country on royalties, excluding natural resource royalties, received by a resident or corporation of the other country not having a permanent establishment in the country imposing the tax shall not exceed 15 percent of the gross amount thereof. The term "royalties" is defined for the purposes of the article.

Article 12 provides that a resident or corporation of one country subject to tax in the other country on income from real property, including gains from the sale or exchange of such property, or on royalties in respect of the operation of mines, quarries, or other natural resources, may elect for any taxable year to compute such tax on such income on a net basis.

Article 13 contains the provisions relating to income from personal services. Subject to prescribed conditions, a reciprocal exemption from tax with respect to personal service income is provided. The general exemption applies only to individuals earning income from the performance of personal services in an independent capacity. There is a special provision with respect to public entertainers, such as athletes, musicians, and actors. Individual public entertainers who are residents of one country and who receive income for services performed in the other country would remain taxable within such other country to the extent that such income exceeds an average of \$100

(or its baht equivalent) for each day the individual is present or if the aggregate amount received for the services exceeds \$3,000 (or its baht equivalent).

Articles 14 and 15 contain provisions for the promotion of cultural exchanges. Article 14 relates to the reciprocal exemption from tax on the personal service income of visiting teachers, subject to prescribed conditions. Article 15 relates to the reciprocal exemption from tax on certain items of income in the cases of students and trainees, subject to prescribed conditions.

Article 16 provides a reciprocal exemption from tax for wages, salaries, and similar compensation, and for pensions, annuities, or similar benefits, paid by, or from public funds of, one of the countries or a political subdivision thereof to an individual who is a national of that country for services rendered to that country or to any of its political subdivisions in the discharge of governmental functions. In applying this article, U.S. social security payments would not be considered as compensation paid by the United States for services rendered to the United States.

Article 17 lays down rules applicable to the "personal service articles," namely, articles 13 (income from personal service), 14 (teachers), 15 (students and trainees), and 16 (governmental salaries). It is provided that the exceptions provided in those articles shall not extend to individuals who are citizens of or have immigrant status in the country granting the benefits and that reimbursed travel expenses will be considered income from personal services but will not be taken into account in determining whether the maximum income exemptions in articles 13 and 15 have been exceeded. It is provided further that, if an individual qualifies for the benefits of more than one of the provisions in articles 13, 14, and 15, he may select the application of that provision most favorable to him, but he may not claim benefits of more than one provision in any taxable year.

Article 18 relates to the deduction for charitable contributions. It provides that, in computing taxable income for purposes of the U.S. income tax, a U.S. citizen, resident, or corporation may deduct contributions made to qualifying charitable organizations in Thailand, subject to prescribed conditions.

Article 19 provides that a resident or corporation of one country shall be taxable in the other country only on income derived from sources within such other country, then specifies various items of gross income which are to be treated, for this purpose, as income from sources within one or the other of the countries.

Article 20 provides that interest, dividends, or compensation for personal services performed aboard ships or aircraft considered under article 19 (1) (a), (b), or (c) to be from sources within one of the countries shall be exempt from tax by the other country, except as otherwise provided in article 29. The purpose of this provision is to extend the application of the source rules to persons not citizens, residents, or corporations of either of the two countries but receiving items of specific income from sources within one of the two countries.

Article 21 provides that no provision of the convention is to be construed so as to restrict in any manner any exclusion, exemption, deduction, credit, or other allowance presently or subsequently accorded (1) by the laws of one country in determining the tax im-

posed by that country or (2) by any other agreement between the two countries.

Article 22 is the credit article. It is provided that each country is to allow a foreign tax credit for the appropriate amount of taxes paid to the other country. Subparagraph (a) relates to the credit to be allowed against U.S. tax. Subparagraph (b) relates to the credit to be allowed against Thai tax. Although applying reciprocally the principle of allowing a foreign tax credit for taxes paid to the other country, the article provides flexibility with respect to the technical formulation of the credit rules.

Article 23 contains the nondiscrimination (national treatment) provisions. A national of one country who is a resident of the other country is not to be subjected in such other country to more burdensome taxes than is a national of such other country who is resident therein. Essentially the same principle is applied in regard to the treatment of (1) a permanent establishment which a national or corporation of one country has in the other country and (2) a corporation the capital of which is wholly or partly owned by one or more nationals or corporations of the other country.

Articles 24 (consultation and taxpayer claims), 25 (exchange of information), 26 (assistance in collection), 27 (exchange of legal information), and 28 (taxpayer claims) contain provisions relating to administrative cooperation and assistance with a view to preventing fiscal evasion and also preventing double taxation contrary to the convention. These provisions are substantially along the lines of provisions in existing income tax conventions of the United States.

Article 29 provides that, regardless of any other provision of the convention, the United States may tax individuals who are citizens or residents of the United States and U.S. corporations, and Thailand may tax individuals who are residents of Thailand and Thai corporations, as if the convention had not come into effect. It is provided further, however, that these provisions are not to be construed to deny the benefits conferred by certain articles of the convention, namely, (1) in the case of the United States, articles 5, 6, 13, 14, 15, 16, 17, 18, 19, 22, and 23; and (2) in the case of Thailand, articles 6, 13, 14, 15, 16, 17, 19, 22, and 23.

Article 30 provides for ratification and the exchange of instruments of ratification and prescribes that the convention shall have effect (1) in the case of U.S. taxes, for taxable years beginning on or after January 1 of the year following that in which the exchange takes place, and (2) in the case of Thai taxes, for taxable years or accounting periods beginning on or after January 1 of the year following that in which the exchange takes place. Special provisions are included, however, with respect to the effectiveness of articles 5 and 6. It is provided that the convention shall continue in effect indefinitely, but may be terminated by either party at any time after 5 years from the date of entry into force of the convention, provided that prior notice of at least 6 months has been given for that purpose, in which event the convention shall cease to be effective as to United States and Thai taxes according to a specified formula.

The convention has the approval of the Department of State and the Department of the Treasury. The Department of the Treasury will be prepared to supply further details on the convention and an-

swer any questions that may be raised by the Senate in connection with its consideration thereof.

Respectfully submitted.

DEAN RUSK.

(Enclosure: Income tax convention with Thailand, signed March 1, 1965.)

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THAILAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of Thailand,

Desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,

Have agreed as follows:

ARTICLE 1

TAXES COVERED

(1) The taxes which are the subject of the present Convention are:

(a) In the case of the United States, the Federal income tax, including surtax, imposed by the Internal Revenue Code (but not including the tax on improperly accumulated earnings or the personal holding company tax).

(b) In the case of Thailand, the income tax imposed by the Revenue Code.

(2) The present Convention shall also apply to taxes substantially similar to those covered by paragraph (1) of this Article which are subsequently imposed in addition to, or in place of existing taxes.

(3) For the purpose of Article 23, this Convention shall also apply to taxes of every kind, whether imposed at the national, state or local level.

ARTICLE 2

GENERAL DEFINITIONS

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States thereof and the District of Columbia;

(b) The term "Thailand" means the Kingdom of Thailand;

(c) The terms "one of the Contracting States" and "the other Contracting State" mean the United States or Thailand, as the context requires;

(d) The term "person" comprises an individual, a corporation and any other body of individuals or persons;

(e) The term "United States corporation" means a corporation, or any entity treated as a corporation for United States

tax purposes, which is created or organized under the laws of the United States or any State thereof or the District of Columbia;

(f) The term "Thai corporation" means a company created or organized under the laws of Thailand or any other kind of juridical person created or organized under the laws of Thailand, or any body or group of persons without juridical personality if such person, or such body or group of persons, is taxed in Thailand in substantially the same manner as a company created or organized under the laws of Thailand;

(g) The terms "resident or corporation of one of the Contracting States" and "resident or corporation of the other Contracting State" mean a resident or corporation of the United States or a resident or corporation of Thailand, as the context requires;

(h) The term "competent authority" means;

(i) in the United States, the Secretary of the Treasury or his delegate;

(ii) in Thailand, the Minister of Finance or his authorized representative.

(2) As regards the application of the present Convention by a Contracting State, any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of the present Convention.

### ARTICLE 3

#### DEFINITION OF PERMANENT ESTABLISHMENT

(1) The term "permanent establishment" means a fixed place of business through which a resident or corporation of one of the Contracting States engages in trade or business.

(2) The term "a fixed place of business" includes, but is not limited to, an office; a store or other sales outlet; a workshop; a factory; a warehouse; a mine, quarry or other place of extraction of natural resources; a building, construction or installation site.

(3) Notwithstanding paragraph (1) of this Article, a permanent establishment shall not include sites or facilities used only for one or more of the following activities:

(a) for the processing by another person of goods or merchandise belonging to the resident or corporation;

(b) for the purchase of goods or merchandise for the account of the resident or corporation;

(c) for the storage and/or delivery of goods belonging to the resident or corporation, other than goods or merchandise—

(i) held for sale by such resident or corporation in a store or other sales outlet; or

(ii) purchased and resold in that Contracting State by the resident or corporation, or by an independent agent or agents for or on behalf of the resident or corporation;

(d) for the collection of information for the resident or corporation;

(e) for advertising, the conduct of scientific research, the display of goods or merchandise, or the supply of information if

such activities have a preparatory and auxiliary character in the trade or business of the resident or corporation;

(f) for construction, assembly or installation projects if the site or facilities are used for such purpose for less than three months.

(4) Even if a resident or corporation of one of the Contracting States does not have a permanent establishment in the other Contracting State under paragraphs (1)-(3) of this Article, nevertheless he shall be deemed to have a permanent establishment in the latter State if he engages in trade or business in that State through an agent who—

(a) has an authority to conclude contracts in the name of that resident or corporation and regularly exercises that authority in the latter State unless the exercise of its authority is limited to the purchase of goods or merchandise;

(b) regularly secures orders in the latter State for that resident or corporation; or

(c) maintains in the latter State a stock of goods or merchandise belonging to that resident or corporation from which he regularly makes deliveries.

(5) Notwithstanding paragraph (4) of this Article, a resident or corporation of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it uses the services in that State of a bona fide broker, general commission agent, forwarding agent, custodian or other agent of independent status acting in the ordinary course of its business. For this purpose, an agent shall not be considered to be an agent or independent status if it acts as an agent exclusively or almost exclusively for the resident or corporation (or for that resident of corporation and any other person controlling, controlled by, or under common control with that resident or corporation) and carries on any of the activities described in paragraph (4) of this Article.

(6) The fact that a corporation of one of the Contracting States controls or is controlled by or is under common control with (a) a corporation of the other Contracting State or (b) a corporation which engages in trade or business in that other Contracting State (whether through a permanent establishment or otherwise), shall not be taken into account in determining whether the activities or fixed place of business of either corporation constitutes a permanent establishment of the other corporation.

(7) A resident or corporation of one of the Contracting States shall be deemed to have a permanent establishment in the other Contracting State if that resident or corporation provides the services in the latter State of public entertainers referred to in Article 13, paragraph (3).

(8) If a resident or corporation of one of the Contracting States has a permanent establishment in the other Contracting State at any time during the taxable year, it shall be considered to have a permanent establishment in that other Contracting State for the entire taxable year.

## ARTICLE 4

## BUSINESS PROFITS

(1) A resident or corporation of one of the Contracting States shall be exempt from tax in the other Contracting State with respect to its industrial or commercial profits if that resident or corporation has no permanent establishment in that other Contracting State.

(2) If a resident or corporation of one of the Contracting States has a permanent establishment in the other Contracting State, tax may be imposed by the other Contracting State on all industrial or commercial profits of that resident or corporation from sources within that other Contracting State.

(3) In the determination of the industrial or commercial profits of a resident or corporation of one of the Contracting States having a permanent establishment in the other Contracting State there shall be allowed as deductions expenses which are reasonably connected with such profits, including executive and general administrative expenses wherever incurred.

(4) No profits shall be deemed to be derived from sources within the Contracting State in which a permanent establishment is located merely by reason of the purchase of goods or merchandise.

## ARTICLE 5

## INVESTMENT CREDIT

(1) A resident of the United States or a United States corporation owning at least 25 percent of the total combined voting power of the stock of an eligible corporation (as defined in paragraph (2)) shall be entitled to credit against the amount of United States income taxes otherwise payable for the taxable year an amount equal to 7 percent of (a) the new investments made by such person in the eligible corporation during such year, and (b) such person's pro rata share of the creditable reinvested earnings of the eligible corporation. The creditable reinvested earnings of an eligible corporation for a taxable year shall be an amount equal to one-half of its earnings and profits for the year, reduced by the amount of any dividends distributed during such year. The credits allowed to a resident of the United States or a United States corporation under this paragraph shall not, however, exceed the amount of United States property invested by such person in the eligible corporation (either as new investments or through purchase by the eligible corporation out of such person's pro rata share of reinvested earnings).

(2) A United States corporation or a Thai corporation shall be an eligible corporation if at least 80 percent of its gross income, if any, for the taxable year is derived from the active conduct of one or more of the qualified trades or businesses described in paragraph (3) and on each day of the taxable year at least 80 percent in value of its assets consist of assets (including assets located outside Thailand) used or held for use in connection with such trades or businesses.

(3) For the purposes of this Article, a qualified trade or business shall be any trade or business conducted within Thailand and consisting of:

(a) the manufacture or production of property (not including the extraction, refining, or similar processing of any mineral, ore, oil or gas) or the processing of agricultural or horticultural products or commodities (including but not limited to livestock, poultry, fur-bearing animals or any kind of fish);

(b) the marketing of agricultural or horticultural products or commodities (including but not limited to livestock, poultry, fur-bearing animals or any kind of fish);

(c) the furnishing or sale of electrical energy, water, gas (if furnished through a local distribution system), sewage disposal services, public transportation, telephone service or telegraph service;

(d) the catching or taking of any kind of fish;

(e) the sale of tangible personal property to the general public through one or more retail establishments; or

(f) the performance of services utilized within Thailand, if the services are industrial, financial, technical, scientific, engineering or architectural in nature or are rendered as an incident of a trade or business of the kind described in (a) through (e), and any payments in consideration of such services are reasonable in amount and are not contingent either in whole or in part on the sales, productivity, or profits of the person for whom these services are performed.

(4) If a resident of the United States or a United States corporation described in paragraph (1) directly or indirectly withdraws any property from an eligible corporation, the United States income taxes otherwise payable by such United States resident or corporation for the year of withdrawal shall be increased by an amount not exceeding (i) 7 percent of the amount of property deemed to have been withdrawn or (ii) the amount by which United States income taxes of such resident or corporation have been reduced (or otherwise would be reduced) under the provisions of paragraph (1) by reason of investments made in the eligible corporation in the year in which the property is withdrawn, in any of the three preceding years or in the next succeeding year, whichever amount is less. A resident of the United States or a United States corporation shall be considered to withdraw property from an eligible corporation if—

(a) the eligible corporation makes any distribution of property to such person or to any person who is a related person with respect to such investor and such distribution is either (i) not out of earnings and profits or (ii) is out of earnings and profits, but only to the extent that such distribution exceeds the amount which would have constituted reinvested earnings, within the meaning of paragraph (1), had there been no such distribution;

(b) the eligible corporation pays (or any person pays on its behalf) all or any part of an indebtedness to such person or to any person who is a related person with respect to such investor;

(c) such person disposes of stock in, or an indebtedness of, the eligible corporation or a corporation which is a related person with respect to such investor and which owns stock or indebtedness in the eligible enterprise;

(d) a corporation which is a related person with respect to such investor and which owns stock or indebtedness in the eligible corporation disposes of all or part of such stock or indebtedness. If an eligible corporation ceases to be eligible or if a resident of the United States or a United States corporation ceases to own 25 percent of the stock of an eligible corporation as set forth in paragraph (1), such person will be deemed to have disposed of his entire interest in the eligible corporation. For purposes of this paragraph, a withdrawal of property shall be considered a withdrawal from the eligible corporation if the withdrawal is made from another corporation conducting in Thailand a trade or business similar or related to a trade or business conducted in Thailand by the eligible corporation and if the United States person making the withdrawal owns at least 25 percent of the total combined voting power of the stock of such other corporation.

(5) For purposes of this Article—

(a) The term "United States property" means any tangible personal property which has been manufactured, constructed, produced, grown or extracted in the United States and thereafter continuously used, if at all, only in the United States; and

(b) The term "new investment" means the transfer of money or tangible personal property by a resident of the United States or a United States corporation to the eligible corporation, other than in satisfaction of a pre-existing indebtedness, but only to the extent that—

(i) the asset does not represent, directly or indirectly, funds borrowed within Thailand;

(ii) immediately following the transfer, the asset is used or held for use by the eligible corporation in the conduct of a qualified trade or business; and

(iii) such resident or corporation does not receive, in the taxable year in which the transfer is made, payment in consideration thereof (other than payment in the form of stock or indebtedness of the eligible corporation).

(6) The credit against United States income taxes provided in paragraph (1) shall be subject to such regulations as are prescribed by the Secretary of the Treasury of the United States or his delegate to effectuate the provisions of this Article and to further define and determine the terms, conditions and amounts referred to herein.

## ARTICLE 6

### TAX DEFERRAL FOR TECHNICAL ASSISTANCE

(1) If a resident or corporation of one of the Contracting States provides to a corporation of the other Contracting State for use in connection with a trade or business actively conducted by the latter corporation in that other Contracting State any (i) patent, invention, model, design, secret formula or process, or similar property right, (ii) information concerning industrial, commercial or scientific knowledge, experience or skill or (iii) technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial or like services, and if in consideration thereof such person receives from the latter corporation its stock, or rights to acquire its stock, such person

may elect not to include in income for purposes of United States taxes and Thai taxes which are the subject of this Convention any amount otherwise includible by reason of the receipt thereof. In that event, otherwise deductible expenses incurred in the transaction shall not be currently deducted to the extent that they are allocable to amounts excluded from income as provided in this Article. If the stock or rights so received are thereafter disposed of, the amount so excluded (or, if such stock is sold or exchanged for less than such amount, the amount received upon the sale or exchange) shall then be included in income in the manner in which it would have been included upon receipt of such stock or rights. The deductions disallowed by reason of this Article shall be allowed upon a disposition of the stock or rights so received and any gain upon such disposition shall be determined as if such amount had been included in income, and such deductions allowed, upon receipt of such stock or rights. For purposes of this paragraph, the exercise of rights to acquire stock shall not be considered a disposition and no amount shall be included in income (nor any deductions allowed) until the stock acquired upon such exercise is thereafter disposed of.

(2) (a) With respect to United States taxes, the provisions of this Article shall be subject to such regulations as are prescribed by the Secretary of the Treasury of the United States or his delegate to effectuate the provisions of this Article and to further define and determine the terms, conditions and amounts referred to herein.

(b) With respect to Thai taxes, the provisions of this Article shall be subject to such regulations as are prescribed by the Minister of Finance or his authorized representative to effectuate the provisions of this Article and to further define and determine the terms, conditions and amounts referred to herein.

(c) To the extent provided by applicable regulations, a portion of any stock to which this Article applies may be required to be deposited with a bank or other depository for the purpose of assuring collection of the taxes payable under this Article upon disposition of the stock.

## ARTICLE 7

### SHIPPING AND AIR TRANSPORT

(1) (a) Income which a resident or corporation of the United States derives from the operation in international traffic of aircraft registered in the United States shall be exempt from taxation in Thailand.

(b) Income which a resident or corporation of Thailand derives from the operation of aircraft in international traffic shall be exempt from taxation in the United States.

(2) (a) The amount of tax imposed by Thailand on income derived by a resident or corporation of the United States from the operation in international traffic of ships registered in the United States shall be reduced to 50 percent of the amount which would have been imposed in the absence of this Convention.

(b) The amount of tax imposed by the United States on income derived by a resident or corporation of Thailand from the operation of ships in international traffic shall be reduced to 50 percent of the amount which would have been imposed in the absence of this Convention.

## ARTICLE 8

## RELATED ENTERPRISES

(1) Where conditions are made or imposed between two related enterprises which differ from those which would be made between independent enterprises, then any income which would, but for these conditions, have accrued to one of the enterprises but, by reason of those conditions, has not so accrued, may be included in the income of that enterprise and taxed accordingly.

(2) In determining the income of an enterprise, deductions shall be allowed for amounts paid to a related enterprise for services, including managerial or administrative services, if they would be allowed if paid to an unrelated enterprise, but only in an amount which does not exceed the amount which would be charged by an unrelated enterprise for the same or similar services under the same or similar conditions.

(3) For purposes of this Article, an enterprise is related to another enterprise if either enterprise participates directly or indirectly in the management, control or capital of the other, or if any person or persons participate directly or indirectly in the management, control or capital of both enterprises.

(4) For purposes of this Article, an "enterprise" means a corporation, partnership or other entity, or the income producing activity of an individual (including an individual in his individual or his fiduciary capacity, or as a member of a partnership).

## ARTICLE 9

## DIVIDENDS

The rate of tax imposed by one of the Contracting States on dividends paid by a corporation of that Contracting State to a corporation of the other Contracting State not having a permanent establishment in the former Contracting State shall not exceed 20 percent of the gross amount thereof if the recipient corporation has owned not less than 25 percent of the voting stock of the paying corporation for at least six months immediately prior to the date on which the dividend becomes payable.

## ARTICLE 10

## INTEREST

Interest received by the Government of one of the Contracting States or any agency or instrumentality wholly owned by that Government shall be exempt from tax by the other Contracting State.

## ARTICLE 11

## ROYALTIES

(1) The rate of tax imposed by one of the Contracting States on royalties received by a resident or corporation of the other Contracting State not having a permanent establishment in the former Contracting State shall not exceed 15 percent of the gross amount thereof.

(2) For the purposes of this Article, the term "royalties" means any royalties, rentals or other amounts paid as consideration for the use of, or the right to use:

(a) copyrights, artistic or scientific works, patents, designs, plans, secret processes or formulae, trademarks, motion picture films, films or tapes for radio or television broadcasting, or other like property or rights, or

(b) information concerning industrial, commercial or scientific knowledge, experience, or skill.

The term does not include any royalties, rentals or other amounts paid in respect of the operation of mines, quarries or other natural resources.

(3) For purposes of this Article, the term "royalties" shall also include income derived from the alienation of property or information described in paragraph (2). In respect of such income, a resident or corporation of one of the Contracting States, being subject to tax in the other Contracting State, may elect for any taxable year to compute the tax on such income on a net basis as if such resident or corporation were engaged in trade or business in that other Contracting State.

## ARTICLE 12

### INCOME FROM REAL PROPERTY

A resident or corporation of one of the Contracting States subject to tax in the other Contracting State on income from real property, including gains derived from the sale or exchange of such property, or on royalties in respect of the operation of mines, quarries, or other natural resources may elect for any taxable year to compute that tax on such income on a net basis as if such resident or corporation were engaged in trade or business in that other Contracting State.

## ARTICLE 13

### INCOME FROM PERSONAL SERVICES

(1) An individual who is a resident of one of the Contracting States shall be exempt from tax by the other Contracting State with respect to income from personal services if—

(a) he is present within the latter Contracting State for a period or periods not exceeding in the aggregate 180 days during the taxable year, and

(b) such income is not deducted in computing profits subject to tax in the latter Contracting State, and

(c) in the case of employment income, the services are performed as an employee of a resident or corporation of the former Contracting State.

(2) For purposes of paragraph (1) of this Article, the term "income from personal services" includes employment income and income earned by an individual from the performance of personal services in an independent capacity. The term "employment income" includes income from services performed by officers and directors of corporations, but does not include income from personal services performed by partners which shall be treated as income from the performance of services in an independent capacity.

(3) Notwithstanding paragraph (1) of this Article, the income from personal services of public entertainers, such as athletes, musicians and actors, from their activities as such, may be taxed in the Contracting State in which the services are performed if such income exceeds either \$100 (or its equivalent in Baht) for each day the individual is present in the latter Contracting State or an aggregate amount of \$3,000 (or its equivalent in Baht).

#### ARTICLE 14

##### TEACHERS

An individual who is a resident of one of the Contracting States at the beginning of his visit to the other Contracting State and who, at the invitation of the Government of the other Contracting State or of a university or other accredited educational institution situated in the other Contracting State, visits the latter Contracting State for the purpose of teaching or engaging in research, or both, at a university or other accredited educational institution shall be exempt from tax by the latter Contracting State on his income from personal services for teaching or research at such educational institution, or at other such institutions, for a period not exceeding two years from the date of his arrival in the latter Contracting State.

#### ARTICLE 15

##### STUDENTS AND TRAINEES

(1) (a) An individual who is a resident of one of the Contracting States at the beginning of his visit to the other Contracting State and who is temporarily present in the other Contracting State for the primary purpose of—

(i) studying at a university or other accredited educational institution in that other Contracting State,

(ii) securing training necessary for qualification in a medical profession, or

(iii) studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary or educational organization,

shall be exempt from tax by that other Contracting State with respect to—

(A) gifts from abroad for the purposes of his maintenance, education, study, research or training;

(B) the grant, allowance, or award; and

(C) income from personal services performed in the other Contracting State in an amount not in excess of \$2,000 or its equivalent in Baht for any taxable year; or, if such individual is securing training necessary for qualification in a medical profession, not in excess of \$5,000 or its equivalent in Baht for any taxable year.

(b) The benefits under this paragraph shall only extend for such period of time as may be reasonably or customarily required to effectuate the purpose of the visit, but in no event shall any individual have the benefits of this paragraph for more than five taxable years.

(2) A resident of one of the Contracting States who is present in the other Contracting State for a period not exceeding one year, as an employee of, or under contract with, a resident or corporation of the former State, for the primary purpose of—

(i) acquiring technical, professional, or business experience from a person other than that resident or corporation of the former State, or

(ii) studying at a university or other accredited educational institution in that other Contracting State,

shall be exempt from tax by that other Contracting State with respect to his income from personal services performed in the other Contracting State for that period in an amount not in excess of \$5,000 or its equivalent in Baht.

(3) A resident of one of the Contracting States who is present in the other Contracting State for a period not exceeding one year, as a participant in a program sponsored by the Government of the other Contracting State, for the primary purpose of training, research, or study shall be exempt from tax by that other State with respect to his income from personal services performed in that other Contracting State and received in respect of such training, research, or study in an amount not in excess of \$10,000 or its equivalent in Baht.

#### ARTICLE 16

##### GOVERNMENTAL SALARIES

Wages, salaries, and similar compensation, and pensions, annuities, or similar benefits paid by, or from public funds of, one of the Contracting States or the political subdivisions thereof to an individual who is a national of that Contracting State for services rendered to that Contracting State or to any of its political subdivisions in the discharge of governmental functions shall be exempt from tax by the other Contracting State.

#### ARTICLE 17

##### RULES APPLICABLE TO PERSONAL SERVICE ARTICLES

(1) The benefits of Articles 13, 14, 15 and 16 shall not extend to citizens of, nor to individuals having immigrant status in, the Contracting State granting the benefits.

(2) For purposes of Articles 13, 14, 15 and 16, reimbursed travel expenses shall be considered to be income from personal services or compensation, but shall not be taken into account in computing the maximum amount of exemptions specified in Articles 13 and 15.

(3) An individual who qualifies for benefits under more than one of the provisions of Articles 13, 14 and 15 may select the application of that provision most favorable to him, but he shall not be entitled to the benefits of more than one provision in any taxable year.

#### ARTICLE 18

##### DEDUCTION FOR CHARITABLE CONTRIBUTIONS

In the computation of taxable income under the United States income tax, a deduction shall be allowed to citizens and residents of the United States and to United States corporations for contributions to

any organization created or organized under the laws of Thailand which constitutes a charitable organization for purposes of the income tax laws of Thailand if—

- (a) such contributions are used entirely within Thailand; and
- (b) the recipient organization has qualified as a charitable organization under subsection 501(c)(3) of the United States Internal Revenue Code.

Such deduction shall not exceed an amount which would have been allowable under section 170 of the United States Internal Revenue Code if such organization had been created or organized under the laws of the United States and if such contributions were used within the United States.

## ARTICLE 19

### TAXATION AT SOURCE

(1) A resident or corporation of one of the Contracting States shall be taxable in the other Contracting State only on income derived from sources within that other Contracting State. For this purpose, the following items of gross income shall be treated as income from sources within a Contracting State:

(a) Interest paid by that Contracting State, including any local government thereof, or by a resident or corporation of that Contracting State, except that interest paid by a resident or corporation of that Contracting State—

(i) with a permanent establishment outside both Contracting States to a resident or corporation of the other Contracting State, or

(ii) with a permanent establishment in the other Contracting State

directly out of the funds of such permanent establishment on indebtedness incurred for the sole use of, or on banking deposits made with, such permanent establishment shall be treated as income from sources within the State where such permanent establishment is located.

(b) Dividends paid by a corporation of that Contracting State.

(c) Compensation for personal services performed aboard ships or aircraft operated by a resident or corporation of that Contracting State (and, in the case of the United States, registered in the United States), if rendered by a member of the regular complement of the ship or aircraft.

(d) Compensation for personal services performed within that Contracting State (including private pensions or annuities paid in respect of such services) and income from providing personal services performed within that Contracting State.

(e) Rentals from personal property located within that Contracting State.

(f) Royalties for using, or for the right to use, in that Contracting State, property or information described in paragraph 2 of Article 11.

(g) Gain derived from the sale of rights to use property or information described in paragraph 2 of Article 11 if—

(i) the sale takes place within that Contracting State, or

(ii) the sale is a sale of rights to use such property or information within that Contracting State and such rights are acquired by a resident or corporation of that Contracting State or out of the funds of a permanent establishment located in that Contracting State.

(h) Income from real property located in that Contracting State (including gains derived from the sale of such property, but not including interest from mortgages or bonds secured by real property) and royalties from the operation of mines, quarries, or other natural resources located in that Contracting State.

(2) Income from goods produced (in whole or in part) by a taxpayer within one of the Contracting States and sold to a buyer within the other Contracting State shall be allocated in part to the production and in part to the sale. Such allocation shall be made, where possible, by reference to prices and terms agreed upon by independent parties engaged in the same or similar transactions, and otherwise by reference to the part of the aggregate sales and property of the taxpayer within that Contracting State and to other relevant factors. For purposes of this paragraph, the word "produced" includes manufactured, fabricated, extracted, processed, or grown.

(3) With respect to the kinds of income covered by the rules in paragraph (1) of this Article, any income which is not attributed to sources within a Contracting State by such rules shall be treated as income from sources outside that Contracting State.

#### ARTICLE 20

##### EXEMPTION FROM TAX FOR INCOME FROM SOURCES IN OTHER CONTRACTING STATE

Interest, dividends or compensation for personal services performed aboard ships or aircraft which is ascribed by the provisions of subparagraphs (1)(a), (1)(b) or (1)(c) of Article 19 to sources within one of the Contracting States shall be exempt from tax by the other Contracting State, except as otherwise provided by Article 29.

#### ARTICLE 21

##### PROTECTION OF TAXPAYER RIGHTS UNDER OTHER LAW

The provisions of the present Convention shall not be construed to restrict in any manner any exclusion, exemption, deduction, credit or other allowance now or hereafter accorded (a) by the laws of one of the Contracting States in the determination of the tax imposed by that State or (b) by any other agreement between the Contracting States.

#### ARTICLE 22

##### ELIMINATION OF DOUBLE TAXATION

Double taxation shall be avoided in the following manner:

(a) The United States shall allow to a resident or corporation of the United States as credit against its tax specified in subparagraph (1)(a) of Article I the appropriate amount of taxes paid to Thailand. For this purpose, the rules set forth in Article 19 shall be applied to

determine the source of gross income; but, otherwise, the amount of the deduction shall be determined in accordance with the applicable revenue laws of the United States. It is agreed that, by virtue of the provisions of subparagraph (b) of this Article, Thailand has satisfied the similar credit requirement of the Internal Revenue Code with respect to taxes paid to Thailand.

(b) Thailand shall allow to a resident or corporation of Thailand as credit against its tax specified in subparagraph (1)(b) of Article 1 the appropriate amount of taxes paid to the United States. Such appropriate amount shall be based on the amount of tax paid to the United States but shall not exceed that portion of the Thai tax which net income from sources within the United States bears to the entire net income subject to Thai tax. In computing such portion, the rules set forth in Article 19 shall be applied to determine the source of gross income. In determining such entire net income, a loss incurred in any country shall not be taken into account.

## ARTICLE 23

### NONDISCRIMINATION

(1) A national of one of the Contracting States who is a resident of the other Contracting State shall not be subjected in that other Contracting State to more burdensome taxes than is a national of that other Contracting State who is resident therein.

(2) A permanent establishment which a national or corporation of one of the Contracting States has in the other Contracting State shall not be subject in that other Contracting State to more burdensome taxes than is a national or corporation of that other Contracting State carrying on the same activities. This paragraph shall not be construed as obliging either Contracting State to grant to nationals of the other Contracting State not resident in the former Contracting State any personal allowances or deductions which are by its law available only to residents of that former Contracting State.

(3) A corporation of one of the Contracting States, the capital of which is wholly or partly owned by one or more nationals or corporations of the other Contracting State, shall not be subjected in the former Contracting State to more burdensome taxes than is a corporation of the former Contracting State, the capital of which is wholly owned by one or more nationals or corporations of that former Contracting State.

## ARTICLE 24

### CONSULTATION

(1) The competent authorities of the Contracting States may communicate with each other directly for the purpose of giving effect to the provisions of the present Convention. Should any difficulty or doubt arise as to the interpretation or application of the present convention, or its relationship to conventions between one of the Contracting States and any other State, the competent authorities shall endeavour to settle the question as quickly as possible by mutual agreement.

(2) In particular, the competent authorities of the Contracting States may consult together to endeavour to agree—

(a) to the same apportionment of industrial or commercial profits between a resident or corporation of one of the Contracting

States and its permanent establishment situated in the other Contracting State; or

(b) to the same allocation of income between an enterprise and its related enterprise, dealt with in Article 8, and to the appropriate procedures for effectuating such apportionment or allocation.

#### ARTICLE 25

##### EXCHANGE OF INFORMATION

(1) The competent authority of one of the Contracting States shall exchange such information with the competent authority of the other Contracting State as is pertinent to carrying out the provisions of the present convention or preventing fraud or fiscal evasion in relation to the taxes which are the subject of the present Convention.

(2) The competent authority of the Contracting State to which a request for information is made shall not exchange information unless that information would be available under the taxation laws and administrative procedures of that State if the tax of the other State, to which the request for information relates, were the tax of the former State and were being imposed by that State.

(3) Any information exchanged shall be treated as secret and shall not be disclosed to any persons other than those (including a court or administrative body) concerned with the assessment, collection or enforcement of the taxes which are the subject of the present convention.

(4) No information shall be exchanged which would disclose any trade, business, industrial, or professional secret.

#### ARTICLE 26

##### ASSISTANCE IN COLLECTION

(1) Each of the Contracting States shall endeavour to collect such taxes imposed by the other Contracting State as will ensure that any exemption or reduced rate of tax granted under the present Convention by the other State shall not be enjoyed by persons not entitled to such benefits. The Contracting State making such collections shall be responsible to the other Contracting State for the sums thus collected.

(2) In no case shall the provisions of this Article be construed so as to impose upon either of the Contracting States the obligation to carry out administrative measures at variance with the regulations and practices of the Contracting State endeavouring to collect the tax or which would be contrary to that State's sovereignty, security or public policy.

#### ARTICLE 27

##### EXCHANGE OF LEGAL INFORMATION

(1) The competent authorities of the Contracting States shall notify each other of any amendments of the tax laws referred to in Article 1(1) and of the adoption of any taxes referred to in Article 1(2) by transmitting the texts of any amendments or new statutes at least once a year.

(2) The competent authorities of the Contracting States shall exchange the texts of all published material interpreting the present Convention under the laws of the respective States, whether in the form of regulations, rulings or judicial decisions.

(3) The texts transmitted under this Article shall be in the language of the transmitting State.

#### ARTICLE 28

##### TAXPAYER CLAIMS

A taxpayer shall be entitled to present his case to the Contracting State of which he is a citizen or resident, or, if the taxpayer is a corporation of one of the Contracting States, to that State, if he considers that the action of the other Contracting State has resulted, or will result for him in taxation contrary to the provisions of this Convention. Should the taxpayer's claim be considered to have merit by the competent authority of the Contracting State to which the claim is made, it shall endeavour to come to an agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation contrary to the provisions of the Convention.

#### ARTICLE 29

##### SAVINGS CLAUSE

(1) Regardless of any other provision of the present Convention, the United States may tax individuals who are citizens or residents of the United States and United States corporations as if the present Convention had not come into effect. However, this paragraph shall not be construed to deny the benefits conferred by Articles 5, 6, 13, 14, 15, 16, 17, 18, 19, 22 and 23.

(2) Regardless of any other provision of the present Convention, Thailand may tax individuals who are residents of Thailand and Thai corporations as if the present Convention had not come into effect. However, this paragraph shall not be construed to deny the benefits conferred by Articles 6, 13, 14, 15, 16, 17, 19, 22 and 23.

#### ARTICLE 30

##### EFFECTIVE DATES AND RATIFICATION

(1) The present Convention shall be ratified and the instruments of ratification exchanged at Washington as soon as possible.

(2) After the exchange of instruments of ratification, the present Convention shall have effect—

(a) in the case of United States taxes, for taxable years beginning on or after the first day of January of the year following that in which such exchange takes place;

(b) in the case of Thai taxes, for the taxable years or accounting periods beginning on or after the first day of January of the year following that in which such exchange takes place.

(3) Notwithstanding the provisions of paragraph (2) of this Article—

(a) Article 5 shall have effect—

(i) with respect to the credit for new investments, for taxable years beginning on or after the first day of January

of the year in which the exchange of instruments of ratification takes place; and

(ii) with respect to the credit for reinvested earnings of an eligible corporation, to such earnings for taxable years ending after the first day of January of the year in which such exchange takes place.

(b) Article 6 shall have effect with respect to stock or rights to acquire stock received on or after the first day of January of the year in which the exchange of instruments of ratification takes place.

(4) The present Convention shall continue in effect indefinitely, but it may be terminated by either of the Contracting States at any time after five years from the date specified in paragraph (2) of this Article, provided that at least six months' prior notice of termination has been given. In such event, the present Convention shall cease to be effective—

(a) in the case of United States taxes, for taxable years beginning on or after the first day of January next following the expiration of the six-month period;

(b) in the case of Thai taxes, for taxable years or accounting periods beginning on or after the first day of January next following the expiration of the six-month period.

(5) Notwithstanding the provisions of paragraph (4) of this Article—

(a) the benefits provided under Articles 5 or 18 may be terminated by the United States at any time after five years from the date specified in paragraph (2) of this Article.

(b) the benefits provided under Article 6 by either of the Contracting States to residents and corporations of that Contracting State may be terminated at any time after five years from the date specified from the date in paragraph (2) of this Article. If such benefits are terminated, the other Contracting State may terminate benefits provided under Article 6 to residents and corporations of the former Contracting State at any time after termination by the former Contracting State.

(c) any termination under this paragraph shall not prejudice benefits available with respect to transactions entered into prior to such termination.

IN WITNESS WHEREOF the undersigned, having been duly authorized thereto by their respective Governments, have signed the present Convention.

DONE in duplicate at Bangkok on this first day of March, one thousand nine hundred and sixty-five, in the English language.

For the Government of the United States of America:

GRAHAM MARTIN

*Ambassador.*

For the Government of Thailand:

THANAT KHOMAN

*Minister of Foreign Affairs.*

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