TAX PROTOCOLS WITH BELGIUM AND GERMANY

HEARING

BEFORE THE

SUBCOMMITTEE OF THE COMMITTEE ON FOREIGN RELATIONS UNITED STATES SENATE

EIGHTY-NINTH CONGRESS

FIRST SESSION

ON

EXECUTIVE G, 89TH CONGRESS, 1ST SESSION

SUPPLEMENTARY INCOME TAX PROTOCOL WITH BELGIUM

EXECUTIVE I, 89TH CONGRESS, 1ST SESSION

TAX PROTOCOL WITH THE FEDERAL REPUBLIC OF GERMANY

OCTOBER 13, 1965

Printed for the use of the Committee on Foreign Relations

U.S. GOVERNMENT PRINTING OFFICE
54-647 O WASHINGTON : 1965

COMMITTEE ON FOREIGN RELATIONS

J. W. FULBRIGHT, Arkansas, *Chairman*

JOHN SPARKMAN, Alabama
MIKE MANSFIELD, Montana
WAYNE MORSE, Oregon
RUSSELL B. LONG, Louisiana
ALBERT GORE, Tennessee
FRANK J. LAUSCHE, Ohio
FRANK CHURCH, Idaho
STUART SYMINGTON, Missouri
THOMAS J. DODD, Connecticut
JOSEPH S. CLARK, Pennsylvania
CLAIBORNE PELL, Rhode Island
EUGENE J. McCARTHY, Minnesota

BOURKE B. HICKENLOOPER, Iowa
GEORGE D. AIKEN, Vermont
FRANK CARLSON, Kansas
JOHN J. WILLIAMS, Delaware
KARL E. MUNDT, South Dakota
CLIFFORD P. CASE, New Jersey

CARL MARCY, *Chief of Staff*
DARRELL ST. CLAIRE, *Clerk*

CONTENTS

TAX PROTOCOLS WITH BELGIUM AND GERMANY

WEDNESDAY, OCTOBER 13, 1965

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

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 4221, New Senate Office Building, Senator Albert Gore presiding.

SENATOR GORE. The committee will come to order.

The Subcommittee on Tax Conventions of the Committee on Foreign Relations is meeting today to receive testimony on the supplementary income tax protocol with Belgium signed on May 21, 1965, and the tax protocol with the Federal Republic of Germany signed on September 17, 1965.

Our first witness is Mr. Stanley S. Surrey, Assistant Secretary of the Treasury.

Mr. Surrey, we are glad to have you. I believe you have a prepared statement. Will you please proceed in your own way.

STATEMENT OF STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY; ACCOMPANIED BY NATHAN GORDON, DIRECTOR FOR INTERNATIONAL TAX AFFAIRS, OFFICE OF THE SECRETARY, TREASURY DEPARTMENT

Mr. SURREY. Thank you, Mr. Chairman. I have a prepared statement, but I think in view of the technical aspects of this treaty, it might be easier if I discussed the highlights of the treaty.

The existing Belgian convention came into effect in 1952. The protocol is a modification of the existing Belgian convention occasioned by a change in the internal law of Belgium. The protocol is designed to bring the treaty provisions into conformity with situations created by the new Belgian law. It is a relatively short protocol and is restricted primarily to this principal effect.

The Belgian Government in the early 1960's changed its method of taxing corporations and individuals to such an extent that the existing treaty became outmoded, and it was necessary therefore to enter into negotiations. Negotiations were limited to dealing with this particular point. We expect in the future to have further negotiations with the Belgian Government to modernize other provisions of the convention in the light of the recent OECD model convention, and changes that have occurred since 1952.

The principal aspect of the protocol as it affects U.S. shareholders deals with withholding by Belgian corporations on U.S. corporations having an interest in the Belgian corporation. The Belgian system

provides for a 30-percent tax on corporate profits, and they also withhold a tax which is nominally at the rate of 15 percent on dividends paid to domestic shareholders and foreign shareholders. But under the technical way in which that withholding tax is applied, it actually amounts to 18.2 percent of the amount of cash that a shareholder receives as his dividend.

The U.S. rate of withholding on dividends going to Belgian shareholders in U.S. corporations, under the existing treaty, is 15 percent. The Belgian Government desired to maintain the withholding at a rate of 18.2 percent, which is the rate which they have applied in their recent treaties as well as their internal withholding rate.

The U.S. Government thought that the two withholding rates should be reciprocal, and if we were going to limit our withholding to 15 percent, the Belgian Government should do likewise.

After a good deal of discussion, which kept the negotiations running from about 1962 to 1964 over this and other points, the Belgian Government agreed to the U.S. suggestion, and this protocol places their withholding at an actual 15 percent rather than 18.2 percent which would occur under their internal law. This reduced rate of 15 percent applies only to registered shares. As you know, there are two systems in effect with respect to share issuance in many European countries, a system of registered shares, in which the stock is registered in the name of the owner, as is the system in the United States, and a system of bearer shares, in which there is no identification of the owner, but it is simply a matter of coupons.

In the case of Belgium, where there is a direct investment by an American company, that is, an American parent and a Belgian subsidiary, as far as we know, shares are always registered, so that in the case of direct investment of this fashion, the treaty will apply the 15-percent rate.

Also, any person who has a bearer share can very readily convert that share to a registered share without any difficulty, so that anybody can take advantage of this 15-percent rate. The Belgians were unable to apply the lower rate to bearer shares because of complications in administration that they thought would occur. We therefore decided not to press to a conclusion at this time our feeling that the rate also should be reduced to 15 percent for bearer shares. But we will take that up again after the Belgians have considered whether they can handle such a reduction administratively. However, as a matter of actual fact, due to a variety of aspects of the Belgian law, in most cases of bearer shares of the typical Belgian corporations in which Americans invest, the actual effective rate of tax comes out quite often even less than 15 percent. So we do not think that this is in any way restrictive on American interests.

The balance of the protocol deals with the methods by which Belgium will give relief to Belgians who have income from U.S. sources. The existing convention had provisions to that effect, but they were outmoded by the changes in Belgian law. Consequently what this part of the treaty does is simply bring up to date the methods by which Belgium will give relief to its citizens and residents who invest in the United States.

As you know, we have the foreign tax credit for this purpose. Belgium has a more complicated arrangement, which in some cases involves a credit and in some cases involves an exemption.

In addition, the Belgians under this protocol have given somewhat additional relief to those of its residents who are U.S. citizens living in Belgium and deriving income from the United States. In the case of dividend and interest income, investment income, we tax our citizens in full. If Belgium taxed them in full and gave them no relief, there would be rather heavy double taxation. Consequently, in its treaties with foreign countries, the United States seeks to have some recognition by the other government of the fact that we tax our citizens wherever they are in full, and in this treaty Belgium does give some partial recognition to that effect, and does give——

Senator GORE. What do you mean "partial"?

Mr. SURREY. In the typical case Belgium will grant anybody living in Belgium a credit of 15 percent of the dividends or interest. Now, that is the amount that we normally withhold on a Belgian resident. But in the case of an American, since we impose tax in full, the Belgians go further and say that in any event an American will not be taxed by Belgium at more than 15 percent on his American investment income. So that they limit their tax to 15 percent of the American investment income.

That is a more generous treatment of the U.S. citizen than it is of their other residents getting income from the United States.

Aside from these matters, there is no other particular matter of significance in the protocol. The protocol becomes effective, if ratified, starting with 1963 when the new Belgian law became effective. So that under the protocol, we would recognize the changes in Belgian law starting with the year 1963, except that the rate of 18.2 must be reduced to 15 percent for registered shares for those years as well as for the future.

It may be that certain of our organizations which happen to hold Belgian shares, do not receive in effect the U.S. foreign tax credit because they do not pay any taxes, such as American charities and American pension trusts. We do not know whether they do or do not hold Belgian shares. They may feel that the Belgian law, in adopting the withholding rate, could have been regarded as contrary to the existing U.S. treaty. In this protocol we preserve the rights of these organizations to contest that withholding tax for prior years if they feel inclined to do so. We do not know whether there are any organizations that are so interested or not. But if they are, their rights are fully protected under this protocol.

I think that is the sum and substance of the Belgian protocol.

Senator GORE. I wish to place in the record at this point a more detailed treatise of this protocol which you have prepared and submitted.

Mr. SURRY. Yes; I would like, Mr. Chairman, to place both my written statement which I prepared and then a longer technical memorandum.

Senator GORE. All right, and the same will be true with respect to the German protocol to which you can address your remarks now.

(The statement and the technical memorandum concerning the Belgian protocol referred to above follow.)

STATEMENT ON THE PROTOCOL TO THE UNITED STATES-BELGIUM INCOME TAX CONVENTION BY STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY

Mr. Chairman, I am appearing before you today to urge favorable action on the supplementary protocol to the income tax convention now in effect between

the United States and Belgium. The original convention was agreed to in October 1948 and has been the subject of two protocols since that time, in 1952 and in 1957. The existing convention follows in broad outline the general pattern of tax treaties which the United States has negotiated with the other industrialized countries of the world. The provisions of this protocol are also consistent with the general principles contained in these treaties.

The agreement contained in this protocol covers a limited range of matters, and is principally directed toward issues arising out of Belgium's 1962 revision of its domestic tax system. This revision required the United States and Belgium to renegotiate the existing income tax convention between the two countries, since that convention had been negotiated against the background of an altogether different Belgian tax system. The two countries agreed to deal in this protocol with the most pressing points which emerged from the Belgian revision of its tax laws. It is the intention of both countries to renegotiate the remaining portion of the convention when there is a further opportunity to do so. In order to insure such further consideration, the protocol contains an expiration date beyond which it can not be extended.

The principal matters dealt with in the protocol relate to (1) the Belgian taxes which are the subject of the convention, (2) the taxation of dividends and interest, and (3) the Belgian commitment to provide tax relief for its residents and corporations deriving income from sources within the United States upon which the United States also imposes tax. A detailed technical memorandum describing the provisions of the protocol is attached.

DESCRIPTION OF BELGIAN TAX LAW

In order to better understand the provisions of the protocol, it is necessary to describe briefly the basic provisions of the new Belgian tax law. Under Belgian law, there are four classes of income tax: an individual income tax; a corporate income tax; an income tax on legal entities (political subdivisions and nonprofit-making organizations); and an income tax on nonresidents. The income tax on nonresidents applies both to individuals and corporations and applies generally only to income which nonresidents receive from sources within Belgium.

The collection of Belgian income taxes relating to investments and wages is accomplished generally through a system of withholding or prepayments applicable to certain kinds of income. In the case of income from personal property (including stocks and bonds), there is both a standard and an additional personal property prepayment. In the case of income from real property, a standard and an additional prepayment are also imposed. In the case of wages and other remuneration, a standard professional prepayment is imposed.

The protocol specifically applies the convention to these various Belgian taxes.

TAXATION OF DIVIDENDS AND INTEREST

Belgian withholding on dividends

Under the present treaty, the United States may impose a tax on dividends from U.S. sources received by a resident or corporation of Belgium not having a permanent establishment within the United States at a rate not exceeding 15 percent. Under the existing treaty, Belgium is precluded from imposing a tax similar to the withholding tax imposed by the United States in the case of nonresident aliens and foreign corporations.

The protocol permits Belgium to impose a tax not in excess of 15 percent on dividends derived from Belgian sources by a U.S. resident or corporation not having a permanent establishment in Belgium. The protocol specifies that the 15-percent rate of tax shall apply only to dividends which are paid on registered shares. Thus, in the case of registered shares, a reduction to 15 percent is provided by the protocol from the regular Belgian withholding rate of 18.2 percent under its standard personal property prepayment.[1] It should be pointed out that the 18.2-percent rate of tax still applies in the case of dividends which

[1] The 18.2-percent rate results from the fact that the standard personal property prepayment is imposed at the rate of 15 percent of the amount of dividends actually distributed grossed up by an amount equal to the special dividends received credit granted under Belgian law. To take account of this special credit, the standard personal property prepayment applicable to dividends is calculated on eighty-five seventieths of the amount actually distributed and the effective rate of tax is thus 18.2 percent of the dividend actually distributed.

are paid on bearar shares. Typically, shares held by a U.S. parent corporation in a Belgian subsidiary are in registered form.

During the negotiations leading to the protocol, the United States urged a general Belgian withholding rate under the treaty of 15 percent. However, the Belgian authorities indicated that they would encounter serous difficulties in administering their tax system if a reduced rate of tax were applied to bearer shares as well as registered shares. As I have indicated, this protocol will be in effect for a limited period of time, and it is expected that by the expiration of that period Belgium will have developed appropriate procedures to permit a general maximum rate of tax on Belgian source dividends paid to U.S. persons of 15 percent. Actually, even under present Belgian law, because of the exemptions and credits which are contained therein, the effective rate of tax on dividends paid on bearer shares is generally below 18.2 percent and frequently less than 15 percent. Even in those cases where the effective rate of tax on bearer shares may exceed 15 percent, the holder of those shares can readily convert them to registered shares and thereby obtain the benefits of the 15-percent rate.

Exemption from Belgian additional personal property prepayment

The protocol provides an exemption from the Belgian additional personal property prepayment with respect to dividends and interest paid to a resident or corporation of the United States not having a permanent establishment in Belgium. In the absence of this provision, a U.S. resident or corporation would be subject to a 15-percent tax on the amount received (after deduction of the standard personal property prepayment) in addition to the amount withheld as the standard prepayment. Thus, under this provision of the protocol, Belgium will not impose this additional prepayment on dividends and interest paid to U.S. residents and corporations from Belgian sources.

Dividends and interest paid by Belgian and United States corporations

Under the protocol, the United States agrees to exempt from tax dividends and interest paid by a Belgian corporation to a person other than a citizen, resident, or corporation of the United States. A provision of this type is contained in many of the tax treaties to which the United States is a party and operates to eliminate application of those rules contained in the Internal Revenue Code under which in certain circumstances dividends and interest paid by a foreign corporation may be regarded as being from U.S. sources.

The protocol contains a reciprocal provision under which Belgium will not tax dividends or interest paid by U.S. corporations to a person other than a resident or corporation of Belgium unless collection is made in Belgium. The reservation regarding collection in Belgium was included because of the problem of administering the Belgian tax laws in those cases where dividends or interest are paid on bearer shares or bonds to a recipient in Belgium through a collection agent (such as a bank) located there.

RELIEF FROM DOUBLE TAXATION

As is standard in tax treaties, the United States agrees to allow an appropriate credit against U.S. taxes for Belgian taxes paid by a U.S. resident or corporation. The obligation of the United States under this provision of the protocol is satisfied by the foreign tax credit provisions contained in the Internal Revenue Code.

The protocol also contains a series of provisions under which Belgium agrees to grant relief from double taxation to its residents and corporations on U.S. source income. In general, the protocol contains a broader commitment by Belgium to avoid double taxation than is present in the existing convention.

In the case of Belgian corporations not having a permanent establishment in the United States which receive dividends from U.S. sources, Belgium agrees to grant to these corporations the same exemptions from Belgian corporate income tax as would be granted if the paying corporation were a Belgian company. The exemption amounts to either 85 percent or 95 percent of the amount of the dividend after deducting the U.S. tax withheld, depending on the character of the recipient's business. In addition to these exemptions, Belgium also agrees to permit a Belgian corporate recipient of U.S. dividends to elect under certain conditions to have the dividends exempted from Belgian personal property prepayment. This provision will operate to permit a Belgian corporation receiving U.S. dividends to accumulate or reinvest a larger portion of these dividends than would otherwise be permitted under Belgian law.

In the case of a Belgian resident receiving dividends and a Belgian resident or corporation receiving interest from the United States, Belgium agrees in the protocol to permit a deduction from its tax attributable to the dividends and interest of at least 15 percent of the amount received, after deducting the U.S. tax withheld. This provision, which is contained in present Belgian law, represents a commitment by Belgium to continue to allow this deduction.

If a Belgian resident or corporation has a permanent establishment in the United States and dividends, interest, and royalties derived by such Belgian resident or corporation are taxed by the United States because of the existence of the permanent establishment, Belgium agrees in the protocol to exempt such income from tax.

The protocol also deals with the problem of double taxation in the case of a U.S. citizen residing in Belgium who is liable for income tax in both countries on his worldwide income. The convention does not restrict the right of the United States to tax its citizens, and consequently this individual is not entitled to the reduced rates of U.S. tax provided in the treaty for residents of Belgium on U.S. source income. Consequently, both Belgium and the United States will be taxing his U.S. source income at progressive rates. The protocol provides a measure of relief from double taxation to such an individual by limiting the Belgian income tax which may be imposed on U.S. source dividends, interest, pensions, annuities, and royalties received by a U.S. citizen residing in Belgium to 15 percent of such income after reduction of that tax by the 15-percent Belgian foreign tax credit on income from personal property.

EFFECTIVE DATES AND EXPIRATION

The effective dates provided in the protocol correspond generally to the effective dates of the new Belgian tax law applicable to the items of income involved. Where a new feature has been introduced into the convention the provisions are applied prospectively.

A special transitional rule is provided primarily for the benefit of U.S. tax-exempt organizations deriving dividend income from Belgium. Belgium is prohibited under the existing convention from imposing tax "similar to" that withheld at the source by the United States in the case of nonresident aliens and foreign corporations. Under the protocol Belgium is permitted to impose such a withholding tax effective as to payments on or after January 1, 1963. The special transitional rule, effective until January 1, 1965, preserves for tax-exempt organizations and other comparable taxpayers any rights which they might have under the treaty prior to this protocol, since such taxpayers cannot benefit from the foreign tax credit provided in the Internal Revenue Code.

The protocol is to remain in effect until January 1, 1968, except that it may be extended by mutual consent of the parties until no later than December 31, 1970.

CONCLUSION

The protocol which is before you deals with a limited number of questions primarily arising from the Belgian revision of its tax system. These changes in the treaty are essential to coordinate the new Belgian system with the treaty and thereby permit the treaty to operate as intended.

The protocol liberalizes the statutory taxation by Belgium of Belgian source dividends paid to U.S. investors. The reduction in the rate of Belgian withholding tax in the case of registered shares from 18.2 percent to 15 percent and the elimination of the additional personal property prepayment are significant benefits to U.S. investors in Belgium and the United States. The agreement by Belgium to provide relief from double taxation where U.S. source income is involved is an important additional benefit to the U.S. citizens involved. For these reasons, and because the protocol is an important step in keeping our existing treaties current, I urge you to recommend that the Senate advise and consent to the ratification of this protocol.

TECHNICAL MEMORANDUM OF TREASURY DEPARTMENT CONCERNING PROPOSED PROTOCOL AMENDING THE INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND BELGIUM

On May 21, 1965, a protocol was signed at Brussels modifying and supplementing the existing convention between the United States and Belgium for the

avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed at Washington on September 9, 1952, and on August 22, 1957.

The purpose of the proposed protocol is to amend the provisions of the existing convention to reflect the changes made in the Belgian tax laws by the act of November 20, 1962. This change in internal law required (1) redesignation of the Belgian taxes to which the convention applies; (2) revision of the provisions of paragraph (2) of article VIII, concerning the Belgian tax on dividends paid by Belgian corporations to residents, corportions, or other entities of the United States; (3) the addition of a new article VIII–B concerning dividends and interest; and (4) revision of paragraph (3) of article XII, concerning the Belgian commitment to provide tax relief for its residents or corporations deriving income from sources within the United States upon which U.S. income tax is levied.

The amendment to paragraph (2) of article VIII of the convention permits Belgium to tax dividends from Belgian sources received by U.S. residents, corporations, or other entities, but prescribes a maximum limitation on the rate of tax that may be imposed if such recipient has no permanent establishment in Belgium.

New article VIII–B provides an exemption (1) from the Belgian additional personal property prepayment for dividends and interest paid to a resident, corporation, or other entity of the United States not having a permanent establishment within Belgium; (2) from U.S. tax for dividends and interest paid by a Belgian corporation to a person other than a citizen, resident, corporation, or other entity of the United States; and (3) from Belgian tax for dividends and interest paid by a U.S. corporation to a person other than a resident, corporation, or other entity of Belgium unless such income is collected in Belgium.

The amendment to paragraph (3) of article XII is designed to afford substantial relief from double taxation in the case of Belgian residents or corporations deriving certain types of income from sources within the United States upon which U.S. income tax is paid.

In addition to these substantive amendments certain technical amendments were also made.

Article II of the proposed protocol contains provisions for the ratification and entry into force of the protocol. The effective dates of those provisions of the protocol correspond generally to the effective date of similar provisions in the new Belgian law. Other amendments will generally take effect on the first day of January of the year following the year in which the instruments of ratification are exchanged.

The proposed protocol when ratified, is to remain in effect until January 1, 1968. This termination date may be extended to, but not later than, January 1, 1971, by mutual agreement of the parties.

A detailed summary and explanation of the protocol follows:

ARTICLE I

Article I of the proposed protocol is made up of eight paragraphs which contain the following modifications to the original convention:

Paragraph 1

Taxes covered.—Paragraph 1 of article I of the protocol redesignates the Belgian taxes covered by the treaty. These include the four classes of income taxes imposed under the Belgian law of November 20, 1962, the prepayments and additional prepayments relating to those four classes of taxes, and any proportional taxes supplementing those classes.

The law of November 20, 1962, provides for an individual income tax (l'impot des personnes physiques); a corporate income tax (l'impot des societes); an income tax on legal entities (l'impot des personnes morales); and an income tax on nonresidents (l'impot des nonresidents).

The individual income tax is imposed at graduated rates ranging from 0 to 55 percent on the worldwide income of individuals resident in Belgium.

The corporate income tax is imposed on corporations which have their statutory seat (as designated in the corporate charter), their principal establishment, or their central control and managment in Belgium, and which carry on a business or other profitmaking activities. The tax is imposed on profits from all sources, plus all gains realized on the sale or use of corporate assets. The

rate of tax on corporate profits is generally 30 percent although the rate may vary on income which is not distributed to the shareholders of the corporation.

The income tax on legal entities applies to the political subdivisions of Belgium and those legal entities which neither carry on a business nor perform activities of a profitmaking nature. The tax is due on income from movable and immovable property (generally corresponding to personal and real property, respectively) and is collected through a system of prepayments.

The income tax on persons not resident in Belgium applies both to individuals and corporations. This tax applies in general to income received from sources within Belgium. In the case of nonresident individuals the tax is imposed at graduated rates ranging from 0 to 55 percent, as in the case of resident individuals, and in the case of nonresident corporations, the tax is imposed at a rate of 35 percent.

In most cases, the Belgian income-tax liability of a nonresident individual or corporation is satisfied through a system of prepayments. Such prepayments will not, however, satisfy the tax obligation of such person if he carries on a business through a permanent establishment in Belgium. In such case, the tax on nonresidents will be assessed and any prepayments previously paid may, subject to statutory limitations, be allowed as a credit against such tax.

The Belgian law contains a form of withholding or prepayment system applicable to certain types of income. This system is made up of three standard prepayments and two additional prepayments, as follows:

1. The standard personal property prepayment (precompte mobilier).
2. The additional personal property prepayment (complement de precompte mobilier).
3. The standard real property prepayment (precompte immobilier).
4. The additional real property prepayment (complement de precompte immobilier).
5. The standard professional prepayment (precompte professionnel).

The standard personal property prepayment is withheld by the Belgian payor (or Belgian fiduciary recipient) on certain income from movable property. In the case of individuals and corporations not resident in Belgium this prepayment (and the additional personal property prepayment) applies only to income from movable property which is considered to be from Belgian sources. The standard prepayment is withheld at a flat rate of 15 percent of the net amount of interest and royalties distributed to the recipient. The standard prepayment on dividends is withheld at the statutory rate of 18.2 percent.

The additional personal property prepayment is generally imposed on income from movable property if the recipient of such income does not authorize the distributing agent to give certain information to the Belgian tax authorities. Under Belgian law, this prepayment is imposed on nonresidents whether or not such authority is given. The amount withheld is 15 percent of the net amount of any interest or dividend distributed, after deduction of the standard personal property prepayment.

The real property prepayment is levied on certain income from immovable property situated in Belgium. This prepayment is generally based on "cadastral income," an estimated income based on the gross annual rental value of the property. An amount equal to 25 percent of the gross annual rental value of buildings and 10 percent of the gross annual rental value for land, is allowed as an expense. The rate of the prepayment is not uniform in that it contains elements of national, provincial, and municipal taxes, but generally is approximately 21 percent of the cadestral income. The standard real property prepayment is computed on the basis of actual rental income where the property is used by the lessee in a business.

The additional real property prepayment applies only to nonresident individuals and corporations, and then only if such persons are residents of a country with which Belgium has an income-tax convention which reserves to Belgium the exclusive right to tax such income. Because the United States reserves the right in the present convention to tax its citizens, residents, and corporations on income from real property, this additional real property prepayment does not apply to residents or corporations of the United States.

The standard professional prepayment applies to wages and salaries, remuneration paid by a corporation to managers, directors, and persons with similar functions, pensions, certain prizes and subsidies, and alimony paid to nonresident individuals. The amount of the prepayment is based on a special graduated tax schedule ranging from 0 to 50 percent.

Paragraph 2

Territory covered.—Paragraph 2 of article I of the protocol provides a necessary technical amendment to the previous definition of the term "United States" by deleting the words "the territories of Alaska and of Hawaii."

Paragraph 3

Belgian tax on dividends.—Paragraph 3 of article I of the protocol deletes paragraph (2) of article VIII of the basic convention (relating to the taxation of dividends by Belgium) and replaces it with a new provision. Existing article VIII(2) provides that Belgium shall not impose on dividends derived from sources within Belgium by a resident, corporation, or other entity of the United States not having a permanent establishment within Belgium any tax in the nature of a personal complementary tax or surtax thereon, or any tax similar to that withheld in the United States on dividends derived by nonresident aliens and foreign corporations.

New paragraph (2) provides that the rate of Belgian tax applicable to dividends derived from sources within Belgium by a resident, corporation, or other entity of the United States not having a permanent establishment in Belgium shall not exceed 15 percent of the amount distributed. However, this reduction in the rate of tax will apply only to dividends paid on registered shares which have been held in that form for a period of 12 months immediately prior to the date on which such dividends become payable (or for such period as the Belgian corporation paying the dividends has been in existence). Typically, shares held by a foreign parent in a Belgian subsidiary are in registered form. The second sentence of new paragraph (2) provides that, in all other cases, a U.S. resident, corporation, or other entity not having a permanent establishment within Belgium and deriving dividends from sources within Belgium will not be subject to Belgian tax at a rate in excess of 15 percent of the taxable amount of such dividends, determined in accordance with Belgian law in effect on May 21, 1965, the date of signature of the proposed protocol.

The Belgian law as of that date provides that nonresident individual and foreign corporate shareholders of Belgian corporations are subject to the Belgian income tax on nonresidents covered under article I(1)(b)(iv) of the convention, as amended by article I(1) of this protocol, with respect to dividends they receive. This tax is fully satisfied by the imposition of the Belgian standard personal property prepayment and the additional personal property prepayment if the taxpayer is not engaged in trade or business in Belgium through a permanent establishment, does not have a dwelling at his disposal in Belgium, and is not otherwise subject to the assessment of the basic Belgian tax. The Belgian personal property prepayment is imposed at the rate of 15 percent of the amount of the dividends actually distributed grossed up by an amount equal to the special dividends received credit (credit d'impot) which is granted under article 35(6) of the law of November 20, 1962, to individual shareholders of Belgian corporations who are subject to assessment of the individual income tax or of the income tax on nonresidents as it applies to individuals. In order to take account of this special credit, the personal property prepayment applicable to dividends paid by Belgian corporations is calculated on $^{85}/_{70}$ of the amount actually distributed and the effective rate of this tax is thus 18.2 percent of the dividend actually distributed. Under the protocol, as indicated above, this 18.2 percent rate is reduced to 15 percent in the case of registered shares, since the base of the tax is limited to the amount actually distributed. In the case of bearer shares, the base of the tax is the amount of the dividend as calculated under Belgian law, which thus includes the addition for gross up and hence provides the 18.2 percent effective rate.

The third sentence of new paragraph (2) of article VIII describes an additional form of income to be covered, for Belgian tax purposes, by the dividend article. Under Belgian law, the term "dividends" refers to distributions made by a Belgian corporation with respect to its shares or distributions by a Belgian joint stock company. It does not specifically refer to distributions made by a Belgian company other than a corporation or a joint stock company with respect to the capital invested in such company. These payments are, however, subject to the personal property prepayment imposed under Belgian law at the 18.2-percent rate (15 percent of $^{85}/_{70}$ of the amount received) in the same manner as dividends paid by corporations and joint stock companies and, in addition, are not allowed as a deduction in computing the taxable income of the distributing company. The protocol treats these amounts, for Belgian tax purposes, as dividends under the convention.

The arrangement provided in the protocol whereby Belgium may tax dividends on registered shares at a maximum rate of 15 percent and dividends paid on

bearer shares at a maximum rate of 18.2 percent results from the serious administrative difficulties which Belgium indicated it would encounter if a general maximum rate of tax of 15 percent were provided in the protocol. As indicated in the discussion of paragraph (5) of article II, this protocol shall remain in effect for a limited period, and it is anticipated that by the expiration of that period Belgium will have developed appropriate procedures to permit a general maximum rate of tax on all dividends of 15 percent. Actually, under present Belgian law, the effective rate of tax on dividends paid to nonresidents on bearer shares by Belgian corporations is frequently less than 18.2 percent, or even 15 percent. Moreover, if the effective rate of tax exceeds 15 percent, it is a simple matter for bearer shares to be converted by the holder into registered shares so that the benefits of the 15-percent rate can be ensured.

Paragraph 4

Paragraph 4 of article I of the protocol adds a new article VIIIB to the basic convention. This article contains additional rules dealing with the taxation of dividends and interest under the treaty.

Paragraph (1) of new article VIIIB provides an exemption from the Belgian additional personal property prepayment in effect on May 21, 1965 (normally withheld at the rate of 15 percent of the amount distributed after deduction of the standard prepayment), with respect to dividends and interest paid to a resident, corporation or other entity of the United States not having a permanent establishment in Belgium. This exemption from additional prepayment applies even where the standard prepayment on dividends paid on registered or bearer shares was computed at less than 15 percent and thus is less than the maximum tax collectible by Belgium under the provisions of new article VIII(2).

Paragraph (2) of new article VIIIB provides for exemption from U.S. tax with respect to dividends and interest paid by a Belgian corporation to a person other than a citizen, resident, corporation or other entity of the United States.

Paragraph (3) of new article VIIIB contains the Belgian counterpart of paragraph (2), providing that Belgium will not tax dividends or interest paid by U.S. corporations to a person other than a resident, corporation or other entity of Belgium unless collection is made in Belgium. Belgium reserves the right to tax such dividends or interest if collection is made in Belgium since Belgium regards this tax as an important element in the administration of its tax laws in those cases where dividends or interest are paid on bearer shares or bonds to a recipient in Belgium through a Belgian collection agent.

Paragraph 5

Paragraph 5 of article I of this protocol adds the words "on such income" to the second sentence of article IX(1) of the convention after the word "tax" and before the word "as."

Article IX(1) of the convention permits Belgian investors to elect for any taxable year to be taxed by the United States on their real property rental and natural resource royalty income "as if such resident, corporation or entity were engaged in trade or business within the United States through a permanent establishment" and thus to be taxed on a net basis. This permits the electing person to take those deductions normally allowed under U.S. law to nonresident alien individuals and foreign corporations engaged in trade or business in the United States with respect to such income.

The words added by paragraph 5 of the protocol make it clear that the net basis election extends only to income from real property rentals and natural resource royalties.

Paragraph 6

Paragraph 6 of article I of the protocol amends the provisions of paragraphs (2) and (3) of article XII of the convention relating to the allowance of credits and other relief by the country of the taxpayer's residence for tax imposed by the treaty country where the income derived by the taxpayer has its source.

U.S. foreign tax credit.—New paragraph (2) of article XII modifies the original provision of the convention granting credit against U.S. tax for Belgian taxes in order to eliminate the requirement that the credit be determined under section 131 of the Internal Revenue Code of 1939 as in effect on the date of entry into force of the basic Belgian convention. The proposed change guarantees the basic allowance by the United States of a tax credit while making clear that flexibility is permitted as to the technical formulation of the credit rules.

The credit shall be based on the total amount of the Belgian taxes referred to in new paragraph (1)(b) of article I of the treaty which are paid to Belgium. Under the protocol, the amount of the credit is that proportion of U.S. taxes which net income from sources within Belgium bears to total net income. The obligation of the United States under this paragraph is satisfied by the rules contained in sections 901 through 905 of the Internal Revenue Code of 1954, and the regulations thereunder. Moreover, to the extent that the rules provided in sections 901–905 produce a more favorable result, the U.S. taxpayer may calculate his credit under the code.

Belgian relief from double taxation.—New paragraph (3) of article XII contains eight subparagraphs dealing with the relief Belgium is to grant its own residents or corporations under the treaty to take account of U.S. taxes paid by such persons on their U.S. source income. These provisions are based upon the law of Belgium relating to the imposition of tax on Belgians receiving income from sources outside Belgium. Under the terms of the proposed protocol, present Belgian statutory law is liberalized with respect to (1) U.S. source dividends received by a Belgian corporation, (2) U.S. source business and personal service income, and (3) certain items of U.S. source income received by a citizen of the United States who is a resident of Belgium.

Dividends derived by Belgian corporation or other entity.—Subparagraph (a) of new paragraph (3) of article XII has the effect of incorporating into the convention the present statutory treatment of Belgian corporations or other entities. It provides that dividends taxed by the United States under article VIII (1) of the convention at the reduced 15-percent rate shall be exempt from Belgian corporate income tax to the extent that such exemption would be granted under Belgian law in force on May 21, 1965, if both corporations were Belgian corporations subject to the Belgian corporate income tax. The amount of this exemption is 85 percent (in the case of a financial corporation) or 95 percent (in the case of an industrial corporation) of the amount of the dividend after reduction for all expenses and taxes, including the U.S. withholding tax and Belgian personal property prepayment.

Subparagraph (b) of new paragraph (3) of article XII provides a treaty exception, in favor of U.S. source dividends, to the above rules dealing with the imposition by Belgium of tax on dividends received by a Belgian corporation or other entity subject to Belgian corporate income tax. This exception is in addition to the exemption provided in subparagraph (a).

Under the provisions of subparagraph (b), a Belgian corporation or other entity which receives dividends from a U.S. corporation on stock which has been directly owned by that Belgian corporation or other entity for a period of 6 months immediately prior to the date upon which the dividends become payable (or for such period of time as both the distributing and the recipient corporation have been in existence), may elect to have such dividends exempted from the Belgian personal property prepayment ordinarily applicable to such dividend. A Belgian corporation may elect this treatment by making a written request for such exemption when filing its annual tax return or before the expiration of the period allowed for the filing of such return. Under this provision, the Belgian corporation deriving a dividend from a U.S. corporation (after the withholding of U.S. tax at the source at the 15-percent treaty rate) (1) will not be required to pay the personal property prepayment due on receipt and (2) will be permitted to calculate its statutory corporate income tax exemption (as provided in subparagraph (a)) on the full dividend received. This treatment permits the qualified Belgian corporation or other entity receiving dividends from U.S. corporations to accumulate or reinvest a larger portion of such dividends than would be the case under Belgian law in the absence of this treaty provision. However, dividends accorded this exemption shall not be deducted for purposes of determining the personal property prepayment applicable to dividends distributed by the recipient corporation or other entity to its shareholders or members.

Under this rule, a Belgian corporation receiving a dividend of $85 (after the withholding of U.S. tax at the source at the 15-percent treaty rate) (1) will not have to pay the $12.75 personal property prepayment due on receipt and (2) may calculate its statutory 85 or 95 percent corporate income tax exemption on the full $85 dividend. In the case where the 85-percent exemption is applicable, corporate income tax would be paid with respect to 15 percent of the full $85, or $12.75, and would amount to $3.83 (30 percent of $12.75). Thus, of the $85 received, $81.17 ($85—$3.83) will remain available for reinvestment or other

use. If the recipient corporation distributes these dividends, it must then withhold the personal property prepayment at the 18.2 percent rate on the full amount of the distribution, since, under subparagraph (b) of new paragraph (3) of article XII, the amount excluded from the corporate income tax is not excluded from the imposition of the personal property prepayment. Therefore, assuming a total distribution of the amount remaining available for redistribution, or $81.17, the personal property prepayment would be calculated on the full $81.17 and would amount to $14.77 (18.2 percent of $81.17). The shareholders of the Belgian corporation would thus receive a dividend of $66.40 ($81.17—$14.77).

Dividends derived by individual residents of Belgium.—Subparagraph (c) of new paragraph (3) of article XII incorporates into the convention the statutory treatment which Belgium presently grants to its residents with respect to foreign source dividends. It provides that where a resident of Belgium receives dividends taxed by the United States under article VIII(1) of the convention at the reduced 15-percent rate, Belgium shall deduct from its tax attributable to that income an amount which shall not be less than 15 percent of the net dividends received in Belgium after deduction of U.S. tax withheld at the source under article VII(1). This provision, in effect, allows a credit against Belgian tax, which allowance is in addition to credits which Belgium now affords with respect to any Belgian prepayments withheld on receipt of the dividend income.

Interest derived by Belgian resident, corporation or other entity.—Subparagraph (d) of new paragraph (3) of article XII provides relief with respect to interest taxed by the United States under article VIIIA of the treaty and received by a Belgian resident, corporation, or other entity. As is the case under subparagraph (c) of this paragraph, the relief is presently embodied in the Belgian tax system with respect to interest taxed abroad and derived either by an individual or corporate resident of Belgium. The relief is a credit in the amount of not less than 15 percent of the interest received after deduction of U.S. tax. This credit is to be applied against the final individual or corporate income tax liability in addition to the credit for any personal property prepayment withheld upon receipt of the interest income.

U.S. citizens residing in Belgium.—Subparagraph (e) of new paragraph (3) of article XII contains a special provision dealing with certain income derived by a citizen of the United States who is a resident of Belgium and thus liable to income tax in both countries on worldwide income. This provision replaces article XII(3)(c) of the original convention which reduced the former Belgian personal complementary tax due by citizens or residents of the United States who were also residents of Belgium to one-fourth of the amount otherwise owing with respect to their U.S. source income which was taxed by the United States. The new provision affords substantially similar relief to our citizens under the revised Belgian tax laws. It provides that the Belgian individual income tax proportionately attributable to dividends, interest, pensions, annuities, or royalties received by a citizen of the United States residing in Belgium from sources within the United States may not exceed 15 percent of that income, after allowance of the lump-sum foreign tax credit.

Though residence in Belgium would ordinarily entitle individuals to an exemption from, or reduction in rate of, U.S. tax on specified items of income under the treaty, such benefits are not available to U.S. citizens. The new provision provides a measure of relief in these circumstances by reducing the amount of Belgian tax which can be imposed on the specified items of income.

The application of subparagraph (3) can be illustrated as follows:

A citizen of the United States residing in Belgium receives $3,000 in dividends from a U.S. corporation and, in addition, $4,000 net personal service income earned in the course of his employment in Belgium. The standard personal property prepayment due on the $3,000 in dividends is $450 (15 percent of $3,000), which will be creditable against the individual income tax. His income, after allowance of appropriate deductions, amounts to $7,000 and his tax liability to Belgium, computed without regard to credits, is $2,450 (35 percent of $7,000) under the progressive rates provided in Belgian law. The proportion of that liability which is attributable to the individual's U.S. source dividends is $1,050 (three-sevenths of $2,450). This tax must then be reduced by the Belgian lump-sum credit for foreign tax amounting to 15 percent of the dividends received, or $450. Under subparagraph (e), the amount of tax attributable to the dividends remaining after reduction of the Belgian foreign tax credit, or $600 ($1,050—$450), cannot amount to more than 15 percent of the dividends received. Thus, the citizen's total tax would amount to $1,850, computed by adding the

Belgian tax due under subparagraph (e) with respect to the dividends ($450) to the tax due with respect to the taxpayer's Belgian source income ($1,400), representing a net tax savings of $150. The $450 already paid as standard personal property prepayment would be credited against the $1,850.

Business income derived by Belgian resident, corporation, or other entity.—Subparagraphs (f) and (g) of new paragraph (3) of article XII contain the rules to be applied under the protocol by Belgium with respect to income which is received by Belgian residents, corporations, or other entities and which is taxed by the United States in accordance with the convention. The items of income specified in subparagraphs (f) and (g) shall be exempt from Belgian tax, but Belgium reserves the right to take this income into account for the purpose of determining the rate of tax which is to be applied against the remaining income.

The items of income exempted from Belgian tax under subparagraph (f) are: (1) industrial and commercial profits subject to U.S. tax by reason of their being attributable to the maintenance by the taxpayer of a permanent establishment in the United States (article III (1) and article IV of the convention); (2) income from real property situated in the United States and U.S. natural resource rentals or royalties (articles VI and IX (1) of the convention); (3) salaries, pensions, and annuities paid by the United States, or by any political subdivision thereof, to U.S. citizens residing in Belgium (article X (1) of the convention); (4) compensation for labor or personal services performed in the United States and taxed by the United States in accordance with article XI of the convention; and (5) any other business or personal service income which may be taxed by the United States in accordance with the treaty. The "other business or personal service income" mentioned in subparagraph (f) has reference to professional income (revenus professionnels) as that concept is used in Belgian tax law. Among items included in this category other than "industrial and commercial profits" and "compensation for personal services," as these terms are used in the treaty, are gains from the sale or exchange of capital assets used in a trade or business and remuneration paid to persons involved in the management of Belgian corporations.

Subparagraph (g) provides that Belgium will grant exemption to its residents, corporations, or other entities with respect to interest, dividends, and royalties which are taxed by the United States by reason of the fact that the Belgian taxpayer receiving that income has a permanent establishment in the United States, but that Belgium will include the exempt income to determine the rate of tax applicable to the taxable portion of the taxpayer's other income.

Net operating loss deduction.—Subparagraph (h) of new article XII(3) of the treaty provides that the amount of income of any Belgian resident, corporation, or other entity which is exempted from Belgian tax, in accordance with the provisions of subparagraphs (f) and (g) of new paragraph (3), shall be reduced by the amount of any net operating loss deducted in the same year in computing the U.S. tax. This reduction applies only to the extent that such loss has been deducted from income which would be subject to Belgian tax in any year.

Paragraph 7

Paragraph 7 of article I of the protocol amends the French text of paragraph (1) of article XV of the original convention, relating to the exchange of information between the competent authorities of the two treaty countries. Under this article only such information as is "available under the respective taxation laws of the contracting States" shall be exchanged. The proposed change makes the French translation coincide with the substance of the English text.

Paragraph 8

Paragraph 8 of article I of the protocol deletes article XII of the convention. This article contained the authorization for, and provided the procedures to be followed in, extending the original convention, as amended, to any of the colonies or overseas territories of either treaty country. This provision is obsolete inasmuch as Belgium no longer has any such colonies or territories. In practice, the provision never applied to the United States.

ARTICLE II

Paragraph 1 of article II provides that the protocol shall be ratified and the instruments of ratification exchanged as soon as possible.

Paragraphs 2, 3, and 4 of article II contain the provisions setting out the effective dates of the several provisions of the protocol. Generally, the effective dates correspond to the effective dates of the new Belgian tax laws applicable to the same income.

Subparagraph (a) of paragraph 2 of article II provides that the protocol will apply to income received by individuals during the calendar year 1963, taxable years ending within 1963, and subsequent taxable years. Subparagraphs (b) and (c) provide the rules governing the effective dates of the provisions contained in the protocol dealing with the U.S. corporate income tax and the Belgian corporate income tax applicable to corporations, companies limited by shares, and other entities subjected to that tax. The provisions also deal with the effective date of the protocol as applied to the Belgian tax on legal entities and the Belgian tax on nonresidents.

With respect to Belgian prepayments and additional prepayments, subparagraph (d) provides that the protocol shall apply to the prepayment imposed on real property income of the year 1963 or subsequent years. The protocol shall apply to the prepayments and additional prepayments imposed on other income which is distributed or paid on or after January 1, 1963, by payors established in Belgium or paid on or after that date by payors established in the United States and collected by residents, corporations, or other entities of Belgium.

Thus, a Belgian corporation may elect the exemption from personal property prepayment which is provided under new article XII(3)(b) of the treaty with respect to dividends paid by a U.S. corporation on or after January 1, 1963, and a U.S. resident, corporation, or other entity will be entitled to the 15-percent rate of Belgian tax provided under new article VIII(2) with respect to dividends paid on registered shares on or after that date.

Subparagraph (e) provides that the effective date for the deletion of the extension provision of article XXII of the treaty is to be June 30, 1960, the date on which Belgium granted independence to the last of its overseas territories or colonies.

The provisions of the protocol which introduce new features into the basic convention are applicable only prospectively. Thus, under paragraph 3 of article II, the provisions of paragraphs (2) and (3) of new article VIIIB of the treaty, granting exemption from the tax of one country with respect to dividends and interest distributed by corporations of the other country to persons not resident in the first country, are made applicable with respect to income paid during taxable years beginning on or after January 1, of the year following that in which the instruments of ratification of the protocol are exchanged.

Paragraph 4 of article II of the protocol contains a special rule which was included for the purpose of giving continued application to the provisions of old article VIII(2), prohibiting the imposition by Belgium of any tax "similar to" that withheld at the source on dividends under U.S. law in the case of nonresident aliens and foreign corporations. This rule in effect relates to any U.S. resident, corporation, or other entity which, by reason of its taxable status in the United States, cannot benefit from a credit against U.S. tax for Belgian taxes imposed with respect to the dividends it receives. The rule provides that, in such a case, article VIII(2), as amended by this protocol, shall apply only to dividends paid on or after January 1, 1965. In determining whether a taxpayer in fact can benefit from the credit, the amount of the credit is to be computed without regard to income derived from, or taxes paid to, foreign countries other than Belgium as provided in article XII(2) of the convention, regardless of the manner in which the taxpayer actually calculated his credit for United States tax purposes. If the taxpayer receives no tax benefit under this computation, the provisions of this paragraph shall apply.

The special rule contained in paragraph (4) of article II is intended to apply mainly to U.S. tax-exempt organizations which, by reason of their exemption from U.S. tax, cannot benefit from the foreign tax credit and must bear the full burden of Belgian taxes imposed on the dividends received from Belgium. It preserves any rights which such taxpayer might have under article VIII(2) of the treaty as it existed before this protocol with respect to the relationship of the 1962 changes in Belgian tax law to the provisions of existing article VIII(2) prohibiting any Belgian tax "similar to" that withheld at the source on dividends under U.S. tax law.

Examples of the organizations to which the provision would apply are charitable foundations and pension trusts but would not encompass a U.S. regulated investment company which has invested most of its assets in foreign stocks or

securities and which distributes at least 90 percent of its investment income to its own shareholders, since in such cases the benefits of the foreign tax credit described in section 901(b)(1) of the code are passed through to the shareholders of the investment company if the company makes the election provided under section 853 of the code.

The word "recipient" of the dividends, as it is used in this paragraph of article II, means the U.S. taxpayer upon whom U.S. tax liability finally rests with respect to dividends, such as a resident of the United States who is either a partner in a U.S. partnership or a beneficiary of a U.S. trust which currently distributes its income.

Paragraph 5 of article II of the protocol provides that the protocol shall remain in effect with respect to income of calendar or taxable years beginning before January 1, 1968, or with respect to payments made before that date where withholding taxes are involved. The protocol may be continued in effect after January 1, 1968, if an extension of time is agreed to by the two countries through an exchange of diplomatic notes. However, the application of the protocol may in no event be extended beyond December 31, 1970. If the protocol is terminated, the provisions of the basic convention which have been deleted or amended by the protocol will be reinstated in effect with respect to income of taxable years beginning on or after January 1, 1971.

Mr. SURREY. Thank you.

Senator GORE. Before you go to the German protocol, let me ask you one question. Is it unusual to negotiate a protocol with a time limit which the Belgian protocol contains?

Mr. SURREY. I think it is somewhat unusual, and I do not know, in retrospect, if we would have done it that way. The problem was this. We were beginning, when efforts were made to bring these negotiations to a conclusion in 1964, to explore with European governments a modernization of existing treaties in the light of the OECD model, and additional thoughts that we had had in some of the newer treaties that had been ratified by the Senate. The Belgians were very anxious, on the other hand, to come to an early decision on a revision of the treaty with respect to the matters that I have addressed myself to, because, I think, we were the last government with which they had not yet come into agreement on accommodating their treaties to their revisions. So they were anxious to deal only in that narrow segment.

In addition, neither we nor they had explored in full a number of the implications of the OECD draft. We realized that would take time. Consequently the U.S. delegation agreed with the Belgian request that the protocol be limited to the matters I have stated.

We were interested in having some assurance that the Belgian Governnment would look at the remaining aspects of the treaty, and consequently we put in this termination date as a sort of prod to both their government and to ourselves in the Treasury to make sure that we look at this matter again in the near future with respect to these other clauses, and to bring the existing clauses of the treaty dealing with other matters into conformity with newer versions. That is the reason for it. It may have been unnecessary, but at the time we though it would be a useful prod to both governments.

PROTOCOL WITH GERMANY

With respect to the protocol with Germany, this is a more extensive protocol. It in part grows out again of a change in the German law that has occurred since the basic German treaty was negotiated. The German corporate tax system is different from ours. As you know, we have now a straight 48-percent rate on corporate profits.

The Germans have a two-rate system under which there is a 51-percent rate on profits retained by the corporation and a 15-percent rate on profits distributed by the corporation, a much lower rate which favors distribution by corporations.

Under our existing treaty with Germany, in the case of parent subsidiary investment, each country limits its witholding rate to 15 percent. The German delegation, starting in 1960, urged that in view of the fact they had a very low rate on distributed dividends, 15 percent on the profits involved as compared with our 48-percent rate, they should have a higher withholding rate, and asked that the withholding rate on parent subsidiary situations be perhaps 25 percent, which is their standard rate of withholding unless reduced by treaty. The U.S. delegation, over a period of years, said that the rates in this case should be reciprocal. If we limit ourselves to 15 percent, we thought the Germans ought to do the same, despite their lower corporate rate. We said that was an internal matter, and one that should not affect the withholding rate.

The Germans disputed that position, and in most of their other treaties with other countries do have a withholding rate higher than 15 percent to reflect their lower corporate rate on distributed profits.

After a good deal of analysis, it turned out that one of the principal problems the Germans saw with their lower rate of 15 percent on distributed profits was that in some cases it paid American corporate parents to have the profits of their German subsidiaries completely distributed, to pay all relevant German taxes on the distribution, and even our tax on the dividend less the foreign tax credit, and then immediately reinvest the profits in the German subsidiary.

This was in a sense a technical maneuver, perfectly proper, to obtain the maximum advantage of the lower German rate, and there was a tax saving under that method of operation as compared with leaving the profit simply in the German subsidiary subject to the 51-percent rate.

The Germans thought that this gave certain of the American subsidiaries an unfair competitive advantage as against indigenous German companies. We thought if this was the crux of their problem, then we should deal only with that problem in the treaty and otherwise keep the withholding rate at 15 percent. So this protocol deals with that situation and says that in the case of a reinvestment of dividends such as I have described, the German tax rate on withholding can be 25 percent. But in all other cases where there is no reinvestment, then the rate remains at 15 percent as does our rate.

So the protocol has a rather complex provision dealing with this situation. This matter was carefully discussed with American interests in Germany before this particular solution was negotiated with the Germans. We think it is favorable to American interests, and is at the same time an accommodation to what was a real German problem in this situation and a competitive difficulty that the Germans felt was serious.

Senator GORE. Will the American interests be adversely affected by this or can they adjust themselves to this new arrangement?

Mr. SURREY. I think they can adjust themselves, Mr. Chairman, to this new arrangement. It will mean that they will be paying the German rate of 51 percent if they leave their profits in Germany,

and I think that is the accommodation that they will make. We have discussed this with them.

Now, the other changes in the protocol begin with the modernization of certain clauses in our treaties to follow the OECD draft. For example, this protocol contains a revision of the definition of permanent establishment to follow the OECD draft. That OECD draft has been contained, for example, in the treaty with Luxembourg, which this committee approved last year. As you know, if an American company has a permanent establishment in Germany, then the German Government can tax the American company on its business done in Germany. If it does not have a permanent establishment, then it is not taxable on its business done in Germany.

We tax German corporations doing business directly with the United States only if they have a permanent establishment here. Now the permanent establishment can be a variety of things, it can be a warehouse, for example, or an office building and the like, and one of the items mentioned is a place of management. That was contained in the Luxembourg draft, and since it was a new term, there was some discussion at the time of the Luxembourg draft on how it would be interpreted. We cleared that up with an exchange of letters with the Luxembourg Government and we have in this case had an understanding with the German Government that is similar to that with Luxembourg.

I do not think that this place of management definition will cause trouble the way we understand it will be interpreted by them and the way we would interpret it ourselves. To have a place of management you have to really be managing the company.

Now, in addition, there is, I think, a more important aspect of this protocol, under the traditional American treaties if, for example, an American corporation were to do business in Germany, it would be subject to full corporate tax of 51 percent on its business done there, if it had a permanent establishment. In addition, if the American corporation has investment income from Germany, or royalty income from Germany, if it also has a permanent establishment, it cannot have the advantages of the reduced rates of the German tax under the treaty on such things as royalties and interest or dividends.

For example, the existing treaty exempts royalties from tax by Germany, but if an American corporation which is getting royalties has a permanent establishment, which may be completely unconnected with these royalties, the exemption does not apply, and similarly on our part. If a German corporation doing business in the United States through a permanent establishment also happens to have royalty income, unassociated with that business, nevertheless the exemption does not apply. This in technical international tax terms is described as the force of attraction. The permanent establishment attracts all the other income that comes from the country to it, and subjects it to the full corporate tax.

The OECD treaty abandons that force of attraction, and it says in essence that the permanent establishment should attract to it only those other items of income that are effectively connected with it. "Effectively connected with it" is the terminology used. But if they are unrelated, these other items of income remain separate and obtain whatever treaty advantages they would otherwise have obtained.

In this German treaty protocol, we have embodied this newer version of the OECD formula and abandoned the force of attraction in favor of the effectively connected rule. We think it works for better treatment of international transactions and is, I think, going to be the pattern that most modern treaties will have. This is, I think, the first protocol having this rule that has come before this committee. There was a partial version of this in the United Kingdom treaty which extended only to royalty income but not to other forms of income, but this protocol for the first time extends this idea to all forms of income.

The next matter that is of importance is the treatment of royalties. Under the existing treaty, royalties, patent royalties, copyright royalties and the like, are exempt from tax by the country of source, and the country of incorporation or residence taxes in full, so that an American corporation deriving patent royalties from a German licensee does not pay German tax but pays the full 48-percent U.S. tax with no foreign tax credit because there is no foreign tax.

Uncertainties arose in Germany as to whether the term royalty included payments for know-how, and varying interpretations were given by the German authorities in particular cases. It was an unsettled question in the German law. In this protocol, the Germans have agreed, starting with 1963, to exempt know-how royalties, which was the interpretation the United States had thought was proper. They agreed to that starting in 1963, and in a letter—in an exchange of letters which I will submit for the record (see p. 26) also indicate that if there had been an express holding or ruling in any situation previous to 1963 with respect to any taxpayer, they will in effect abide by that ruling of exemption, even in the years prior to 1963.

I think this is highly favorable to American interests and settles this matter which was of great concern to a number of American companies.

The next matter—I think this is getting near the end—is that under our internal law, we largely exempt capital gains of foreigners where the gains arise in the United States. The German law was not that way, and they did subject foreigners to a capital gains tax. Under the peculiarities of German law, that capital gains tax could be imposed in some situations where the entire transaction occurred outside of Germany, but the tax would be imposed because the subject matter of the transaction was stock in the German corporation. So, for example, if a U.S. company, owning a German subsidiary, sold the stock of that subsidiary in the United States to another U.S. company, Germany would levy a 51-percent tax on that transaction, saying in effect that it arose out of a German activity.

Under this protocol, Germany gives up its tax in that case, and this is a distinct benefit to U.S. interests because the German tax would otherwise apply in some situations where people would not expect it to apply. It also benefits the U.S. Government because we do not have to give a foreign tax credit any longer for this tax.

The other parts of the protocol deal with restatement of the German rules by which double tax relief, relief against double taxation, is given to German residents and Germany corporations investing in the United States. They really pretty much bring the treaty into conformity with existing German internal law.

And then one other clause which I think is of importance and is new to our treaties. This deals with this kind of situation. When a U.S. parent has a foreign subsidiary, a number of transactions take place. Goods are sold to that subsidiary. Services may be rendered to that subsidiary. Our Government is interested in the charges that occur in these transactions between a U.S. parent and a foreign subsidiary to see that the U.S. parent receives a fair return for the goods it sells or the services it renders, to make sure that its U.S. income, subject to U.S. tax, is fairly reflected. We have the authority to make adjustments where there has been improper accounting.

Our adjustments would generally be in the form, in this situation, of ascribing income to the U.S. parent. For example, the U.S. parent may have undercharged its foreign subsidiary for goods. The U.S. Internal Revenue Service may say that it should have charged more for these goods. If it is successful in that contention, it means that the German subsidiary in turn should have paid more and should have a higher deduction under its German tax and is entitled in effect to a refund from Germany.

These transactions are so difficult that sometimes they are not decided and terminated for a considerable period of time. In many cases the two countries may not agree until after the statute of limitations may have run on the ability of, say, the German Government to make a refund. This protocol says that if the two Governments come into agreement as to what is the proper allocation of profits or other matters of this nature, such as source of income, then they have authority to carry out that agreement despite limitations in the Code, such as the statute of limitations on the carrying out of that agreement; and the same rule would apply to the United States if the situations were reversed and we reached agreement to make a refund. Then, in effect, our statute of limitations is put to one side.

I think clauses of this nature, which we are endeavoring to incorporate in all of our treaties with the major countries, will greatly facilitate what is probably coming to be one of the most difficult problems in international transactions, and that is a fair allocation of income between one country and another, and the ability to carry out an agreement, once it is reached. The clauses will permit us and foreign governments and American taxpayers and foreign taxpayers to reach rational results in these cases. So I regard this as an important step forward in international transactions and in international rules.

Senator GORE. Germany has not taken any action on the treaty, has she?

Mr. SURREY. No, Mr. Chairman. Their parliament has not come into session until after the recent elections. We understand that their parliament, their legislature will meet this year, and the German authorities involved with these matters will make every effort to have the treaty ratified this year. They regard that as an important matter.

Senator GORE. A loss of revenue to the German Government and thus a larger payment on the part of the U.S. interests will be involved in the ratification this year or after this year, will it not?

Mr. SURREY. I think there may be cases in which the figures for a particular company are large, but this has never been a point of discussion with the German authorities, and they have been anxious to

have the treaty ratified. I have never had this point brought up. Mr. Gordon who talked with the German authorities recently, confirms their desire to get this ratified this year. One of the biggest items is their giving up their tax on know-how royalties, which is much larger than anything else involved, and that is effective as of January 1963. So it would not make any difference when it was ratified.

Senator GORE. Have you had any assurances in writing of the German intent to secure early ratification?

Mr. SURREY. We do not have it in writing. Mr. Gordon discussed this matter with the German authorities about a week ago in Paris, and I think both governments agreed to informally take every step necessary. I am certain that if the treaty is ratified by us, that within this year we and they will make every effort to assure its ratification in Germany.

Senator GORE. Thank you, Mr. Secretary.

Mr. SURREY. Thank you.

(The statement and memorandum on the tax protocol with the Federal Republic of Germany referred to above follows:)

STATEMENT ON THE PROTOCOL AMENDING THE INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND THE FEDERAL REPUBLIC OF GERMANY BY STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY

Mr. Chairman and members of the committee, I am very glad to discuss the protocol signed September 17, 1965, to amend the income tax convention between the United States and the Federal Republic of Germany, which was entered into in 1954. The protocol is the result of discussions which have taken place over a period of years to deal with a number of problems that emerged under the convention as it now stands and to take account of changes made in the German income tax system in the years since the convention came into effect.

I do not propose to discuss each provision of the protocol, since the President, in transmitting the protocol to the Senate, also transmitted a memorandum which summarizes each article in the protocol. Moreover, at the end of my remarks I will submit for the record a comprehensive technical memorandum which goes into considerable detail in connection with each article of the protocol. I shall therefore confine my remarks to the principal provisions of the protocol.

I should like, first, to note that on the whole the protocol will have a greater impact on the application of German tax laws than on U.S. tax laws. It will bring German tax practices more into line with U.S. tax practices and thus bring about a greater degree of reciprocity than has hitherto prevailed with respect to certain types of transactions and income flows. In general, therefore, the protocol produces tax changes which are beneficial to Americans having interests in Germany.

Article 1 of the protocol restates the taxes covered by the convention. It describes more precisely than at present the German taxes falling within its scope and adds certain German taxes which are not measured by income, the trade tax, and the tax on capital. The consequence of this change is to enlarge the tax benefits accruing to U.S. residents and corporations holding German assets by also granting them exemption from these nonincome taxes on those assets.

PERMANENT ESTABLISHMENT PROVISIONS

Article 2 of the protocol provides for a new definition of the term "permanent establishment." This is a key term in tax treaties since a taxpayer not having a permanent establishment in a country may not under our treaties be taxed on industrial or commercial profits arising within the country. The definition of the term, in effect, sets forth what types of activity constitute a permanent establishment and hence establishes the limits within which an enterprise of one country may conduct activities in the other country without being subject to tax on industrial or commercial profits in that other country. The definition

of a permanent establishment in this protocol is essentially the same as in our tax conventions with Luxembourg and Sweden, which have been approved by the Senate, and in our convention with Belgium which is also before your committee. I would like specifically to mention one aspect of this definition, the phrase which refers to a "place of management." A place of management, like an office, store, or factory, can constitute a permanent establishment. Some have feared that this phrase may be interpreted by Germany to hold a permanent establishment to exist if a business executive from an American corporation should make certain decisions in that country with respect to the operations of his firm's subsidiary there, even though the decisions are made in a place temporarily occupied by the executive as living quarters.

In this connection, I would like to submit a memorandum of understanding which accompanies the protocol (see p. 25). The first item in that memorandum provides that "a hotel room or similar place temporarily occupied by officials of an enterprise exercising management functions shall not be interpreted to constitute a place of management." This issue also was considered in connection with the tax convention with Luxembourg, and we there entered into an exchange of letters which provided that decisions taken by executives which are solely of a technical or scientific nature will not be interpreted to constitute "management." We have agreed with the German tax authorities that a similar principle will apply in the application of the term "management" used in this protocol. We have not included this in the memorandum of understanding only because the time necessary to reach terminological precision in both the English and German languages would have delayed too long consummation of the protocol. I am confident that in the application of the term "place of management," the fears that have been expressed will prove to be groundless. I should like to point out that the language used in the protocol is taken from the OECD model convention. We are seeking to achieve as much uniformity among the industrialized countries as possible in the terminology used in tax conventions. For this reason, we and the German authorities preferred not to alter the permanent establishment language but to arrive at a clearer understanding of what the language means through the memorandum of understanding and our discussions.

Article III of the existing convention provides that an enterprise of one country with a permanent establishment in the other may be taxed in that other country on its industrial or commercial profits. The tax will be at the regular rates applicable to business income. It goes on to say, moreover, that all other income from that country, such as investment income or royalty income, which accrues to the enterprise will be treated as income of the permanent establishment and taxed at such regular rates together with the profits which are actually attributable to the operations of the permanent establishment. Thus, if a German company having a marketing branch in the United States holds, say, U.S. government bonds, the interest it receives is treated as the income of the permanent establishment and taxable to it even though the convention provides for tax exemption of interest paid to a German corporation which does not have a permanent establishment here. The taxation of a foreign enterprise which has a permanent establishment on all income from sources within the United States at regular rates has come to be referred to as the "force of attraction". It produces anomalous situations and tends to discourage investment in the United States by the foreigners most likely to invest here.

The protocol amends the convention so as to abandon the "force of attraction". To accomplish this result, the protocol amends articles III, VI, VII, and VIII and adds a new article IXA. Under these new provisions, a permanent establishment of a firm in the other country will be taxable at regular rates only on the business income attributable to the activities of the permanent establishment or the investment income "effectively connected" with the activities of the permanent establishment. Other income, such as investment income or royalties which are not effectively connected to the firm's business activities in the country, will be treated in accordance with the relevant provisions in the convention regarding those types of income. Hence, if a German firm derives interest income which is not effectively connected with the activities of its permanent establishment in the United States, the interest would be tax exempt under the convention.

This is not the first tax convention to depart from the "force of attraction" approach. Our tax convention with the United Kingdom was amended some years ago to extend the exemption which otherwise applied to royalty payments to cases where the recipient of the royalties had a permanent establishment situated in

the country from which the royalties were derived where such payments are not directly associated with such permanent establishment. However, this protocol is the first convention which fully eliminates the "force of attraction" principle.

I should like to add that the treaties written among the European countries, as well as the OECD model convention, generally do not contain the "force of attraction" principle. Instead, they rely on the "effectively connected" doctrine.

The memorandum of understanding expounds on the meaning of the term "effectively connected" and is intended to minimize administrative problems that might arise in its application.

TAX RATE ON DIVIDENDS AND PROFITS

In the existing income-tax convention, provision is made for a reduced rate of withholding tax of 15 percent on dividends paid by a 10-percent-or-more-owned subsidiary corporation in one country to a parent corporation in the other country. As respects the United States, this is in lieu of our 30-percent statutory rate. Under article 4 of the protocol, this reduced rate would apply to all noneffectively connected dividends paid from one country to a recipient in the other, and thus will extend to portfolio investments. This extension of the reduced rate of tax applicable to dividends brings the German convention more nearly into line with most of the other tax conventions to which the United States is a party. At the same time, the protocol increases the withholding tax rate in certain situations to deal with what Germany has considered to be an abuse resulting from the interaction of the split rate German corporation tax and the reduced withholding tax rate in the treaty.

The German corporate tax on distributed profits (15 percent) is much lower than that on retained profits (51 percent). As a result, some American companies with German subsidiaries have found it to their tax advantage to distribute all of the profits from such German subsidiaries as dividends to the U.S. parent, subjecting those profits to the low German corporate tax rate on distributed profits and to the 15-percent German withholding tax (and also to the U.S. tax, but with application of a credit for the German taxes), and then immediately to reinvest the balance in the German subsidiary. The combination of the low German corporate tax on distributed profits and the treaty withholding tax, even with any U.S. tax that had to be paid, often was lower than what the German corporate tax alone would have been on the undistributed profits involved had they been simply retained by the German subsidiary rather than being distributed and reinvested. To eliminate the incentive to distribute and reinvest in such cases, the protocol provides that Germany may continue to impose its statutory withholding tax rate of 25 percent on dividends which are distributed and then reinvested in Germany by the parent company. For this purpose, an investment made in a German subsidiary by a U.S. parent company in the year in which the latter receives dividends from the subsidiary, or in either the year immediately preceding or following the receipt of such dividends, is considered to be a reinvestment of the dividends received. However, the amount deemed reinvested in any year must exceed 7½ percent of the dividends received from the subsidiary in such year for this provision to apply.

In connection with the abandonment of the "force of attraction" principle which I mentioned earlier, the protocol also provides in article 4 that if dividends paid to a foreign enterprise are unrelated to the operations of its permanent establishment in the country from which the dividends are paid, such dividends will not be taxable at regular rates to such foreign enterprise. Instead they will be taxed at the 15-percent withholding tax rate applicable to a foreign enterprise which does not have a permanent establishment in the source country.

The same principle is established by article 5 of the protocol with respect to interest received by a person in one country from sources within the other, and by article 6 with respect to royalties. Both types of income are thus exempt under the convention from tax in the source country when not effectively connected with a permanent establishment situated therein.

Article 6 of the protocol revises the tax treatment of royalties in one other respect also. Prior to the protocol, royalties were exempt from tax in the source country when received by a resident or corporation of the other country. However, in some cases the German authorities had been placing a stricter construction on the term "royalty" than was the case in the United States. For example, they did not apply the exemption to payments for "know-how." The

protocol revises the definition of royalties so that not only are payments for the use of or right to use patents, copyrights, and similar property rights covered by the exemption, but also payments for the use of or right to use knowledge, experience, and skill ("know-how") are exempt. It has been agreed that this expanded exemption will be applicable from January 1, 1963, and in some cases the exemption will apply to earlier periods as well. In this connection, I would like to submit for the record an exchange of letters between the Treasury and the German Ministry of Finance relating to this question, which indicates the cases in which the German exemption will apply prior to January 1, 1963.

Under existing U.S. law, capital gains realized by nonresident aliens and foreign companies are exempt from tax in the United States except in limited cases. Under German law, however, capital gains of Americans are taxable under circumstances that are not so restricted. Since the treaty now contains no provision on capital gains, the reciprocity in the tax treatment of capital gains is lacking. Article 8 of the protocol remedies this by establishing rules for the exemption of capital gains. The principal advantage to the United States lies in the changed tax treatment with respect to what the Germans refer to as "a substantial participation"—where a taxpayer, an individual, or corporation, owns 25 percent or more of the shares of a Germany company. If the owner of such an interest in a German company disposes of any shares, the profits derived from their sale are treated under Germany law as profits derived from within Germany and are therefore subject to tax there. The German view is that under these circumstances the owner of the stock is in effect doing business in Germany and therefore the gains derived from the sale of the stock represents the realization of profits within Germany. This situation has posed problems for American companies who sought to reorganize their holdings in a German subsidiary or to dispose of their interest in a German corporation. Such companies found themselves subject to tax in Germany under circumstances where no tax was levied in the United States, as in the case of a tax-free reorganization. Or if the sale took place in the United States, the gain was considered to have a source in the United States and therefore no credit was allowed for the tax imposed by Germany. Under the protocol, such situations will no longer arise since Germany will not tax any gain on the disposition of shares in a Germany company. The memorandum of understanding attached to the protocol makes explicit that the exemption applies to stock in a subsidiary company (substantial participation) disposed of by a parent corporation. Moreover, as in the case of other income, the "force of attraction" principle will be replaced by the "effectively connected" concept with respect to capital gains.

Under German law, payments received by a U.S. resident for services which are performed in the United States but the results of which are utilized in Germany are considered to be income earned in Germany and subject to tax there. For example, if an engineer in the United States prepares drawings for use in connection with a manufacturing process, which drawings are transmitted to Germany and utilized there, Germany would tax the engineer on the income he receives for his services in preparing the drawings. This German tax would be imposed even though the engineer never left the United States, on the ground that his income is derived from the utilization in Germany of the fruits of his services. Under U.S. law, the income would have a source in the United States because the services are performed here and no part of the Germany tax imposed on such income would be allowable as a credit against U.S. tax. Article 9 of the protocol amends the existing convention to eliminate German tax in such situations and thus removes the double taxation that now exists.

This article of the protocol also tightens up somewhat the tax treatment of personal service income. Prior to the protocol, the exemptions contained in article X of the convention applied to services performed as an employee of, or under contact with, either (1) a natural person resident in, or a company of, the country of the taxpayer's residence—in which case there was no limitation on the amount of compensation which was exempt from source country taxation, or (2) any other employer—in which case the exemption from source country taxation was limited to cases in which compensation received for such labor or personal services did not exceed $3,000. Amended article X of the convention requires that, as a prerequisite to exemption, compensation be received for services performed as an employee of, or under contract with, only a natural person resident in, or a corporation of, the country of the taxpayer's residence. Moreover, the amended article requires that such compensation be borne directly by such an individual resident or corporate employer, and not by a permanent

establishment maintained by such employer in the country of source. This change brings the convention into conformity with the OECD model draft convention.

Article XV of the existing convention contains the basic provisions for eliminating double taxation. Under its terms Germany does not impose a tax on its residents or companies receiving income from sources within the United States if under the convention such income is taxable in the United States. This has resulted in certain tax advantages which Germany does not wish to perpetuate for German taxpayers receiving some forms of income from sources within the United States. Consequently, article 12 of the protocol revises the tax treaty so that in the case of portfolio dividends and Government wages, salaries, and pensions Germany will be permitted to impose tax on amounts received from U.S. sources but will allow a credit for U.S. tax imposed on such income. Exemption will continue where dividends are paid by a U.S. corporation to a German parent corporation. For this purpose a parent company is defined as one which owns 25 percent or more of the voting stock of the corporation paying the dividends. Article XV also provides that U.S. citizens or residents who also are residents of Germany for tax purposes (and, therefore, are subject to tax in both countries on their worldwide income) shall be allowed a credit against German tax for U.S. taxes on any U.S. sources income regardless of other provisions of the treaty.

Under U.S. tax law, nonprofit institutions abroad may qualify for exemption from U.S. tax on their income from U.S. sources and may secure a ruling from the Internal Revenue Service as to their nontaxable status. In other words, a German nonprofit institution may acquire the same tax-exempt status as a domestic nonprofit institution. However, German law does not accord U.S. organizations the exemption from German tax which German institutions enjoy. There are some American nonprofit institutions that have obtained German securities by bequest or otherwise and are subject to tax in Germany on the income from such securities. Article 13 of the protocol revises the existing convention by inserting a new article as a result of which American nonprofit institutions may qualify for exemption from tax in Germany on income from sources there. It thus would achieve reciprocity in the tax treatment of nonprofit institutions.

The existing convention contains provisions for exchanges of information between the tax authorities of the two countries to prevent fraud and to carry out the various provisions of the convention. However, the existing language has been construed to preclude the use by one country of tax information obtained in the other in proceedings before a court or other administrative body. Article 14 of the protocol would amend the existing language of the convention so as to permit the disclosure of such information in a court or other administrative proceeding involving the assessment and collection of taxes.

The objective of the tax conventions to eliminate double taxation has sometimes been frustrated by the fact that refunds could not be made in appropriate cases. Assume for example that transactions have taken place between a German subsidiary and a U.S. parent corporation and that upon audit of the return of the parent company the U.S. tax authorities find that the income reported by the parent company had been understated. Perhaps the price charged the subsidiary company for goods sold to it by the parent corporation was too low. A deficiency might be assessed against the parent company and U.S. tax imposed on an amount which had previously been reported as a profit by the German subsidiary and had been subject to tax in Germany. Assume, further, that the German tax authorities are in agreement with the U.S. tax authorities that the price charged the German subsidiary is too low. Unless the Germans can make a refund of the tax previously collected on the income of the subsidiary, which is now to be treated instead as additional profits of the American parent company, there will be double taxation. However, the authority for Germany to make refunds might have expired because the length of time taken for the U.S. tax authorities to make the deficiency assessment exceeded the time during which a refund could be made by the German authorities. Article 15 of the protocol amends the existing convention so that under these circumstances a refund could be made by the German authorities. In other words, the protocol would extend the statute of limitations for the purpose of making refunds in appropriate cases. The same provision would apply to the United States.

The dividend article of the protocol will affect dividends paid on or after January 1, 1965; the royalty article will affect such payments made on or after

January 1, 1963; and all other articles of the protocol will become effective for taxable years beginning on or after the first day of January in the year in which the exchange of instruments of ratification occurs.

I have discussed what I believe to be the most important provisions of the proposed protocol to the convention between Germany and the United States, and I urge the committee to take prompt action in reporting it out with a recommendation for ratification. With your permission, I am submitting for the record a memorandum of understanding with the German authorities on the permanent establishment and other questions, an exchange of letters on the "know-how" question, and the technical memorandum on the protocol.

MEMORANDUM OF UNDERSTANDING BETWEEN TAX DELEGATIONS OF GERMANY AND THE UNITED STATES CONCERNING THE PROTOCOL SIGNED SEPTEMBER 17, 1965, TO MODIFY THE INCOME TAX CONVENTION OF JULY 22, 1954

The representatives of the German Ministry of Finance and of the U.S. Treasury Department hereby agree that the protocol modifying the Income Tax Convention of July 22, 1954, between Germany and the United States of America shall be applied in accordance with the following principles:

1. In the application of article II of the convention a hotel room or similar place temporarily occupied by officials of an enterprise exercising management functions shall not be interpreted to constitute "a place of management."

2. For purposes of determining whether a corporation that has received a dividend has made a reinvestment in the corporation paying the dividend so that paragraph (3) of article VI of the convention applies to the dividend deemed to have been reinvested, paragraph (5) of that article shall be interpreted so that loans which do not constitute more than a temporary addition to the capital of the corporation paying the dividend, as for example trade credit extended in accordance with the general credit practices followed in the trade or business concerned, shall not be deemed to constitute reinvestments. The renewal or conversion into equity capital of loans outstanding as of December 31, 1964, other than those mentioned in the foregoing sentence, shall not be deemed to constitute a reinvestment.

3. The term "effectively connected" as used in articles VI, VII and VIII of the convention shall be so construed that items of income referred to in the respective articles will be considered to be effectively connected with a permanent establishment if such items of income accrue to the recipient by virtue of assets (*a*) held by the permanent establishment or (*b*) held by the recipient specifically to promote the business activities of the permanent establishment, or if the activities of the permanent establishment are a material factor in realizing such items of income. As used in article IX A of the convention, the term "effectively connected" shall be so construed that gain to which the article applies will be considered to be effectively connected with a permanent establishment if the gain is derived from the alienation of property (*a*) held by such permanent establishment or (*b*) held specifically to promote its business activities.

4. Both delegations agree that the amendment effected by article 6 of the protocol shall not influence the interpretation to be given to article VIII of the convention prior to the amendment.

5. The exemption of capital gains provided by article IX A of the convention is understood to apply to the sale, liquidation or other alienation of a "wesentliche beteiligung" (substantial participation) in a company.

6. In the event that either the U.S. income tax or Federal Republic tax, as it applies to corporations, is substantially changed, or if experience in individual cases indicates that the application of article VI leads to effects that are not in accordance with the basic principles underlying that article, the competent authorities of the contracting States shall consult together for the purpose of ascertaning whether it is necessary to amend article VI.

Done at Bonn in duplicate, in the Engish and German languages, each text having equal authenticity, this 18th day of October 1965.

For the U.S. Treasury Department.

ARTHUR BLASER.

For the Federal Ministry of Finance.

FALK.

TREASURY DEPARTMENT,
ASSISTANT SECRETARY,
Washington, D.C., August 27, 1965.

DEAR MR. FALK: To avoid possible difficulties in the future concerning the tax treatment accorded by the tax authorities in the Federal Republic of Germany to payments for know-how made prior to January 1, 1963, to U.S. recipients, I am writing my understanding of the agreement we reached in the course of our discussions on the modification of the existing income tax convention.

Remuneration for know-how paid prior to January 1, 1963, from sources in the Federal Republic to a resident or corporation or other entity of the United States will be exempt from Federal Republic tax provided the competent German tax assessment authorities by virtue of an audit report or for other reasons have stated that such remuneration is exempt from tax. Such a statement will be deemed to have been made if the competent authority in rendering its decision did not expressly disagree with an audit report holding such remuneration to be tax exempt. Such remuneration will be tax exempt provided the said statement was not revoked prior to the payment of the remuneration.

If this accords with your understanding of the matter, I would appreciate it if you were to send me, as promptly as possible, a letter confirming it.

Sincerely yours,

(Signed) STANLEY S. SURREY.

MR. LUDWIG FALK,
Ministerial Director,
Ministry of Finance,
Bonn, Germany.

MINISTERIALDIREKTOR DR. FALK, IM,
BUNDESMINISTERIUM DER FINANZEN,
BONN, *September 23, 1965.*

Prof. STANLEY S. SURREY,
Assistant Secretary, Treasury Department,
Washington, D.C.

DEAR MR. SURREY: Thank you for your letter of August 27, 1965. I have pleasure in confirming as follows my understanding of the agreement we reached in the course of our discussions on the protocol to amend the United States/German income tax convention:

Remuneration for know-how paid prior to January 1, 1963, from sources in the Federal Republic to a resident or corporation or other entity of the United States will be exempt from Federal Republic tax provided the competent German tax assessment authorities by virtue of an audit report or for other reasons have stated that such remuneration is exempt from tax. Such a statement will be deemed to have been made if the competent authority in rendering its decision did not disagree with an audit report expressly holding such remuneration to be tax exempt. Such remuneration will be tax exempt provided the said statement was not revoked prior to the payment of the remuneration.

You will note that I changed the wording of the last sentence of the preceding text by inserting "expressly" between "report" and "holding" in order to make it quite clear to the German reader that the findings of the audit report must expressly mention the tax exemption of the payments for know-how. In view of what the term "holding" means in this context, that change does not alter the substance of what is contained in our exchange of letters.

Sincerely yours,

FALK.

TECHNICAL MEMORANDUM OF TREASURY DEPARTMENT CONCERNING PROPOSED PROTOCOL AMENDING THE INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND THE FEDERAL REPUBLIC OF GERMANY

A protocol was signed at Bonn on September 17, 1965, modifying the existing incom tax convention between the United States and the Federal Republic of Germany. This protocol had its inception in the desire of the contracting parties, in some cases occasioned by changes in their respective tax laws, to make certain changes in the convention and to extend it both to certain other taxes

and to some additional items of income. The extension in the coverage of this convention to certain German taxes imposed upon capital necessitated an amendment in the title of the original convention to include after the words "with respect to taxes on income" the words "and to certain other taxes."

This protocol contains 18 articles and includes a memorandum of understanding concerning the interpretation to be given to certain of its provisions. It covers a broad range of subjects, including the taxation of business and personal service income, dividends, interest, rents, royalties, and capital gains, as well as a redefinition of the concept of "permanent establishment," the granting of relief from double taxation by the country of the taxpayer's residence, and the abandonment of the so-called force-of-attraction doctrine. In addition the protocol contains a new provision empowering the competent authorities of the two countries to make adjustments in tax liability, including refunds, and determinations as to the source of particular items of income, in order to avoid double taxation in appropriate cases. Such adjustments may be necessary, for example, when disparate allocations of income are made in relation to trade transactions between a German and a related United States enterprise. A summary and explanation of the protocol follows.

ARTICLE 1

Taxes covered

Article 1 of the protocol amends existing article I of the convention, relating to the taxes referred to in the treaty.

The amended article adds two German taxes to the list of those covered by the treaty and eliminates a German tax (the Berlin emergency contribution, i.e., Notopfer) which the Federal Republic no longer imposes.

The additional German taxes covered by the amended convention are the German trade tax (Gewerbesteuer) and the German capital tax (Vermoegensteuer). The Government of the Federal Republic relinquished its right to impose its tax on capital with respect to certain U.S. taxpayers, under article 11 of the protocol, even though the United States does not impose comparable taxes and could not make a reciprocal concession.

The German Government also relinquished its right to impose the trade tax, which is computed on the basis of business profits, capital, and wages paid, where no German income or corporation tax can be imposed under the treaty. As a result, new paragraph (3) of article I of the convention makes clear that the entire trade tax is covered under the treaty and not just the portion thereof which is computed on the basis of profits or capital.

The United States, however, will continue to allow a foreign tax credit only for the portion of the trade tax which is computed on the basis of business profits.

ARTICLE 2

Permanent establishment

Article 2 of the protocol redefines the term "permanent establishment" in article II(1)(c) of the existing convention. This redefinition corresponds in all material respects with article 5 of the model income tax convention prepared by the OECD Fiscal Committee, with the following exceptions:

1. The phrase "a store or other sales outlet" has been added to the list of those fixed places of business which, if maintained or used by the taxpayer in carrying on his business in the taxing jurisdiction, will constitute a permanent establishment;

2. The provisions of clause (cc) of new subparagraph (c) have been revised to provide that a taxpayer of one country can maintain facilities for one or more of the activities enumerated therein without being considered as having a permanent establishment in the other contracting state. Thus, the goods of a taxpayer of one country can be stored in a fixed place of business of the taxpayer in the other contracting state for delivery, display, or processing by an unrelated party, and the taxpayer may engage in purchasing, advertising, research, and similar activities through such a fixed place of business without being considered as having a permanent establishment.

Paragraph 1 of the memorandum of understanding which supplements this protocol provides a definition of the term "a place of management," which appears in new article II(1)(c)(ff) of the existing convention, by excluding therefrom a hotel room or similar place temporarily occupied by officials of an enterprise who are exercising management functions therein. Thus, the executives of a U.S. corporation can visit the Federal Republic and make decisions in a

hotel room or similar place which they temporarily occupy during such visit, which decisions affect the management of that corporation's business without such room or similar place being classified as "a place of management" (and, therefore, a permanent establishment) for purposes of the convention. It was also agreed that the term "management" should be interpreted to exclude decisions which are solely of a technical or scientific nature.

ARTICLE 3

Industrial or commercial profits

Article 3 of the protocol limits existing article III of the convention, which relates to industrial or commercial profits, by providing that such profits are taxable by the source country only if an enterprise of the other contracting state is engaged in trade or business in the source country through a permanent establishment and if such industrial or commercial profits are (1) attributable to such permanent establishment, (2) derived from sales of goods or merchandise of the same kind as those sold through such permanent establishment, or (3) derived from other business transactions of the same kind as those effected through such permanent establishment.

Example 1. A German company maintains a permanent establishment in the United States through which it sells and services computer equipment. In addition, it sells office furniture in the United States through an independent agent. The profits derived from the sale of the office furniture are exempt from U.S. tax under the convention, since the office furniture is not the same kind of goods or merchandise as the computer equipment being sold through the permanent establishment.

Paragraph (2) of new article III of the treaty contains the provision found in the original convention requiring the allocation of profits between the enterprise's home office in one treaty country and permanent establishment in the other country on an "arm's length" basis.

Paragraph (3) of new article III provides that there shall be allowed as deductions all expenses, wherever incurred, which are reasonably connected with the industrial or commercial profits taxable to the permanent establishment. This paragraph is similar to paragraph (4) of article III of the original convention. The revised paragraph, however, states specifically that deductions shall be allowed if reasonably connected with the permanent establishment's profits without regard to the country in which those expenses are incurred. Thus, where an enterprise of one country uses a patented formula in the manufacturing operations it is carrying on through a permanent establishment in the other country, all or a portion of the royalty which the enterprise must pay for the use of the patented formula may be deducted in computing the amount of the industrial or commercial profits attributable to the permanent establishment which is taxable in such other country.

Paragraph (4) of new article III of the treaty provides that no profits shall be deemed to be derived by an enterprise merely by reason of the purchase of goods or merchandise by a permanent establishment of the enterprise, or by the enterprise itself, for the account of the enterprise. Essentially the same provision is contained in article III (2) of the original treaty.

Paragraph (5) of new article III of the treaty contains a definition of the term "industrial or commercial profits," for purposes of the convention. Such term includes income derived by an enterprise in the active conduct of a trade or business and generally excludes income, such as dividends, interest, royalties, and capital gain which is specifically dealt with in other articles of the convention.

Prior to this protocol, it was not clear that income derived from the furnishing of services of employees of a U.S. enterprise within Germany (or for utilization in Germany) constituted "industrial or commercial profits" within the meaning of article III of the convention, or personal services within the meaning of article X of the convention. New paragraph (5) of article III of the convention, added by the protocol, specifically provides that the term "industrial or commercial profits" includes "income derived by an enterprise from the furnishing of services of employees or other personnel." The services referred to include income from the furnishing, by a corporate or other enterprise, of engineering, marketing research, consultant, advertising, advisory, legal, accounting, entertainment, or other services whether performed by its own employees or by individuals who are not technically employees but who are under contract with that enterprise to perform such services. Thus income derived from the performance of such services within Germany by a U.S. enterprise which does

not have a permanent establishment in Germany will not be subject to German tax. However, the new paragraph has no application to compensation for services which an individual taxpayer renders.

ARTICLE 4

Dividends

Article 4 of the protocol deletes existing article VI of the convention, relating to the taxation of dividends, and replaces it with a new article VI.

Paragraphs (1) and (2) of new article VI provide in general that the tax imposed by the country of source on dividends received by individuals and corporations of the other treaty country shall not exceed 15 percent of the gross amount of the dividends actually distributed. These provisions generally reduce the tax otherwise imposed under the U.S. Internal Revenue Code (usually 30 percent) and under the German income tax law (usually 25 percent). Such paragraphs also expand the coverage of article VI of the existing convention by including for the first time within paragraphs (1) and (2) dividends paid to individual shareholders and less than 10 percent corporate shareholders.

The Federal Republic imposes a lower rate of corporate tax (presently 15 percent) on distributed earnings than it imposes on undistributed earnings (presently 51 percent); and the trade tax which is collected by the municipalities on (among other things) the business profits of a corporation is deductible in computing the Federal Republic corporation tax on undistributed profits.

In the case of dividends paid by a German subsidiary to a German parent corporation which owns directly at least 25 percent of the outstanding stock of such subsidiary, the Federal Republic imposes a supplementary 36-percent tax (Nachsteuer) on the amount of dividends received by the German parent corporation from its 25 percent or more owned subsidiary (to the extent such dividend income is not distributed to the shareholders of the German parent corporation). However, such supplementary tax (Nachsteuer) does not apply to dividends received by a foreign corporation owning stock of the German distributing corporation. In such cases, dividends are subject to German withholding tax of 25 percent at source under German law. Article VI of the original treaty, however, reduces this rate of the German withholding tax to 15 percent in the case of U.S. corporations owning 10 percent or more of the voting stock of the distributing corporation. The application of these rules may be illustrated by the following examples:

Example 1. Assume that a German company X derives $1,000 of business profits; that German company X is wholly owned by U.S. corporation Z; and that neither X nor Z distributes any dividends. The German tax liability of X and the amount available for reinvestment by X is determined as follows:

Pretax profits		$1,000
Trade tax at average of 12.3 percent	$123	
Corporation tax: On undistributed profits (51 percent of $877)	447	
Total tax on $1,000 of profits of German company		570
After-tax profits available		430

Example 2. Assume the same facts as in example 1, except that the only income of Z is the $671 (the maximum dividend distributable by company X from its $1,000 in income after satisfaction of German trade tax and corporation tax liability applicable to such income) distribution from X. The German tax liability of Z and the amount available for reinvestment in X is determined as follows:

Dividend from X	$671	
Amount subject to withholding tax (art. VI of original treaty)	671	
Withholding tax (15 percent of $671)	101	
U.S. tax at 48 percent rate on $671 distribution from German company (after application of gross-up):		
Dividend (reduced by 15 percent withholding) (671 minus $101)		$570
U.S. tax (48 percent of $1,000)	$480	
Foreign tax credit ($329 plus $101)	430	
Net U.S. tax		50
After-tax profit		520

The above examples illustrate the incentive afforded a U.S. parent corporation to maximize distributions from its German subsidiary and reinvest the amount of such distributions in the subsidiary.

To eliminate this incentive, new article VI provides that the German tax imposed with respect to dividends paid on or after January 1, 1965, and received by a U.S. corporation or other entity from a Germany company may exceed 15 percent but shall not exceed 25 percent of that portion of any dividend which is deemed reinvested, on or after that date, under paragraph (5) of the article if—

1. The U.S. recipient corporation or other entity owns directly at least 10 percent of the voting shares of the German company paying the dividend;

2. At the time the dividend is distributed the Federal Republic imposes a corporatioin tax on the distributed profits of the German distributing company at a rate at least 20 percentage points lower than the corporation tax imposed on its undistributed profits.

However, under paragraph (5) of amended article VI the increased withholding tax applies only if such reinvestment exceeds 7.5 percent of the dividends received by the U.S. corporation from the German corporation in the calendar year in which such reinvestment is made. Paragraph (5) also provides that with respect to dividends paid in any year, there shall first be taken into account the amount transferred in the preceding year to the extent that such amounts were deemed to be reinvestments under the above rules and did not result in the imposition of tax under paragraph (3) on any prior dividend.

The provisions of paragraphs (3) and (5) of new article VI of the treaty can be illustrated by the following chart and explanation concerning (1) dividends paid by a Germany company to a U.S. corporation directly owning at least 10 percent of its voting shares and (2) reinvestments made by the U.S. corporation in the German company over a period of years:

Year	Dividend	Reinvestment	Amount taxable at 25-percent rate
1965	$100	0	[1] $100
1966	0	$200	[2] 0
1967	80	10	[3] 80
1968	90	20	[4] 30
1969	70	5	[5] 0

[1] $100 is taxable at 25 percent in 1965 because (*a*) $100 dividend was paid in 1965, and (*b*) $100 of the reinvestment made in 1966 is deemed made in 1965.

[2] No amount is taxable at 25 percent in 1966 because no dividend was paid in 1966.

[3] $80 is taxable at 25 percent in 1967 because (*a*) $80 dividend was paid in 1967, and (*b*) $80 of the reinvestment made in 1966 is deemed made in 1967.

[4] $30 is taxable at 25 percent in 1968 because (*a*) $20 was reinvested in 1968, (*b*) the $10 reinvestment made in 1967 is deemed made in 1968, and (*c*) a dividend in excess of $30 ($90) was paid in 1968.

[5] No amount is taxable at 25 percent in 1969 because the $5 reinvestment is less than 7.5 percent of the dividend ($70) paid in 1969.

For purposes of determining whether paragraph (3) requires the imposition of increased German withholding tax, paragraph 2 of the memorandum of understanding between the United States and the German tax delegations, which is attached to this protocol, provides that paragraph (5) of amended article VI of the convention shall be interpreted to exclude from within the meaning of the term "reinvestment" loans which do not constitute more than a temporary addition to the capital of the German corporation paying the dividend; e.g., trade credit extended in accordance with the general credit practices followed in the trade or business concerned.

Paragraph 2 of the memorandum of understanding also provides that the renewal or conversion into equity capital of loans outstanding as of December 31, 1964 (other than loans constituting only temporary additions to capital) shall not be deemed to constitute a reinvestment. This rule is consistent with the effective date provision of the protocol as applicable to the new dividend article (art. 17(2)(a) of the protocol provides that new article VI shall apply to dividends paid and to reinvestments made on or after January 1, 1965).

Paragraph (4) of new article VI provides that the rule permitting the imposition of the 25-percent withholding tax on dividends shall also apply for U.S. tax purposes in the converse case. This rule will only have effect, however, if the United States enacts a split rate corporate income tax similar to that now in

force in Germany. Consequently, at the present time, paragraph (4) merely provides theoretical, rather than practical, reciprocity under the protocol.

Paragraph (6) of new article VI provides a special rule which in effect gives Germany the right to recapture amounts of tax which subsequently become due by reason of the reinvestment rules contained in new article VI (3) and (5). Under amended article VI of the convention, the Federal Republic will tax only at the reduced 15-percent rate on dividends described in paragraph (3) of new article VI of the convention, but reserve their right to recapture treaty withholding tax benefits from a U.S. parent corporation if subsequent reinvestments are made within the meaning of new article VI(5) of the convention. Paragraph (6) also makes it clear that both the taxpayer U.S. corporation and the German distributing company (the withholding agent) are jointly and severally liable for such recapture.

Paragraph 7 of revised article VI of the convention reflects, in the case of dividends, mutual acceptance of limitation on the "force of attraction" doctrine; i.e., the doctrine which permits taxation of all source country income of a foreign enterprise at graduated rates if such enterprise is engaged in trade or business in the source country through a permanent establishment situated therein. It provides that the reduction in withholding tax rates on dividends will apply only to dividend income not "effectively connected" with a permanent establishment in the country of source. The adoption of this new rule attributing to the permanent establishment only those dividends which are effectively connected with that establishment will make it unnecessary for a taxpayer of one country to isolate his business activities in a subsidiary solely to prevent taxation (by reason of the force of attraction rule) of his investment or other income from sources within the other country.

Paragraph 3 of the memorandum of understanding, which supplements the protocol, provides guidelines for determining whether dividends, interest, royalties, and capital gains are "effectively connected" with a permanent establishment within the meaning of articles VI (dividends), VII (interest), VIII (royalties), and IXA (capital gains) of the amended convention. Such classes of income will be considered under the guidelines to be effectively connected with a permanent establishment maintained in the taxing jurisdiction—

(1) If they accrue to the recipient by virtue of assets which are either—
  (*a*) Held by the permanent establishment; or
  (*b*) Held by the recipient specifically to promote the business activities of the permanent establishment; or
(2) If the activities of the permanent establishment are a material factor in realizing such items of income.

The rule contained in (1)(a) above will apply where, for example, stock certificates are (1) held by or (2) accounted for on the books of the permanent establishment. The rule of (1)(b) above will apply where, for example, a dividend is paid by a U.S. selling subsidiary to its parent German manufacturing corporation, and where the German manufacturing corporation has a U.S. permanent establishment which manufactures products sold exclusively by the U.S. selling subsidiary of the German manufacturing corporation.

The rule contained in (2) above will apply, for example, where the activities of the permanent establishment constitute management of securities producing dividend income, i.e, where an office staffed by employees is maintained in the source country by an investment company of the other contracting state for the purpose of selecting and acquiring suitable U.S. investments, since the activities of the permanent establishment would be a material factor in realizing the dividend income.

Paragraph (8) of new article VI contains a definition of the term "dividends" for purposes of the imposition of German tax under the convention. The provision contains a list of the types of distributions by German corporations or other commercial entities which are treated as dividend income for purposes of German withholding tax at the source. The inclusion of this provision was considered necessary in order to clarify certain interpretive difficulties which had existed under the original convention with respect to the scope of the term "corporation" (for purposes of determining whether distributions from such entities constitute dividends). Paragraph (8) of the new dividend article resolves such difficulties by providing that private limited company distributions and income derived by silent partners both constitute dividend income for purposes of the treaty. In addition distributions with respect to shares in a "kapitalanlagegesellschaft" (investment trust) and in a "kommanditgesell-

schaft auf aktien" (partnership limited by shares) as well as income derived from "kuxe" (mining shares) and "genussscheine" (profit participation certificates) are considered to be "dividends" under paragraph (8) of new article VI.

Paragraph (8) affects only the imposition of German tax under the revised convention and has no bearing upon the characterization of income involved for U.S. tax purposes.

ARTICLE 5

Interest

Article 5 of the protocol amends existing article VII of the convention, which provides for reciprocal exemption from source country taxation of interest on bonds, notes, debentures, securities or any other form of indebtedness (including debts secured by mortages or other encumbrances on real property). The existing article was modified by (1) making the exemption applicable to interest on debts secured by mortgages or other encumbrances on real property and (2) providing for the abandonment of the force of attraction doctrine with respect to interest income.

Paragraph (3) of the new article VII provides for the abandonment of the force of attraction doctrine in the case of interest income. Under that paragraph interest will be exempt from tax in the source country if the resident or corporation of the other country (1) does not maintain a permanent establishment in the source country or (2) receives interest income which is not effectively connected with a permanent establishment which the recipient maintains in the source country. In this connection, the rules contained in paragraph 3 of the memorandum of understanding attached to the protocol relating to the definition of the term "effectively connected" are applicable.

Example 1. A German company makes a loan to a U.S. corporation which customarily buys goods from the company's U.S. branch office. If the loan is made for the purpose of permitting the U.S. customer to remain in business, interest paid on the loan will be considered to be effectively connected with the permanent establishment and will be subject to U.S. tax under section 882 of the U.S. Internal Revenue Code.

Paragraph (4) of the new interest article contains a provision denying the exemption for all, or a portion, of interest paid which exceeds the amount which would be agreed upon on an arm's-length basis.

ARTICLE 6

Royalties

Article 6 of the protocol deletes existing article VIII of the treaty and replaces it with a revised provision dealing with the taxation of royalties. The article of the original treaty was modified to (1) provide for the express inclusion of "know-how" payments, (2) include gains from the alienation of any property or rights giving rise to royalties, and (3) abandon the force of attraction doctrine with respect to royalty income.

Subparagraph (a) of paragraph (3) of existing article VIII defines the term "royalties" to mean any royalties, rentals, or other amounts paid as consideration for the use of, or the right to use, copyrights, artistic or scientific works (including motion picture films, or films or tapes for radio or television broadcasting), patents, designs, plans, secret processes or formulas, trademarks, or other like property or rights, or industrial, commercial, scientific, or other like equipment. The protocol expands this definition of royalties to include amounts which are paid as consideration for knowledge, experience, or skill (know-how).

Under article 17(2)(b) of the protocol, the new royalty article will have effect in respect of royalty payments made on or after January 1, 1963. However, the exemption from German tax for "know-how" payments also will apply to such payments made prior to January 1, 1963, in accordance with a separate letter agreement exchanged by the tax authorities of the United States and Germany, where the competent German tax authorities by virtue of an audit report or for other reasons have stated that such remuneration is exempt from tax. Such a statement will be deemed to have been made if the competent authority in rendering its decision did not disagree with an audit report expressly holding such remuneration to be tax exempt.

Paragraph 4 of the memorandum of understanding accompanying the protocol contains the agreement of the United States and the Federal Republic that the "know-how" amendment effected by article 6 of the protocol (new article VIII of the convention) shall not influence the interpretation to be given to article VIII of the convention prior to such amendment. Thus, where no express decision

had been made holding "know-how" payments made prior to January 1, 1963, to be exempt, the German tax authorities may not make use of the fact that such payments were later specifically included under this protocol as royalties for purposes of concluding that such earlier payments were not covered by the exemption provided for royalties in the existing convention.

Paragraph (3) of new article VIII provides that the term "royalties" shall include gains derived from the alienation of any right or property giving rise to those royalty payments described in paragraph (3)(a) of amended article VIII of the convention. For U.S. tax purposes, this exemption shall apply both to gains derived from the outright assignment of property or rights, and from arrangements for the licensing of such property or rights which are deemed to constitute transactions which produce capital gain income. Thus, where an individual resident in the Federal Republic, who does not have a permanent establishment in the United States, transfers all of his substantial rights in a patent he developed to a U.S. corporation in consideration for payments which are contingent upon the use of such patent by the transferee corporation, the payments he receives shall be exempt under article VIII of the convention from the 30-percent U.S. tax otherwise imposed under section 871(a)(1) of the code, despite the specific inclusion within that paragraph of amounts described in section 1235 of the code which are considered to be gains from the sale or exchange of capital assets.

Paragraph (4) of new article VIII provides for the abandonment of the force of attraction doctrine in the case of royalty income. Under that paragraph, royalties and gains derived from the alienation of any right or property giving rise to such royalties, will be exempt from tax in the source country if the resident or corporation of the other country (1) does not maintain a permanent establishment in the source country or (2) receives royalty income within the meaning of amended article VIII which is not effectively connected with a permanent establishment which the recipient maintains in the source country. (See paragraph 3 of the memorandum of understanding for guidelines in determining whether income is effectively connected.)

Paragraph (5) of the revised royalty article corresponds substantially to paragraph (4) of new article VII of this treaty, relating to interest income. It provides that the exemption afforded under the article shall apply only to that portion of any royalty payment which would have been paid pursuant to an arm's-length agreement.

ARTICLE 7

Real property income and natural resource royalties

Article 7 of the protocol amends existing article IX of the convention relating to real property income and royalties derived from natural resources. As is the case under the existing convention, the new provision grants to each country the right to tax income from real property, and royalties in respect of the operation of mines, quarries, or other natural resources, located in that country, but provides that a resident or corporation of the other country may elect for any taxable year to be taxed on that income in the source jurisdiction on a net basis at the rates that would apply to a resident or company of the contracting state in which the property is located—thus allowing deductions for expenses connected with such income. The provision, as amended, no longer applies to any item of interest income; interest income is dealt with under article 5 of the protocol. In addition, the revised provision contains a clarifying amendment making clear that the election applies only to the rental or royalty income referred to in the article.

ARTICLE 8

Capital gains

Article 8 of the protocol adds new article IXA to the convention, which relates to the reciprocal exemption from tax by the country of source of capital gains (other than gains from the alienation of real property, which is governed by amended article IX of the convention).

Paragraph (1) of new article IXA provides, subject to paragraph (3) or (4) thereof, that gain derived by a natural person resident in Germany or a German company from the alienation of a capital asset (other than gain from the alienation of real property covered under new art. IX) shall be exempt from U.S. tax. Paragraph (3) provides that the exemption shall not apply where the person deriving the gain has a permanent establishment in the United States with which the capital asset alienated is effectively connected.

Paragraph (4) contains a unilateral provision designed to prevent individual German residents who are present in the United States for an extended period of time from benefiting from the exemption provided under paragraph (1) in respect of short-term capital gains. Under paragraph (4) a natural person resident in Germany shall not be exempt from U.S. tax by virtue of the treaty with respect to the gain he derives if—

1. He is present in the United States for a period equal to or exceeding an aggregate of 183 days during the taxable year, and
2. The asset alienated was held by such person for 6 months or less.

A similar provision is contained in the internal German tax law.

Thus an alien individual, resident in Germany who sells in the United States an item of property which constitutes a capital asset in his hands which he has held for more than 6 months shall be exempt from U.S. tax (where no permanent establishment is maintained, or where a permanent establishment is maintained and the capital gain is not effectively connected with such permanent establishment) with respect to any gain derived from such sale regardless of the length of his stay in the United States. Where, however, the asset was held by such individual for 6 months or less prior to its sale, and the taxpayer meets the 183-day test, gain on the sale of such asset will be subject to U.S. income tax whether or not the seller is physically present in the United States when the asset is sold.

In the absence of new article IXA, income from the alienation of a substantial participation in a German company by a resident, corporation, or other entity of the United States would be subject to German tax, without regard to the extent of the seller's business activities or presence in Germany. (Similar transactions would not be subject to tax under the Internal Revenue Code.) Paragraph 5 of the memorandum of understanding accompanying the present protocol provides that the exemption of capital gains found in article IXA applies to the sale, liquidation, or other alienation of a substantial participation in a company.

As previously indicated, paragraph (3) of article IXA provides for the abandonment of the force of attraction rule with respect to the taxation of capital gain income. In this regard, paragraph 3 of the memorandum of understanding provides that the term "effectively connected" shall be so construed that the gain to which article IXA applies will be considered to be effectively connected with a permanent establishment if the gain is derived from the alienation of property either (1) held by such permanent establishment or (2) held by the recipient of the capital gain (home office) specifically to promote the permanent establishment's business activities. Unlike the definition of the term "effectively connected" for purposes of the dividend, interest, and royalty articles of the convention, for purposes of new article IXA that term does not include assets the income from which was derived from activities in which the permanent establishment was a material factor.

ARTICLE 9

Personal service compensation

Article 9 of the protocol deletes the personal service income article of the original treaty (article X) and replaces it with a revised provision dealing with the taxation of such income.

The United States does not tax nonresident alien individuals with respect to compensation for personal services performed outside the United States (whether or not the product of such services is used in the United States). However, only German treaty regulations presently prevent German taxation of limited ($3,000 or less) compensation paid to residents of the United States for services performed outside of Germany where such services are considered under German law as having been utilized in Germany. New article X remedies this situation.

Both paragraphs (1) and (3) of new article X of the convention provide for the exemption from the tax of one country of compensation for labor or personal services (including compensation derived from the practice of a liberal profession and the rendition of services as a director) performed outside that country by an individual resident of the other country. Under this rule, which is in accord with U.S. source rules, a lawyer resident in the United States who performs legal services both in the United States and in the United Kingdom during the taxable year for a German company will be exempt from German tax with respect to the fee he receives in respect of such services, without regard to whether or not such services are considered under German law to have been utilized in Germany.

Paragraphs (2) and (4) of the amended article concern the taxation of income for services performed in one country by an individual resident of the other country and, as such, constitute a restatement of article X as originally included in the treaty.

Paragraph (2) provides that compensation for labor or personal services (including, as is the case under para. (1), liberal profession income and directors' fees) performed in the United States by a natural person resident in the Federal Republic shall be exempt from U.S. tax if the following three conditions are satisfied:

1. He is present in the United States for a period or periods not exceeding a total of 183 days during a taxable year;

2. Such labor or personal services are performed as an employee of, or under contract with, a natural person resident in the Federal Republic or a German company, and such compensation is borne by such resident or company; and

3. Such compensation is not borne by a permanent establishment which such resident or company has in the United States.

Paragraph (4) provides corresponding relief from German tax where the services are performed in Germany by a U.S. resident as an employee of, or under contract with, a U.S. resident, corporation, or other entity.

Certain changes have been made in article X by virtue of the present protocol. Prior to the protocol, the exemptions contained in article X of the convention applied to services performed as an employee of, or under contract with, either (1) a natural person resident in, or a company of, the country of the taxpayer's residence—in which case there was no limitation on the amount of compensation which was exempt from source country taxation, or (2) any other employer—in which case the exemption from source country taxation was limited to cases in which compensation received for such labor or personal services did not exceed $3,000. Amended article X of the convention requires that, as a prerequisite to exemption, compensation be received for services performed as an employee of, or under contract with, only a natural person resident in, or a corporation of, the country of the taxpayer's residence. Moreover, the amended article requires that such compensation be borne directly by such an individual resident or corporate employer, and not by a permanent establishment maintained by such employer in the country of source.

ARTICLE 10

Government pension and salaries; private pensions and annuities

Article 10 of the protocol deletes article XI of the original convention and replaces it with a new provision relating both to governmental salaries and pensions and private pensions and annuities. This revision was made for the purpose of adding language to the original article which would exempt from U.S. tax pensions, annuities, or other amounts paid by Germany or by a juridical person organized under the public laws of Germany as compensation for an injury or damage sustained as a result of hostilities or political persecution.

Amounts paid by reason of political persecution under the National-Socialist regime are considered to be in the nature of reimbursements for the deprivation of civil or personal rights and do not constitute taxable income to the recipients under U.S. law (Rev. Rul. 56-518, C.B. 1956-2, 25).

Provisions such as this one are generally included within income-tax conventions concluded by Germany and are phrased in reciprocal terms. However, in the case of compensation for injuries sustained as a result of hostilities or political persecution, such provisions apply only for purposes of limiting the imposition of tax by Germany's treaty partner.

ARTICLE 11

Taxes on capital

Article 11 of the protocol adds new article XIVA to the existing convention, relating to the imposition of the taxes covered by amended article I of the convention which constitute taxes on capital. This has reference (1) to the portion of the German Gewerbesteuer (trade tax) which is computed on the basis of capital and (2) to the German Vermoegensteuer (capital tax) covered under new article I(1)(b) of the treaty. It has no reference to any taxes imposed by the United States or by any political subdivision thereof, and, as such, constitutes a provision affording relief from German tax only.

Paragraph (1) of new article XIVA provides that capital represented by real property or natural resources mentioned in new article IX of the treaty may be taxed by the country where such property is situated.

Paragraph (2) of the new article provides that capital represented by assets, other than real property or natural resources referred to in paragraph (1) above, which are effectively connected with a permanent establishment of an enterprise of one country may be taxed in the country where the permanent establishment is situated, unless the provisions of paragraph (3) apply.

Paragraph (3) of the new article provides that ships and aircraft of an enterprise of one country and assets, other than real property referred to in paragraph (1), pertaining to the operation of such ships and aircraft shall be exempt from tax by the other country.

Paragraph (4) provides that other elements of capital of a resident, corporation, or other entity of one country shall be exempt from tax by the other country.

As indicated, the new article provides unilateral relief from German capital tax and from the portion of the trade tax applicable to capital in the case of a resident, corporation, or other entity of the United States. Such article affects the imposition of those taxes by Germany in respect of residents of the United States and U.S. corporations or other entities.

In the case of nonresidents and foreign corporations, the portion of the German trade tax computed on the basis of capital is imposed under German law only if such taxpayer maintains a permanent establishment in Germany (world tax series, international program in taxation, Harvard Law School, "*Taxation in the Federal Republic of Germany*," sec. 15/10.2). However, in the case of nonresidents and foreign corporations, under German law the German capital tax is imposed with respect to items of domestic capital, without regard to the maintenance of a permanent establishment in Germany.

It should be noted that the United States is not obliged to grant a foreign tax credit with respect either to the German capital tax or to the trade tax applicable to capital.

ARTICLE 12

Relief from double taxation in country of residence

Article 12 of the protocol deletes paragraph (1) of existing article XV and replaces it with a new provision relating to the relief to be granted by each treaty country to its residents and corporations (and citizens in the case of the United States) with respect to taxes paid to the other country. As under the existing convention, the United States will continue to apply its statutory foreign tax credit system for purposes of affording such relief, while Germany will apply principally an exemption method to achieve a similar result.

(*a*) *Relief to U.S. citizens, residents, and corporations*

Article XV(1)(a) contains an amended foreign tax credit article and also embodies the traditional "saving clauses," reserving to the United States, subject to article XV(2), the right to tax its citizens, residents, or corporations as if the treaty had not come into affect. The amendments made by the protocol to existing article XV(1)(a) are:

(1) The reference to section 131 of the Internal Revenue Code of 1939 (secs. 901 through 905 of the 1954 code), as in effect on the date of the entry into force of the original convention has been deleted. Thus, it has been made clear that modifications in the U.S. law concerning the foreign tax credit made after the effective date of this protocol cannot be barred by the amended credit article.

(2) The principles of the per-country limitation in section 904(a)(1) of the Internal Revenue Code have been incorporated into the convention. The inclusion of the per-country limitation within the convention, however, will not affect the right presently enjoyed by U.S. taxpayers to elect the overall limitation provided under sections 904 (a)(2) and (b) of the code.

(*b*) *Relief to German residents and companies*

Subparagraph (b) of new paragraph (1) of article XV, as amended, provides relief from double taxation to German residents and companies with respect to income from U.S. sources (and also provides unilateral relief from Federal Republic taxation for certain items of capital, the situs of which is in the United States). Subdivision 1. of that subparagraph provides relief for German companies and German residents who are not also U.S. citizens or resi-

dents. Subdivision 2. provides relief for U.S. citizens or residents who are also residents of Germany.

1. *Relief to German companies and German residents who are neither citizens nor residents of the United States.*—Subdivision 1. (aa) provides for relief by the exemption method and subdivision 1. (bb) provides for relief by the credit method.

(aa) Exemption method: Subdivision 1(aa) states that unless the provisions of subdivision 1(bb) apply, there will be excluded from the basis upon which German income, corporation, trade, or capital tax is imposed any item of income from sources within the United States or any item of capital situated in the United States which, under the provisions of the amended convention, is not exempt from tax in the United States. In the case of dividend income, however, such exclusion applies only to dividends subject to U.S. tax paid to a German company limited by shares (kapitalgesellschaft) by a U.S. corporation in which at least 25 percent of the voting shares are owned directly by such German company. Subdivision 1(aa) in addition provides that there shall be excluded from the basis upon which German capital tax or the portion of the German trade tax applicable to capital is imposed any holding, the dividends on which are excluded or if paid would be excluded, from the basis upon which Federal Republic corporation tax is imposed.

For purposes of the imposition of the German taxes on income (income tax, corporation tax, and the trade tax on business profits) and of the German trade tax computed on the basis of capital, the exclusions provided under subdivision 1(aa) apply to those items of income (other than intercorporate dividends, discussed below) which are considered under German law to be derived from sources within the United States.

The rules of subdivision 1(aa) of the new article XV(1)(b) can be illustrated by the following examples:

Example 1. A natural person resident in Germany derived income from alimony paid by a resident of the United States. This income is not dealt with in the treaty, will be subjected to 30-percent U.S. withholding tax and, accordingly, will be excluded from the German income tax base. Although this income could not have been excluded under the original treaty because alimony payments were not "dealt with" in the existing convention, the rule was changed through the elimination of the requirement that income need be "dealt with" in the convention to be excludable thereunder.

Example 2. Compensation paid for services utilized in the United States but performed in Germany is not to be excluded from the basis upon which German income tax is to be imposed, since the income is exempt from U.S. tax under new article X(1) of the treaty. The fact that it is also exempt by U.S. law is immaterial.

The intercorporate dividend exclusion provided in subdivision 1(aa) applies only where the following conditions are satisfied:

(i) The recipient must be a German company limited by shares (kapitalgesellschaft). This includes a stock corporation (aktiengesellschaft), a partnership limited by shares (kommanditgesellschaft auf aktien), a private limited company (gesellschaft mit beschraenkter haftung), a colonial company (kolonialgesellschaft), and a mining company (bergrechtliche gewerkschaft).

(ii) The company distributing the dividend must be a U.S. corporation (other than a corporation described in sec. 861(a)(2)(A)).

(iii) The recipient company must own directly at least 25 percent of the voting shares of the payor corporation.

(iv) The dividends may not be exempt, under the treaty, from U.S. tax.

If any of the above conditions are not met, dividend income received by a German company will not be excluded from the basis upon which Federal Republic corporation tax is imposed (but may be dealt with under the credit method prescribed in subdivision 1(bb) of new art. XV(1)(b)). Thus, the German method is to exempt dividend income of certain German parent corporations and grant a credit against Federal Republic tax in the case of other dividend income from sources within the United States.

The application of the above-described intercorporate dividend exclusion provision can be illustrated as follows:

Example 1. Corporation A, which is organized and managed in the United States, is wholly owned throughout the taxable year by B company, a German stock corporation. Corporation A pays a dividend of $1,000 with respect to all classes of its stock, only 50 percent of the total value of which is represented by

voting shares. U.S. tax is withheld at the source in the amount of $150 under new article VI(1) of the treaty. The entire $1,000 is excludable from the basis upon which German corporation tax is imposed on B company.

In the case of German taxes on capital referred to in the convention (the capital tax and the portion of the trade tax applicable to capital), relief similar to that provided in respect of income taxes is afforded under subdivision 1(aa) of new article XV(1)(b) of the treaty. Thus, there is excluded from the basis on which German capital taxes are imposed any holding, the dividends on which are excluded, or if paid would be excluded, under the treaty for Federal Republic tax purposes. There will be excluded from the basis upon which German taxes on capital are imposed (without regard to the rules of art. XIVA of the revised treaty) if the German taxpayer is a company limited by shares owning directly at least 25 percent of the voting shares of the U.S. corporation, the shares of which constitute the holding in question. In such a case, the holding can include nonvoting shares if the holder owns at least 25 percent of the voting shares of the corporation.

The relief from German tax afforded by the exemption method is somewhat restricted, however, because Germany continues under revised article XV(1)(b) 1(aa) to reserve the right to take the excluded income into account in determining the rate of tax to be applied to the German resident's remaining income (exemption with progression).

(bb) Credit method. Subdivision 1(bb) of new article XV(1)(b) provides that U.S. tax payable under U.S. law, and in accordance with the convention, on the following items of income shall be allowed as a credit against the German income taxes which are payable with respect to such items of income:

(i) Dividends not dealt with in new article IV(1)(b)1(aa); and

(ii) Wages, salaries, pensions, and similar compensation paid by the United States or by its States, territories, or political subdivisions, not being exempt from Federal Republic tax under new article XI(1)(a) of the treaty.

It is also provided that the allowable credit may not exceed the portion of German tax which the above items of income bear to the total amount of all items of income.

Accordingly under article XV(1)(b)1(bb) a credit against German income or corporation tax liabiilty will be granted for U.S. tax imposed with respect to dividends from sources within the United States which are not excluded under subdivision (aa) from Federal Republic tax, and for wages, salaries, pensions, and similar compensation paid by the United States or by its States, territories, or political subdivisions to a German citizen, since the latter amounts are not exempt from German tax under new article XI(1)(a).

2. *Relief to individual residents of Germany who are U.S. citizens or residents.*—Article XV(1)(b)2 of the treaty provides the rules to be applied by Germany in granting relief from double taxation to those German individual residents who are also citizens or residents of the United States and, as a result, are subject to taxation in both countries on their worldwide income.

Subdivision 2 provides that where a natural person subject to unlimited tax liability in Germany is also a citizen or resident of the United States for U.S. tax purposes, subdivision 1(aa) shall apply to those items of income from sources within the United States, and those items of capital situated within the United States which, under the provisions of that subparagraph, are exempt from German tax when received by a natural person who is not a U.S. citizen or resident. It further provides that all other items of income and capital shall be included in the basis upon which German tax is imposed as if the convention had not come into effect, but that the U.S. tax on such other U.S. source income shall be allowed as a credit against German income tax, subject to the provisions of section 34c of the German income tax law (relating to the foreign tax credit limitation) as amended.

These rules with respect to the taxation of U.S. citizens or residents apply to any such individual who is a natural person subject to German tax on his worldwide income. Such an individual is, for German tax purposes, to be taxed in the same manner as an individual resident of Germany who is not a U.S. citizen or resident; i.e., exempt under the convention from Federal Republic tax on any item of income from U.S. sources which is not, under the provisions of the convention, exempt from U.S. income tax.

The same exclusion rules apply with respect to items of capital otherwise taxable to a citizen or resident of the United States who is a resident of Germany.

The application of these rules of exclusion may be illustrated by the following examples:

Example 1. A, a U.S. citizen resident in Germany, is employed by company M, a German company, 100 percent of all classes of stock of which is owned by corporation N, a U.S. corporation. A spends 30 days of the taxable year in the United States working with officials of corporation N. The net amount of A's salary which is attributable to the services rendered in the United States is $1,000. A's entire salary is paid, and is taken as a deduction in computing taxable income, by company M, which has no permanent establishment in the United States. A is not exempt from German tax on the $1,000 of personal service income, since he would have been exempt from U.S. tax under new article X of the treaty had he been a natural person resident in Germany, and not also a citizen or resident of the United States. Therefore, A must include the $1,000 in his taxable income and may take a credit against his German income tax liability with respect to the portion of his U.S. tax which is attributable to that income.

Example 2. B, a resident of Germany, is also considered under U.S. tax law to be a resident of the United States. He derives rentals from real property situated in the United States. Such rental income is exempt from German income tax in B's hands (but must be taken into account in determining the rate of tax applicable to B's nonexcluded income), since the United States could tax it to a nonresident alien individual resident in Germany and it constitutes U.S. source income under the German source rules.

The amount of the credit granted by the Federal Republic under the convention cannot exceed the German income tax payable with respect to the foreign income, i.e., it is limited in the proportion of foreign net income to total net income, as computed under German law. Thus such credit limitation is similar to the per-country limitation described in section 904(a)(1) of the Internal Revenue Code.

ARTICLE 13

Charitable organizations

Article 13 of the protocol adds a new article XVA to the convention, relating to the taxation by one of the contracting states of certain nonprofit organizations of the other contracting state. The new article provides that organizations of one country which are operated exclusively for religious, charitable, scientific, educational, or public purposes shall be exempt from tax in the other country if and to the extent that——

1. Such organization is exempt from tax in its own country; and
2. Such organization would be exempt from the other country's tax if it were organized, and carried on all its activities, in that other country.

Paragraph (1) of article XVA provides for the application of the above rules to German companies or organizations operated exclusively for the stated purposes. Under present U.S. law, a German company or organization operated for religious, charitable, scientific, or educational purposes within the meaning of section 501(c)(3) of the code is exempt from U.S. tax regardless of its place of organization or the geographical scope of its activities.

Paragraph (2) of article XVA reciprocally provides that a U.S. corporation or organization operated for the stated purposes shall be exempt from German tax if and to the extent (1) that it is exempt from U.S. tax and (2) that it would be exempt from German tax if it were a German company or organization and carried on all its activities in Germany. Under present German law, only German companies or organizations operated for the stated purposes are exempt from German corporation tax law and U.S. corporations or organizations having neither their seat nor their business management in Germany are not eligible for this exemption.

Thus new article XVA of the convention in effect creates an exemption from German tax in favor of U.S. charitable organizations while maintaining the present exemption granted in the United States with respect to similar organizations which are created or organized in Germany.

ARTICLE 14

Exchange of information

Article 14 of the protocol provides for the deletion of paragraph (1) of article XVI of the convention and for its replacement with a new paragraph, relating to the exchange of tax information between the competent authorities of the treaty countries. The new article modifies paragraph (1) of existing article XVI of the convention by making clear that taxation information to be exchanged between the competent authorities of the contracting states may be disclosed to a

court or administrative body as well as to other persons concerned with assessment and collection of taxes which are the subject of the convention. It also adds language permitting such information to be disclosed to persons concerned with "enforcement or prosecution" of such taxes.

ARTICLE 15

Taxpayer claims and consultation

Article 15 of the protocol deletes article XVII of the convention and replaces it with a revised provision dealing with (1) the presentation and disposition of taxpayer claims and (2) consultation between the competent authorities of both countries with respect to questions of the interpretation or application of the treaty. Revisions are, however, made only with respect to the portion of the original article which relates to the consultation procedures.

Paragraph (1) of new article XVII, relating to taxpayer claims, is identical with its counterpart in the original treaty.

The language of paragraph (2) has been modified to express more accurately the intention of the parties to the original convention; i.e., that the competent authorities shall "endeavor to settle the question as quickly as possible on mutual agreement." A new sentence also has been added to paragraph (2) specifically authorizing the competent authorities of the contracting states to communicate with each other directly for the purpose of implementing the provisions of the convention.

Paragraph (3) of new article XVII contains a new provision. It states that notwithstanding their internal law the competent authorities of the two treaty countries may consult together to endeavor to agree—

1. To the same attribution of industrial or commercial profits to an enterprise of one country and to its permanent establishment in the other country;

2. To the same allocation of profits between related enterprises as provided in article IV; or

3. To the same determination of the source of particular items of income.

In addition the new provision states that, in the event that the competent authorities reach such an agreement, then taxes shall be imposed on such reattributed and reallocated income by the country to which such profits are attributed or allocated and refund of taxes shall be allowed by the country from which such profits are attributed or allocated. If the competent authorities reach agreement on the source of an item of income, appropriate refunds shall be made reflecting such agreement. Thus, for example, one country might agree that income was not sourced within it and refund any tax withheld on such income or agree that income was sourced in the other country and so consider it for purposes of determining the allowable credit for taxes paid to that other country.

Prior to this protocol, no income tax convention to which the United States is a party contained procedures permitting the appropriate accommodation of tax liability resulting from allocations made by the competent authorities of one country and accepted as proper by the competent authorities of the other country (and by the taxpayer himself). Moreover, impediments of domestic law, such as the statute of limitations or the finality of previous assessments, often prevented effective implementation of any agreement on allocations. Thus prior to the above amendment to article XVII if the U.S. tax authorities made an allocation under article IV of the convention of $100 from German company A to United States parent corporation B, even if the German tax authorities agreed with the adjustment, the German tax authorities were unable to make an adjustment to effect a corresponding reduction in the German tax liability of A company (1) where the claim for refund of tax was filed after the expiration of the period of time allowed for the filing of such claims or (2) where the German tax authorities were barred by the statute of limitations from amending the earlier tax assessment. Accordingly, the $100 of profit allocated by the U.S. tax authorities would be taxed twice, once to A company and once to B corporation.

Paragraph (3) of new article XVII provides a remedy to the above problem by specifying that, in the above case, the German tax authorities may implement their agreement with the reallocation of the $100 of income for the "barred" taxable year from A company to B corporation by refunding to A company the portion of the German corporation tax paid for that barred year with respect to the reallocated income. However, such paragraph will not permit tax deficien-

cies (within the meaning of sec. 6211 of the code) to be asserted against U.S. citizens or residents in cases in which such deficiencies are barred by the statute of limitations.

The provisions of paragraph (3) will apply to any case upon which the competent authorities consult after the treaty goes into effect, regardless of the taxable year to which such case relates.

Paragraph 6 of the memorandum of understanding accompanying the present protocol similarly provides for consulation between the competent authorities of both countries for the purpose of determining whether it is necessary to amend new article VI of the convention, relating to the taxation of dividends, in the event that either the United States or German income tax applicable to corporations is substantially changed, or if experience in individual cases indicates that the effect of the application of new article VI is not in accordance with the purposes underlying the promulgation of that article.

ARTICLE 16

Application to West Berlin

Article 16 of the protocol provides that the present protocol shall also apply to Land Berlin (West Berlin) provided that the Government of the Federal Republic has not delivered a contrary declaration to the Government of the United States within 3 months from the date of entry into force of the protocol. If no declaration is delivered, the protocol becomes effective with respect to Land Berlin in accordance with article XVII of the convention.

ARTICLE 17

Effective dates

Article 17 of the protocol provides for the ratification of the protocol and for the exchange of instruments of ratification. In addition, the dates upon which the various provisions of the protocol are to become effective are provided in this article.

It is provided therein that the protocol shall come into force on the date of exchange of instruments of ratification and that all the articles thereof, other than articles 4 and 6, will be effective for taxable years beginning on or after January 1 of the year in which such exchange of instruments of ratification takes place. Article 4, containing the new dividend article of the convention (art. VI), will have effect with respect to dividends paid on or after January 1, 1965, and paragraph (3) of new article VI will apply to reinvestments made on or after that date. Article 6, containing the new royalty article of the convention (art. VIII), will have effect with respect to any payment made on or after January 1, 1963.

ARTICLE 18

Integration into original treaty

Article 18 of the protocol provides, under paragraph (1) thereof, that the protocol will form an integral part of the original convention of July 22, 1954, and that it will continue in force as long as that convention remains effective. Article XXI of the existing convention provides that either party to the treaty may terminate it at any time after a period of 5 years beginning with the calendar year 1954, the year in which ratification took place, by giving notice in the prescribed manner. No additional 5-year period is prescribed with respect to the duration of the convention, as amended by the present protocol. Accordingly, the convention, as amended by the present protocol, may be terminated by either country at any time and, in such event, will cease to be effective for taxable years beginning on or after January 1 of any subsequent calendar year, provided that the prescribed prior notice of termination has been given by such country on or before June 30 of the preceding calendar year.

Paragraph (2) of article 18 of the protocol provides that the competent authorities of the United States and Germany are authorized to publish the text of the convention, as modified by this protocol, after this protocol comes into force; i.e., after the date of the exchange of instruments of ratification. This provision has no effect upon publication by the United States of the text of this protocol, or of the full text of the convention as amended by this protocol. Either text may be made public by the U.S. Government at any time after the date of signature of the present protocol.

Senator GORE. Is there any witness who wishes to appear in opposition to the treaty? Mr. Allen, do you wish to testify?

STATEMENT OF GEORGE V. ALLEN, PRESIDENT OF THE TOBACCO INSTITUTE, WASHINGTON, D.C.; ACCOMPANIED BY JOHN DONALDSON, ASSISTANT MANAGER OF THE CHAMBER OF COMMERCE'S INTERNATIONAL DEPARTMENT

Mr. ALLEN. Thank you, Mr. Chairman. I have a prepared statement which is very short and which I would like to read, and then, if I may, to add a couple of points of my own that I think may be pertinent.

I am George V. Allen, president of the Tobacco Institute, Washington, D.C. My testimony before this subcommittee is on behalf of the Chamber of Commerce of the United States, on whose International Committee and Foreign Operations Review Subcommittee I serve. I also speak from personal experience as U.S. ambassador to four countries and Assistant Secretary of State. In addition I am chairman of the League of Americans Residing Abroad. Let me add that is a new and a fairly recently organized group. With me is Mr. John Donaldson, assistant manager of the chamber's international department.

The National Chamber supports the Income Tax Conventions with the Federal Republic of Germany and Belgium, pending before the Senate, 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.

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 conventions with Germany and Belgium will accomplish 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. I shall not direct my remarks to these standard treaty provisions, since they have been approved by the Senate in other conventions many times. There are, we note, a few changes of a substantive nature in the pending revised treaty with Germany. We understand the new Belgian treaty to be largely a technical revision.

We believe the U.S. business community will particularly welcome the revised article VIII of the convention, which treats payments for U.S. technical know-how as other tax-exempt royalty payments, much as they are treated under our conventions with other countries and as foreign investment in know-how is treated by the United States.

Another change in the German treaty moves to bring the definition of "permanent establishment," which determines applicability of the host-country income tax, closer into line with the model definition contained in a draft model tax convention developed by the Organization for Economic Cooperation and Development (OECD).

A third substantive change in the German treaty increases from the current 15-percent rate to the 25-percent reinvested earnings rate the withholding tax on dividends.

Mr. Surrey just spoke to that point.

Not every U.S. investor in Germany will find himself benefited by every provision of the new treaty, just as there can be—and are—many honest objections to one or another of the provisions of any double-tax treaty. On balance, however, we want to reiterate the national chamber's firm support for the principle of the avoidance of double taxation through such bilateral treaties.

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 abroad. It has been shown again and again that U.S. direct private productive investment abroad stimulates U.S. exports, returns substantial dollar earnings, and this contributes to our balance of international payments as well as to our competitive position in world markets and to the healthy growth of international trade.

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 U.S. foreign investment. The Chamber of Commerce of the United States therefore urges your subcommittee to support the pending tax conventions with Germany and Belgium, and other such treaties with friendly countries for the avoidance of double taxation.

Now it occurs to me, Mr. Chairman, and I should emphasize that I am speaking more personally than as a representative of the U.S. chamber although I have no reason to believe that my views on this subject would be objected to by members of the chamber. It just has not been discussed. But I am particularly interested in the ratification of these two treaties with two NATO countries, because it seems to me that it is in the general trend toward improving our relations with those NATO countries, and to the extent that language and experience is made more uniform in accordance with standard provisions, and with ruling and experience on those, to that extent possibilities for misunderstandings and disputes with our NATO countries is limited, and it tends to improve the general trade situation with those countries.

I may add a further point. It seems to me that the development of these types of treaties which regularize the establishment and investments of one country and another is just to that extent adding to the general concept of a rule of law in the relations between nations, because these treaties have the effect of laws which through negotiation and experience in living with them tend to develop the concept that relations between nations are settled by standard, legal, recognized methods adopted by the two countries.

Senator GORE. Thank you very much.

Mr. ALLEN. Thank you, sir.

Senator GORE. Are there further witnesses?

(No response.)

Senator GORE. If not, I will insert certain material that has come to me for the record.

(The material referred to follows:)

STATEMENT BY RICHARD N. COOPER, DEPUTY ASSISTANT SECRETARY OF STATE FOR INTERNATIONAL MONETARY AFFAIRS, IN SUPPORT OF PROTOCOLS TO INCOME-TAX CONVENTIONS WITH BELGIUM AND THE FEDERAL REPUBLIC OF GERMANY

Mr. Chairman, I appreciate this opportunity to appear before your committee to state the views of the Department of State regarding the income-tax protocols with Belgium and with the Federal Republic of Germany (Executive G and Executive I, 89th Cong., 1st sess.) that are now before the committee.

These protocols are simply amendments of our existing income-tax conventions with these countries—amendments designed primarily to deal with new problems that have arisen under those conventions—and are not intended to introduce new major policies or principles in our tax treaties, although they do contain, we believe, significantly improved provisions in a number of instances.

Officers of my Department, in testimony before the committee, have frequently stated our conviction that well-conceived tax treaties are of great assistance to the United States in its international economic relations and to the American business community in carrying on business abroad. They minimize conflicts between national tax policies, remove the possibility of discriminatory tax treatment, and eliminate tax irritants affecting international business and international relations. Our basic conventions with Belgium and Germany have been very successful in accomplishing these objectives. If they are to remain an aid to our economic relations with these countries, they must be kept up to date and must undergo adaptations from time to time to assure that they apply equitably to the situations existing in the territories of each party.

Germany and Belgium are two very important foreign markets for U.S. exports, and there are extensive American private investments in each country. While it is not our purpose at present to encourage additional investment in these countries, either through tax-treaty policy or otherwise, American investors there are entitled to the benefit of such protective measures and other assistance as can reasonably be afforded. Moreover, some of our foreign investments generate large and continuing exports from the United States and, indeed, a rapid growth in exports increasingly requires investment abroad in sales and servicing facilities.

In 1964, U.S. exports to the Federal Republic exceeded $1,310 million and imports from there amounted to $1,173 million, leaving a balance in favor of the United States of $137 million. U.S. private investment in Germany totaled $2,077 million at the end of 1964. Dividends, interest, and branch profits repatriated in that year amounted to $178 million, and it has been estimated that an additional $67,500,000 came back to this country in the form of royalties. U.S. exports to Germany are up 169 percent over a decade ago, investments are up fivefold, and investment earnings are up sixfold.

In the case of Belgium, U.S. exports in 1964 amounted to $627 million, and imports totaled $422 million, the balance in favor of the United States being $205 million. Total U.S. private investment in Belgium at the end of 1964 was

$452 million. As in the case of Germany, these represent very large increases over the level a decade ago, in 1954.

Although German and Belgian private investment in the United States by no means approached the amount of U.S. private investment in those countries, there are significant German and Belgian investments here, and both countries are regarded as important potential sources of investment funds in the future which may contribute to the solution of our balance-of-payments problem.

The statistics I have cited reflect the background of growing international economic intercourse against which questions concerning our tax conventions with Belgium and the Federal Republic of Germany, and the protocols for their revision that are now before the committee, should be considered. They reflect more numerous and more complicated relationships between firms domiciled in the United States and those domiciled abroad. Combined with persisting differences in national tax law, these relationships create for national tax authorities the difficult tasks of insuring equitable treatment to taxpayers and minimizing tax distortions to free market decisions concerning foreign trade and investments. Tax treaties represent the response to these difficult tasks, and they must, of course, be continually revised to conform both with current tax law and with contemporary business practice.

The new protocol with Belgium may be described as a minimal revision of the 1948 convention with that country. By a law enacted in 1962, Belgium carried out a thorough reformation of the income-tax system. Some of the rules and principles set out in the 1948 convention are now unworkable or would impede the operation of the new system. The main purpose of the protocol is to make the necessary adaptation of our convention to the new income tax law. I think that both parties recognize that the 1948 convention is in need of a more extensive overhauling for purposes of modernization. The urgency of revision to meet the immediate requirements of the new Belgian law, however, made it undesirable to undertake the time-consuming task of a complete rewriting of the convention at this time. In contemplation of such revision, however, provision is made that the new protocol shall remain in effect no longer than 1971.

The protocol negotiated with the Federal Republic of Germany goes much further in the direction of modernization of the existing convention. The main incentive for its negotiation arose from complaints by German businessmen concerning the limitation in the convention on the taxation by Germany of intercorporate dividends flowing from American subsidiaries in Germany to their parents in the United States. This limitation resulted in a substantial tax advantage for American enterprises as compared with German enterprises in like circumstances. The protocol contains an adjustment in rates in certain circumstances designed to settle this complaint.

In addition, the protocol provides for significant modifications of the provisions of the basic convention that deal, among other things, with taxation of transfers of technical information, with capital gains, and with the rules regarding income attributable to permanent establishments. We believe that a number of these modifications will result in substantial benefits for U.S. enterprises subject to taxation in Germany, and some of them (for example, the more liberal tax treatment of dividends and the new rules governing attribution of income to permanent establishments) should make investment in the United States more attractive to German enterprises.

The Department of State believes, Mr. Chairman, that the new protocols concluded with Belgium and the Federal Republic of Germany are reasonable and practical agreements that are needed for the continuation and further development of effective tax-treaty relationships with these two countries. We urge the committee to give them favorable consideration.

Although these agreements, as I stated previously, are of considerable significance in our economic foreign relations, their content is concerned primarily with detailed and technical matters of tax policy, which fall within the special competence of the Treasury Department. The protocols were negotiated under the direction of Assistant Secretary Surrey, and he can inform you fully and accurately with regard to them.

Thank you, Mr. Chairman.

CLEVITE CORP.,
Cleveland, Ohio, October 11, 1965.

Hon. ALBERT GORE
Chairman, Subcommittee on Tax Treaties,
Senate Committee on Foreign Relations,
Washington, D.C.

DEAR SENATOR GORE: On behalf of Clevite Corp., I am writing to urge that the protocol revising the existing convention between United States and the Federal Republic of Germany be ratified by the Senate prior to adjournment of this session.

The interest of Clevite Corp. in ratification of the protocol prior to December 31, 1965, arises out of the fact that in January 1965, Clevite sold, to International Telephone & Telegraph Corp., at a gain of about $4 million, the entire equity capital of a German limited liability company known as Intermetall G.m.b.h. which was operating a semiconductor manufacturing plant in Germany and selling its products in Western Europe.

Under the present tax convention between Germany and the United States and present law, Clevite's capital gain on this sale would be taxed by the Federal Republic of Germany at a rate of almost 50 percent even though Clevite has no office or business establishment in Germany and is not itself conducting business there. Moreover, while this capital gain is also taxable in the United States at the rate of 25 percent, the $2 million German tax on the gain would be allowed as a credit against the $1 million U.S. tax on it, and entirely eliminate the U.S. tax. Thus, under the present convention, Clevite would pay tax of about $2 million to Germany on the transaction and pay nothing into the U.S. Treasury.

If—but only if—the protocol now pending before you is ratified and becomes effective before the end of this year, entirely different tax consequences would ensue. The protocol contains a new provision, not found in the present convention, which would exempt, from German tax, sales or exchanges of capital assets by U.S. persons or corporations having no permanent establishment in Germany, and such provision will be effective as of January 1 of the year in which instruments of ratification are exchanged. Accordingly, if instruments of ratification of the protocol are exchanged before December 31, 1965, this new provision would apply to Clevite's sale of the equity capital of Intermetall and it will be exempt from German tax. Thus, if instruments of ratification are exchanged before December 31, 1965, instead of paying about $2 million tax to Germany and nothing to the United States Clevite would pay about $1 million to the U.S. Treasury and nothing to Germany.

While Clevite has no knowledge of other 1965 sales or exchanges of German assets by U.S. taxpayers which would be similarly affected by ratification, it seems reasonable to assume that other such sales have occurred or may occur before the end of the year.

Because of its own apparent financial interest and also because of:

1. The favorable effect ratification in 1965 would have on U.S. tax revenues (about $1 million additional for U.S. revenues from Clevite alone); and
2. The favorable effect ratification in 1965 would have on the U.S. balance of payments (about $2 million in Clevite's case alone),

Clevite Corp. respectfully urges that your committee promptly recommend that the Senate ratify the protocol as expeditiously as possible.

Very truly yours,

WILLIAM G. LAFFER, *President.*

MANUFACTURING CHEMISTS' ASSOCIATION, INC.,
Washington, D.C., October 11, 1965.

Hon. WILLIAM J. FULBRIGHT,
Chairman, Committee on Foreign Relations,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The Manufacturing Chemists' Association, Inc., wishes to advise you and your committee that it recommends favorable action on the tax protocol between the United States of America and the Federal Republic of Germany, signed at Bonn on September 17, 1965. The association urges that your committee take this favorable action as quickly as possible so that the Senate can give its advice and consent this year in order that the protocol will come into force for the full calendar year 1965.

The Manufacturing Chemists' Association, Inc., is a nonprofit trade association with 193 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.

As indicated in the report of the Secretary of State, this protocol brings up to date the treaty provisions in light of changes made in the tax system of the Federal Republic of Germany. In addition, various other beneficial changes are made in the tax relationship between the two countries.

Some revisions contained in the protocol which effect substantial improvements in the tax consequences flowing from the German convention are (1) the extension of the treaty to certain Federal Republic taxes which are not income taxes, (2) the adoption of a basic principle throughout the entire protocol that the reduced rates on investment income flowing from Germany will not be taken away merely because the U.S. enterprise has an unrelated permanent establishment in Germany, (3) the broadening of the exemption from tax in the case of royalty payments to "know-how" payments, and (4) the exemption of capital gains from tax in Germany.

From an overall point of view, the protocol sets forth a more satisfactory tax relationship between the two countries.

It is requested that this letter be inserted in the record of the public hearing on the protocol with the Federal Republic of Germany to be held on October 13, 1965, by your Subcommittee on Tax Conventions.

Very truly yours,

M. F. CRASS, Jr.

NATIONAL FOREIGN TRADE COUNCIL, INC.,
New York, N.Y., October 11, 1965.

Re tax protocol with Federal Republic of Germany (S. Ex. I, 89th Cong., 1st Sess.).

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.

The council recognizes the fact that the proposed protocol would be beneficial in several ways including the following:

1. Capital gains would not be subject to German income tax, except in certain circumstances.

2. The provision with regard to royalties has been clarified to make it clear that payments for "know-how" will be exempt from German income tax in the same manner as payments for patent and similar royalties. (However, the council believes that this treatment was in the spirit of the original treaty provision regarding royalties and that, therefore, it should have been retroactive to January 1, 1954. This matter is discussed further in the attached memorandum.)

3. A taxpayer who has a permanent establishment in Germany will not lose the treaty benefits except on income effectively connected with the permanent establishment.

The NFTC suggests deletion or clarification of the term "a place of management" in the treaty definition of "permanent establishment" because there is considerable doubt as to just how this term would be interpreted, particularly by the German tax authorities. The NFTC reasons for this suggestion and proposals as to the manner of clarification are explained in detail in the attached memorandum.

While the National Foreign Trade Council understands the reasons given for the increased German withholding tax on reinvested dividends, it is concerned that other countries may attempt to use this concession in order to obtain an increase in withholding taxes under their treaties with the United States. This matter is also discussed in the attached memorandum.

Despite its concern with reference to several provisions in the treaty which are discussed above, the National Foreign Trade Council does not believe that the Senate should delay its advice and consent to the ratification of the protocol between the United States and the Federal Republic of Germany (S. Ex. I, 89th Cong., 1st sess.).

It is requested that this letter and the attached memorandum be made part of the record of the hearings of the Subcommittee on Tax Conventions, Committee on Foreign Relations, scheduled to be held October 13, 1965, on the tax protocol with the Federal Republic of Germany (S. Ex. I, 89th Cong., 1st sess.).

Very truly yours,

JOSEPH B. BRADY, *Vice President.*

Enclosure.

DETAILED COMMENTS BY NATIONAL FOREIGN TRADE COUNCIL CONCERNING TAX PROTOCOL WITH FEDERAL REPUBLIC OF GERMANY

NFTC COMMENT ON ARTICLE II CONCERNING THE TERM "A PLACE OF MANAGEMENT"

The proposed article II(1)(c) provides in part that a permanent establishment shall include especially "a place of management." The memorandum of understanding between the two delegations provides that: "In the application of article II of the convention, a hotel room or similar place temporarily occupied by officials of an enterprise exercising management functions shall not be interpreted to constitute 'a place of management'."

The basic problem envisioned by the NFTC with regard to the term "place of management" is that there is considerable uncertainty as to just what it will mean in practice.

Recommendation

It is urged that the Senate request that best efforts be made to have the term "a place of management" in article II(1)(c) deleted from the protocol, and that, in any event, it be clarified so that "a place of management" will refer only to a place where the board of directors of the enterprise regularly meets or a place from which the chief executive officers regularly direct the affairs of the enterprise. This clarification will negate any possible inference that the term "a place of management" includes the performance in Germany of activities by a U.S. shareholder, or its employees or representatives, in relation to the shareholder's investment in a German corporation.

Comment

The memorandum of understanding states that a hotel room occupied temporarily by a company official shall not constitute "a place of management." The NFTC fears that this could be interpreted to mean that a bit more than a hotel room, such as a room or rooms in the German subsidiary's office building, frequently used for visitors from the U.S. parent or the loan of parent company personnel or the presence of parent company executives, could constitute a permanent establishment.

Conceivably, if the U.S. parent were to have "a place of management" in Germany which constitutes a permanent establishment, the German tax authorities might claim that the parent would be subject to withholding tax at a rate of 25 percent on part or all of the dividends it receives from the subsidiary. (The German tax authorities might also try to tax the dividend income at 49 percent.) This result could occur because of the proposed provision in paragraph 7 of article VI. That paragraph would deny the reduced withholding tax if the recipient has dividend income which is "effectively connected with such permanent establishment." The memorandum of understanding associated with the protocol provides in paragraph 3 that the term "effectively connected" shall be interpreted to apply where the activities of the permanent establishment are a material factor in realizing such items of income.

It should be made clear that the presence in Germany of executives of the U.S. parent does not ordinarily constitute "a material factor" in the U.S. parent's

realization of dividend income from its German subsidiary. Thus, the lower withholding rate should apply in the typical case where the U.S. parent's board of directors and chief executive officers are regularly located in the United States.

However, under the protocol the German tax authorities could attempt to deny exemption from income tax with regard to interest under article VII, royalties under article VIII and capital gains under article IX A: that is, where the activities of the place of management could be related to the interest, royalty or capital gains as a material factor in realizing such income or gains.

NFTC COMMENT ON ARTICLE III CONCERNING ELIMINATION OF FORCE OF ATTRACTION RULE

The last sentence of paragraph (2) of the proposed article III states that: "other profits of the kind referred to in paragraph (1)" shall be treated as if derived through the permanent establishment.

Comment

It is submitted that this sentence can be read to mean that any industrial or commercial profits of a U.S. enterprise may be treated as if derived through the German permanent establishment, because paragraph (1) apparently refers in its first sentence to all industrial and commercial profits (presumably from sources within Germany, though even this is not clear) of the U.S. enterprise.

Recommendation

NFTC suggests that there should be some appropriate form of clarification to the effect that the "other profits" dealt with by paragraph (2) are only the additional profits referred to in the second sentence of paragraph (1), namely, are derived from sources within Germany from sales of goods or merchandise of the same kind as those sold, or from other business transactions of the same kind as those effected, through the permanent establishment.

NFTC COMMENT ON ARTICLE VI CONCERNING DIVIDEND WITHHOLDING TAX

The new article VI to be inserted by the protocol would provide that the rate of tax withheld on dividends will be 15 percent, with the exception that if a U.S. company has an interest of 10 percent or more in the voting stock of a German company which pays it a dividend Germany may impose a withholding tax as high as 25 percent on the portion of the dividend deemed to be "reinvested" in the German company. In the absence of treaty restrictions, German law at the present time does impose a withholding tax of 25 percent. Under paragraph (5) of this article any investment in the form of a direct or indirect transfer of money or other property by the U.S. company to the Germany company which exceeds 7.5 percent of the dividends received in the year by the former from the latter shall be deemed to be a reinvestment of dividends and additional tax of 10 percent will then be imposed on part or all of dividends received in the preceeding year, the current year or the following year.

Comment

It is noted with regret that it has been considered necessary to acquiesce with the provision that a 25-percent tax would apply to the amount of the dividend deemed reinvested in Germany if such reinvestment exceeds 7.5 percent of the dividend. However, it is understood that justification for agreement to this high withholding tax on reinvested dividends arises from circumstances peculiar in Germany. On this basis, the NFTC does not object to inclusion of this increase in rate but desires to express its concern that this action may be considered to have established a precedent for other countries which may wish to negotiate or renegotiate a treaty with the United States.

In addition, the NFTC suggests that—

(*a*) The 7.5-percent "maximum" seems unreasonably low and could penalize even a moderate flow of investment into the German company;

(*b*) The penalty on reinvestment, if there is one, should apply only where control of the German company will be certain, i.e., where the voting stock interest exceeds 50 percent rather being merely 10 percent or more;

(c) The phrases "directly or indirectly" and "as any other form of investment" in paragraph (5) will likely leave too much scope for vary-

ing interpretations. For example, would a guarantee by the U.S. company of a third party's loan to the German company or the transfer to the German company of rights under a patent constitute "reinvestment of dividends"? It would have been beneficial if the paragraph or the supplementary memorandum of understanding had listed categories of transactions such as these as examples—but not as an all-inclusive list—of transactions which would not be deemed to be reinvestments;

(*d*) Paragraph (2) of the memorandum of understanding may be interpreted to mean that trade credit which is outstanding longer than is normally the case between arm's-length parties or that differs from the usual form of credit in the trade in any other respect will be taken as reinvestment of dividends even though the parties had no intention of creating a permanent or long-term investment.

Recommendation

It would be desirable if appropriate steps were taken by the Treasury Department to seek clarification of the items referred to in (*c*) and (*d*) above.

NFTC COMMENT ON ARTICLE VIII CONCERNING ROYALTIES

The proposed revision of the language of article VIII makes it clear that exemption from German tax extends to payments made after 1962 to a U.S. corporation in respect of "knowledge, experience or skill (know-how)." Clause 4 of the memorandum of understanding stipulates that the insertion of the term "know-how" and other changes in article VIII shall not affect interpretation of the article as it applied to payments made before 1963. Under the article as now worded, payments for the right to use (among other things) scientific works, patents, designs, plans and secret processes and formulas are exempt from German tax if the U.S. payee does not have a permanent establishment in the Federal Republic of Germany.

Comment

For a long period of time U.S. corporations receiving payments from German companies in respect of scientific information and know-how have interpreted the words in article VIII referred to above as exempting these payments from German tax. Therefore, while article VIII is undoubtedly desirable, it would have been preferable either to make the amendments to the wording of the article retroactive to the beginning of the treaty (Jan. 1, 1954) or to state clearly in the memorandum of understanding that so far as tax assessments not yet closed are concerned the change in the wording of article VIII from January 1, 1963, in no way alters or adds to the meaning or intent of the article as it applied to payments on account of scientific information and know-how made prior to that date. If the effective date for the change in wording has any significance at all in regard to such payments, it seems unreasonable, with the treaty in effect now for 11 years, to select so recent a date when taxpayers have long been acting in the belief that the article exempted these payments. Consequently, a much earlier effective date ought to have been selected for the change of language, and in such event (unless, as suggested above, the date was January 1, 1954) clause 4 of the memorandum of understanding would remain unchanged.

NATIONAL FOREIGN TRADE COUNCIL, INC.,
New York, N.Y., October 11, 1965.

Re Supplementary Income Tax Protocol With Belgium (S. Ex. G, 89th Cong., 1st sess.).

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.

The National Foreign Trade Council recommends that the Senate give its advice and consent to the ratification of the Supplementary Income Tax Protocol with Belgium (S. Ex. G, 89th Cong., 1st sess.).

We note, however, that the following recommendations by the National Foreign Trade Council which were submitted to the Treasury Department prior to negotiation of the Supplementary Protocol With Belgium (please see NFTC Ref. No. M–3593 entitled, "Proposals in Connection With Prospective Revision of the Tax Treaty Between the United States and the Kingdom of Belgium," February 1964, copy attached hereto) have not been included:

(1) turnover tax on royalties;
(2) reduced rate of 5 percent on certain dividends;
(3) treatment of credit d'impot as tax on shareholder;
(4) elimination of precompte mobilier prior to amendment of treaty;
(5) elimination of tax on interest;
(6) liberalization of exemption for personal service compensation; and
(7) definition for credit purposes of taxes imposed on company as opposed to those imposed on shareholder.

We also note that there is no provision contained either in the convention or in the protocol relating to the "force of attraction of the permanent establishment" problem.

We also note that the proposed protoctol is merely a stopgap in that it will last for a maximum of 6 years, by the end of which period it is expected that a completely new treaty will be negotiated (see second paragraph of a letter dated July 23, 1965, from the Secretary of State submitting the protocol of the President (p. 2, S. Ex. G, 89th Cong., 1st sess.)).

While we recommend that the Senate give its advice and consent to ratification of the protocol, we hope that in the negotiations for the permanent treaty the foregoing matters will be taken care of.

We note that there is contained in article I (6), of the protocol amending article XII (2) of the basic convention, a provision that a credit be allowed by the United States for Belgian income taxes which is not to exceed that proportion of U.S. taxes which net income from sources within Belgian bears to the total net income of the U.S. taxpayer. We note further that the protocol in no way amends article XX of the present convention, under which it is provided that the convention will not be construed to restrict in any manner a credit allowed under the laws of the United States. Some concern has been expressed, however, that the amended article XII (2) would derogate from sections 901–905 of the Internal Revenue Code of 1954, as amended, particularly section 904(a)(2). While we do not believe that anything contained in the protocol will affect the application of sections 901–905, we suggest that, in view of the concern which has been expressed, the report of the Committee on Foreign Relations contain a specific statement to the effect that nothing contained in the protocol will in any way limit the application of sections 901–905. We understand that the technical memorandum of the Treasury Department concerning the proposed protocol covers this point.

In conclusion, we urge that the Committee on Foreign Relations recommend that the Senate give its advice and consent to the ratification of the proposed protocol and that the committee's report contain specific reference to the fact that the amendment of article XII (2) of the basic convention does not limit the application of sections 901–905 of the Internal Revenue Code of 1954, as amended.

It is requested that this letter and the attached memorandum be made part of the record of the hearings of the Subcommittee on Tax Conventions, Committee on Foreign Relations, scheduled to be held October 13, 1965, on the supplementary income tax protocol with Belgium (S. Ex. G, 89th Cong., 1st sess.).

Very truly yours,

JOSEPH B. BRADY, *Vice President.*

Enclosure.

PROPOSALS IN CONNECTION WITH PROSPECTIVE REVISION OF THE TAX TREATY

Between the

UNITED STATES AND THE KINGDOM OF BELGIUM

National Foreign Trade Council, Inc.
10 Rockefeller Plaza New York, N. Y. 10020

February 17, 1964

The Treasury Department announced on November 7, 1963 that discussions would be held in the near future between Belgium and the United States on possible modifications in the existing Income Tax Convention. It was stated that the principal purpose of the discussion will be to consider revisions that may have been made necessary by recent amendments to the Belgian tax system, although other matters are also likely to be discussed.

The recent amendments to the Belgian tax system to which reference was made apparently are those included in the Belgian Tax Act of November 20, 1962, which in the case of corporate tax is applicable as of the fiscal year 1963 and in the case of individual and partnership income as of the fiscal year 1964. In practical terms, corporate income of 1962 and subsequent years will be taxed according to the new tax law, whereas individual and partnership income will be subject to the new system only as of January 1, 1963. A summary of these changes is contained in a memorandum entitled, "The New Belgian System of Taxation", made available to the National Foreign Trade Council through the courtesy of the Belgian Industrial Information Service, (NFTC Ref. No. M-2866).

Suggestions concerning changes which ought to be proposed by the United States Government are listed below:

1. Article I

Article I (1) (b) enumerates the Belgian income taxes which are covered by the convention. It states:

"(1) The taxes which are the subject of the present Convention are:

* * *

"(b) In the case of Belgium: The income taxes, the national crisis tax, and the personal complementary tax, including all additions to these taxes."

Recommendation

(1) Presumably this list of taxes should now be replaced by the following taxes:

(a) A tax on resident individuals and partnerships (impot des personnes physiques) payable on total income from all sources (calendar year 1963).

(b) A tax on resident corporations and profit making organizations (impot des societes) payable on total income from all sources (calendar year 1962).

(c) A tax on non-profit making organizations (impot des personnes morales) (legal entity income tax) (calendar year 1962).

(d) A tax on non-resident individuals, companies and other legal entities (impot des non-residents) payable on income earned or received in Belgium (companies, etc., (calendar year 1962); individuals, (calendar year 1963)).

(It is understood that the liability to non-resident income tax on patent, royalties, dividends and interest is discharged [by a non-resident company] (provided not received by a Belgian permanent establishment) by payment of the applicable withholding taxes.)

(2) Consideration also should be given to listing the tax prepayments which include the following:

(a) The "precompte mobilier" (personal property income tax prepayment).
The "precompte de controle" (withholding of tax on dividends paid to shareholders).

(b) The "precompte immobilier" (based on presumed rental income.)

(c) The "precompte professionnel" (withholding of tax on wages, salaries, of companies' directors, etc.).

Attention is invited to the statement on Page 4 of the memorandum entitled, "The New Belgian System of Taxation", (Appendix A) to the effect that: "In the case of non-residents, the 'precompte de controle' is not withheld on dividends distributed before January 1, 1965. This situation may become permanent depending on the provisions of tax conventions with other nations".

(3) It is understood that there is a turnover tax ("Taxe sur les locations mobilieres") levied on patent royalties paid by a resident company to a non-resident company. The rate is 6 per cent.

Although this tax apparently is not an "income tax" it is urged that consideration should be given to alleviating the effect of this tax insofar as it affects royalties payable to United States persons. It will be recalled that an agreement concerning the application of turnover taxes to royalties has been

concluded between the United States and France and set forth in a Proces-Verbal signed in Paris, August 4, 1955. (See Executive J, 84th Congress, 2nd Session - "Legislative History of United States Tax Conventions", prepared by the Staff of the Joint Committee on Internal Revenue Taxation, Volume 1, Page 1201 at Page 1206).

Article VIII

Article VIII (1), as supplemented and modified September 9, 1952 provides for a reduction of United States tax on certain dividends derived from sources within the United States corporation by a resident or corporation or other entity created or organized in Belgium not having a permanent establishment within the United States. Article VIII (2) as amended provides that: "Belgium shall not impose on dividends derived from sources within Belgium by a resident or corporation or other entity of the United States not having a permanent establishment within Belgium any tax in the nature of a personal complementary tax or surtax thereon, or any tax similar to that withheld at the source on dividends under United States law in the case of nonresident aliens and foreign corporations".

Since the personal complementary tax has been eliminated, this Article apparently will have to be revised.

Recommendation

(1) It is recommended that this Article be amended to reflect the provisions of Article 10 (2) of the OECD Draft Double Taxation Convention on Income and Capital which provides, in part:

> ***"dividends may be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the law of that State, but the tax so charged shall not exceed:
>
> a) 5 percent of the gross amount of the dividends if the recipient is a company (excluding partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;
>
> b) in all other cases, 15 per cent of the gross amount of the dividends.
>
> The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.
>
> This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid".

(2) An explicit statement should be included in the treaty concerning those taxes which will be treated as withholding taxes. Specifically, the treaty should provide that:

(a) The "precompte de controle" which is not being withheld on dividends being distributed to non-residents before January 1, 1965 will not be withheld in the future.

(b) The "precompte mobilier" should be treated as a tax on the dividend (shareholder) and should be regarded as coming within the provisions of Article 10 of the Draft Double Taxation Convention on Income and Capital. Assuming that the "precompte mobilier" may be treated as a tax on the dividend for purposes of Article 10 of the Draft Double Taxation Convention and the revised Treaty between the United States and Belgium, attention is invited to the fact the 15 per cent "precompte mobilier" is applied to an amount the Belgians refer to as "gross dividend". This gross dividend includes not only the amount of the dividend before the payment of the "precompte mobilier" but also the "credit d'impot" or 15 per cent (½) of the 30 per cent company tax. It is so included because the shareholder receives a credit based on the 15 per cent of the 30 per cent company tax. (See Pages 3, 4, and 5 of NFTC Ref. No. M-2866, attached hereto as Appendix A).

A summary of the reasons indicating that the "precompte mobilier" should be treated as a tax on the dividend is set forth in Appendix B attached hereto.

(c) One half of the corporate taxes which are imposed at a standard rate of 30 per cent in the case of distributed income (credit d'impot) should be regarded as a tax on the shareholder.

(3) Any changes in the treaty in derogation of the existing provisions should be prospective. In this connection it will be recalled that Article VIII (2) provides that "Belgium shall not impose on dividends derived from sources within Belgium *** any tax similar to that withheld at the source on dividends under United States law in the case of non-resident aliens and foreign corporations." In this connection, it is urged specifically that in accordance with the provisions of Article VIII (2), as amended, Belgium may not impose the "precompte mobilier" on dividends payable to United States residents, corporations, or other entities not having a permanent establishment within Belgium prior to the amendment of this Convention.

Article VIII(A)

Article VIII (A) as amended by the Supplementary Convention of September 9, 1952 provides that: "The rate of tax imposed by each of the Contracting States upon interest *** derived from sources within such State by a resident or corporation or other entity of the other State not having a permanent establishment within the former State shall not exceed 15 per cent".

Recommendation

It is recommended that this provision should be changed to agree with the provisions contained in most treaties between the United States and other European countries to the effect that no tax should be withheld on interest derived within Belgium or the United States respectively by a resident corporation or other entity of the other State not having a permanent establishment there.

Article XI

Article XI of the United States-Belgium Tax Convention contains provisions concerning personal services compensation and other payments during temporary presence in the United States and Belgium respectively.

This provision contains several limitations which are more restrictive than those found in comparable provisions of other tax conventions to which the United States is a Party, e.g., Article IX of the Treaty between the United States and France which concerns the same subject is considerably more liberal than Article XI of the Belgian Treaty.

Recommendation

It is recommended that this provision of the Treaty be liberalized. Specifically, it is urged that the provisions of Article XI of the Treaty between the United States and France be regarded as a model.

Article XII (2)

Article XII (2) of the Convention provides that: "In accordance with the provisions of section 131 of the United States Internal Revenue Code as in effect on the day of the entry into force of the present Convention, the United States agrees to allow as a deduction from the income taxes imposed by the United States the appropriate amount of taxes paid to Belgium, whether paid directly by the taxpayer or by withholding".

Recommendation

(1) It is assumed that this Article may be amended. If it is amended, it is urged that the United States specify the taxes which will be allowed as a credit and particularly specify which of the Belgian taxes will be regarded as a tax on the shareholder and which of the taxes will be regarded as a tax on the company. The fact that the tax is one on the shareholder rather than one on the company can result in a practical difference insofar as the amount of credit which will be allowed the United States shareholder.

In this connection, there is attached as Appendix C calculations indicating the amount of net tax payable in the case of a direct credit and the amount payable in the case of an indirect credit. It is noted that the difference is substantial.

It is urged specifically that the United States grant a credit for payment of the "precompte mobilier".

(2) Assuming that there is a question as to whether or not the "precompte mobilier" is a tax on the shareholder, attention is invited to the provision in Article XIII (1) of the United Kingdom-United States Tax Convention which provides that: "the recipient of a dividend paid by a corporation which is a resident of the United Kingdom shall be deemed to have paid the United Kingdom income tax appropriate to such dividend if such recipient elects to include in his gross income for the purposes of United States tax on the amount of such United Kingdom income tax".

It is urged that if there is a question as to whether or not the "precompte mobilier" is a tax on the shareholder that a provision similar to that contained in Article XIII (1) of the U. S. - United Kingdom Tax Convention be included in the U. S.-Belgian Tax Convention.

(3) Article XII (3) contains provisions to allow certain deductions in Belgian tax "In order to take into account the Federal income taxes collected in the United States etc."

It is recommended that this treaty be amended to provide that Belgium will allow taxpayers to credit in full against Belgian tax liability any United States Federal income taxes paid on U. S. source income against Belgian tax liability on such income.

NFTC Ref. No. M-2866

APPENDIX A

REPRODUCED BY NATIONAL FOREIGN TRADE COUNCIL, INC.

THE NEW BELGIAN SYSTEM OF TAXATION

In accordance with the Tax Act of November 20, 1962, a new system of taxation was set up in Belgium. In the case of corporate income, this law is applicable as of January 1, 1963, and in the case of individual and partnership income as of January 1, 1964.

The new Belgian tax system is characterized by the following features:

1. A single tax on total income;

2. Four different categories of taxpayers whose income is subject to a corresponding single tax, namely:

   a. Individuals residing in Belgium, subject to the "impôt des personnes physiques" (individual income tax)

   b. Corporations and other profit-making organizations, liable to the "impôt des sociétés" (corporate income tax)

   c. Non-profit making organizations, liable to the "impôt des personnes morales" (legal entity income tax)

   d. Non-residents, either individuals or companies, subject to the "impôt des non-résidents" (non-resident income tax);

3. A system of prepayments, called "précomptes", credited against the single tax on total income and levied on four sources of income: real property, personal property, remunerations (salaries, wages, fees, pensions, and compensations), miscellaneous.

4. Taxes which were deductible as expenses from the income itself under previous legislation will no longer enjoy this situation, but their rate has been adjusted accordingly. Taxation incidence on total individual income must not exceed 50 per cent.

I. CORPORATE INCOME TAXATION

A. Taxable Base

The corporate income tax applies to the income of corporations and other profit-making organizations established under Belgian law or with their main administrative or management offices in Belgium. However, partnerships may elect to have their profits taxed as part of the individual income of the partners. In this case the partnership is not liable to taxation.

Gross income includes all earnings resulting from the activities of the company or of the partnership. Deductible items consist of business expenses

such as rentals, interest on loans, wages, salaries, pensions, fees, commissions, compensations, capital loans, and amortization. Compensations of corporations' directors or auditors are deductible in so far as they remunerate actual and permanent functions in the corporation.

In the case of earnings composed of dividends or of another form of income from invested capital, 85% of the net amount received by the company may be deducted in the determination of the taxable base. This deduction may amount to 95% for companies engaged in industrial activities which own shares the investment value of which does not exceed 50% of the paid-in capital — revalued if necessary — or of the paid-in capital plus taxed reserves and capital gains written in the books. In the case of earnings in the form of interest, royalties, and real estate income, tax prepayments are deducted from the amount of the corporate income tax on the company's earnings.

B. Tax Rate

The standard rate of the corporate income tax is 30%. In the case of retained earnings in excess of B.Fr.5,000,000 ($100,000)* the tax rate is 35% on that excess amount. The 5% tax paid above the standard rate is, however, refunded when these retained earnings are distributed.

Retained earnings, including reserves and non-deductible expenses, below B.Fr.1,000,000 ($20,000) are subject to a 25% tax.

Example

A company established in Belgium has profits before taxes amounting to $600,000. If the profits are retained, the corporate income tax is computed as follows:

on profits up to $100,000:	$100,000 x 30% =	$ 30,000
on profits over $100,000:	$500,000 x 35% =	$175,000
	Total	$205,000

If the profits are distributed, the corporate income tax amounts to:

$600,000 x 30% = $180,000

If the profits were distributed after being taxed as retained earnings, an amount of $25,000 would be refunded.

C. Taxation of Dividends

When issued, dividends have already been subject to the corporate income tax. In fact, dividends partake of corporate income as well as of individual income. Accordingly, the shareholder is credited against his total tax liability with half of the corporate income tax. This amount, usually equal to 15%, is referred to as "crédit d'impôt" (tax credit).

Upon distribution, the company withholds a 15% levy called "précompte mobilier" (personal property income tax prepayment) on its distributed profits. As part

* Parity: $1.00 = B.Fr.50

of gross dividends, the "crédit d'impôt" must be included in the taxable base for the determination of the "précompte mobilier", which is also credited against the shareholders total tax liability. (No part of the "précompte mobilier", however, may be refunded before fiscal year 1966.)

It should be noted that the same system of prepayment applies to compensations of directors or auditors of corporations who do not carry on actual and permanent activities in the company. It also applies to the income of partners derived from invested capital.

Example

If we consider a hypothetical net profit of 100, the corporate income tax and prepayment will be computed as follows:

Net profit before tax	100
Corporate income tax (15 is credited toward the shareholder's payment of its individual income tax)	30
	70
"Précompte mobilier" (15% on 85)	12.75
Net dividend	57.25
Total tax incidence on distributed profits	42.75%

In the case of a company, as mentioned above, which has $600,000 in net profits and distributes these earnings, the "précompte mobilier" would be computed as follows:

Profits before taxes	$600,000
Corporate income tax at 30%	180,000
	$420,000

Gross dividends (including "crédit d'impôt" or 15% of profits before taxes)

$$\$420{,}000 \times \frac{85}{70} = \$510{,}000$$

"Précompte mobilier": $510,000 x 15% = $76,500

Net dividends: $420,000 - $76,500 = $343,500

In the case of resident stockholders, the agent effecting the payment of dividends, such as a bank or a stockbroker, must also withhold an amount equal to 15 per cent of the net dividend paid out to the shareholder, in the event the latter does not authorize the agent to communicate any information relating to such payments to the Internal Revenue. This amount, called "précompte de contrôle", is also credited against the single income tax to which the individual shareholder is liable on his total income. Any amount

withheld in excess of his tax liability is refunded. (In the case of non-residents, the "précompte de contrôle" is not withheld on dividends distributed before January 1, 1965. This situation may become permanent depending on the provisions of tax conventions with other nations.)

When dividends on which a "précompte mobilier" has already been withheld, are distributed to another corporation, 85 per cent (or in some cases 95 per cent) of the net amount may be deducted for tax purposes. In addition, when these dividends are distributed again by this second corporation, the "précompte mobilier" is due only on the amount exceeding 85 per cent (or 95 per cent) of these. Thus, the taxable base corresponds to 15 per cent (or 5 per cent) of the dividends to which, however, is added the "crédit d'impôt". Accordingly, the "précompte mobilier" is computed in effect on a base derived at by multiplying the taxable part of the dividends by $\frac{85}{70}$.

Example

Assuming that the company has received a net dividend of 57.25 (see example on Page 3), the taxable amount upon a second distribution of this dividend is:

$$57.25 \times 15\% = 8.59$$

However, the taxable base is computed as follows:

$$8.59 \times \frac{85}{70} = 10.43$$

Accordingly, the "précompte mobilier" will be:

$$10.43 \times 15\% = 1.56$$

If for instance, Company B owns 50 per cent of the stock of Company A (see example on Page 3) and thus receives $171,750 as its share in dividends issued by Company A, i.e. $343,500 ÷ 2, the amount of dividends to be included in Company B's taxable income will be:

$$\$171,750 \times 15\% = \$25,762$$

Upon distribution of these "second generation" dividends, the "précompte mobilier" will be computed as follows:

Taxable base: $\$171,750 \times 15\% = \$25,762$

$\$25,762 \times \frac{85}{70} = \$31,282$

"Précompte mobilier": $\$31,282 \times 15\% = \$4,692$

D. Taxation of Interest, Royalties, and other Income from Personal Property

Interest, royalties, and other income from personal property (such as loans, deposits and rentals) are included in corporate profits and are thus subject to the corporate income tax. However, the 15% "précompte mobilier" levied on such income is credited against the payment of the corporate income tax.

E. Taxation of Capital Gains

As a rule, capital gains are subject to the corporate income tax. However, some capital gains are tax exempt when they fall into one of the following categories:

a. Capital gains relating to land, buildings, equipment, or stock, owned for more than five years and if they remain in the company, provided they do not exceed the assets value adjusted on the basis of a legal coefficient, from which depreciation on such assets has been deducted. Capital gains exceeding this amount, however, are taxed at a 15 per cent rate.

b. Capital gains reinvested in fixed assets, equipment, or stock for the purpose of creating a new company or for capital increase, as provided for by a July 15, 1959, law. Four-fifths of these gains are exempted under this law. However, total exemption is granted if the reinvestment takes place in a development area.

F. Dissolution of a Company

In the event of a dissolution, the company pays a 30% tax on amounts distributed in excess of the paid-in capital — revalued if necessary — that do not exceed the amount of previously retained earnings and a 15% tax on amounts in excess of the latter. (The capital of companies founded before 1950 is revalued in accordance with a specific scale for accounting purposes.)

As an example, let us consider the case of a company which distributes assets amounting to $5,000,000, which has a revalued capital of $2,000,000 and retained earnings of $2,500,000. The taxable amount in excess of the capital will be:

$5,000,000 - $2,000,000 = $3,000,000

Tax computation:	30% on $2,500,000 =	$750,000
	15% on $ 500,000 =	$ 75,000
	Total	$825,000

In the event shares issued by the company are repurchased by itself, a 30% special tax is applicable on that part of the cost which exceeds that amount of the paid-in capital represented by the purchased shares.

G. Foreign Earned Income

a. Income from a foreign branch

The rate of the corporate income tax is reduced to one-fourth. Accordingly, it will amount to 7.5 per cent (or to 8.75 per cent on that part of retained earnings exceeding B.Fr.5,000,000 or $100,000).

b. Income from real estate

The rate of the corporate income tax is reduced to one-fourth. It will thus amount to 7.5 per cent or to 8.75 per cent.

c. Dividends

The "précompte mobilier" of 15 per cent is withheld at the source by the first intermediary established in Belgium or is paid by the beneficiary if the dividend was collected abroad. These dividends become part of taxable profits. However, 85 or 95 per cent of the net amount of dividends received may be deducted, and as a consequence, the corporate income tax affects only an amount equal to 15 per cent or 5 per cent of net dividends received from a foreign source.

If a Belgian company in its turn distributes dividends from this foreign earned income, the base for the computation of the income tax prepayment ("précompte mobilier") is arrived at by deducting from the amount of income for distribution 85 per cent or 95 per cent of the amount in net dividends received from a foreign source.

Example

A Belgian company has total profits of $1,000,000, including $100,000 in dividends from foreign sources. A 15% "précompte mobilier" is paid on these dividends and thus net received dividends amount to $85,000.

If profits are retained, the corporate income tax is computed as follows:

Amount exempted: $85,000 x 85% = $72,250

Taxable base: $1,000,000 - $72,250 = $927,750

Corporate income tax: $100,000 x 30% = $ 30,000
$827,750 x 35% = $289,713

$319,713

If the profits are later distributed, the "précompte mobilier" to be withheld on foreign earned dividends is determined as follows:

Deduction of exempted amount:

$100,000 - $72,250 = $27,750

Taxable base which must include "crédit d'impôt":

$$\$27,750 \times \frac{85}{70} = \$33,696$$

"Précompte mobilier": $33,696 x 15% = $5,054

Net dividends: $100,000 - $5,054 = $94,946

d. Interest

The income tax prepayment ("précompte mobilier") of 15 per cent must be paid on net interest received from foreign sources. This prepayment may be deducted from the corporate income tax to be paid by the company. In the event interest has already been taxed abroad, the company receiving this interest is entitled to claim a 15 per cent tax credit.

For instance, if a Belgian company receives $90,000 in interest from a foreign source and a 10% tax has already been withheld abroad on gross interest equivalent to $100,000, the tax incidence in Belgium is computed as follows:

Taxable base:	$100,000 - $10,000 =	$90,000
"Précompte mobilier":	$90,000 x 15% =	$13,500
Corporate income tax:	$90,000 x 30% =	$27,000
Deductions: a. "Précompte mobilier"		$13,500
b. Foreign tax at 15%		$13,500
Remaining to be paid: 0		

e. Royalties

Royalties are subject to the corporate income tax. If royalties have already been taxed abroad, the Belgian taxpayer may claim a 15 per cent tax credit.

H. Real Property Taxation

In the case of a company established in Belgium, actual real property income is subject to the single corporate income tax. However, a prepayment, called "précompte immobilier" is levied on the value of the cadastral income. The cadastral income, which was adjusted in 1962, is the assessed income which the taxpayer derived from the real property he owns, as listed in the Land Register.

The national "précompte immobilier" amounts to 3 per cent. However, provinces and municipalities are authorized to levy an additional tax. As a consequence, the total prepayment amounts to about 20 per cent of the cadastral income and is credited against the corporate income tax up to 20 per cent. It is, however, not refundable. It should be noted that real property income may be exempted from taxation for a five year period within the framework of the 1959 legislation for the encouragement of industrial investments.

II. INDIVIDUAL INCOME TAXATION

A. Taxable Base

Every inhabitant of the Kingdom of Belgium is subject to the individual income tax on his income. An inhabitant is defined as "an individual who is a resident of Belgium or has there the seat of his property's management."

The total net income from all sources and of all kinds forms the taxable base. Income of spouses are combined for tax purposes.

Categories of Income

There are four categories of income, namely: income from real property; income from personal property including capital; income from occupations; and income from miscellaneous sources.

1. Income from Real Property

The income from real property includes:

a. The "cadastral" income of real property located in Belgium. This is a theoretical income based on the assessed value of the real property. An abatement amounting to 2/3 of the "cadastral" income (within certain minima and maxima) is generally granted if the owner himself occupies the property. If the leased property is used by the tenant for business purposes, the taxable base includes that part of the net rent in excess of twice the "cadastral" income.

b. The net amount of the rent or of the renting value of the real property located abroad. "Net amount" is equivalent to 3/4 of the gross rent (or the gross renting value) in the case of built property and to 9/10, in that of unbuilt property.

2. Income from Personal Property

This category of income derived from Belgian or foreign sources includes:

a. Dividends from stock;

b. Income of capital invested by partners (active or not) in partnerships ("société de personnes"). This includes interest from loans made to the company by the partners;

c. Income from government securities with the exception of securities exempted from taxation in accordance with particular legal provisions;

d. Income from bonds, debts, and loans;

e. Income from savings or bank deposits;

f. Income from the renting of personal property.

3. Income from Occupation and Business

This category of income includes:

a. Salaries, wages, pensions, compensations of directors and auditors ("commissaires") of stock corporations;

b. Fees, retainers and other remunerations of independent profit-making activities;

c. Profits derived from industrial, commercial, or agricultural business, as sole proprietor of or as a partner in such a business.

Exemptions from Taxation

Some types of income may be exempted from taxation such as: certain allowances and pensions of a social nature; reimbursement to employees of expenses incurrred by traveling from their home to their place of work; certain capital gains; and certain reserves for "doubtful debts".

Deductions from Gross Income

a. Expenses incurred during the taxable period for the purpose of acquiring or preserving income derived from occupations may be deducted.

b. Instead of deducting actual expenses, a standard deduction may be taken as follows:

- In the case of employees and self-employed individuals:

  20% if the income does not exceed B.Fr.85,000 ($1,700), minimum deduction: B.Fr.7,500 ($150)

  15% if the income falls between B.Fr.85,000 and B.Fr.300,000 ($6,000), minimum deduction: B.Fr.17,000 ($340)

  10% if the income exceeds B.Fr.300,000 ($6,000), minimum deduction B.Fr.45,000 ($900) and maximum deduction B.Fr.60,000 ($1,200)

- A 5% deduction with a maximum of B.Fr.60,000 ($1,200) may be deducted from their remunerations by companies' directors, auditors, and partners (in the case the partnership is subject to the corporate income tax), when these remunerations are not paid to the partners as income from invested capital.

c. Other items may also be deducted from gross income under certain conditions and within certain limits. They include:

- Premium payments on health and disability insurance, contracted in addition to social security insurance;
- Premium payments on life insurance;
- Mortgage payments under certain conditions;
- Contributions to Belgian universities and to organizations assisting newly developing territories.

d. From the net income derived from occupations, a 5% deduction computed on the total amount of this income may also be taken. This deduction must not be less than B.Fr.5,000 ($100) or more than B.Fr.10,000 ($200).

Joint Returns

In the case of joint husband and wife returns, 40% of the wife's income derived from her occupation or business may be deducted. This deduction must not be less than B.Fr.17,500 ($350) or more than B.Fr.25,000 ($500).

4. Income from Miscellaneous Sources

This category of income includes the following:

a. Profits derived from occasional profit-making activities, with the exception of profits derived from normal management of private property;

b. Awards, subsidies, and government annuities granted to scientists, writers, or artists;

c. Support payments such as alimony;

d. Personal property income included in the proceeds of the subleasing or lease transfer of a furnished building or part of it;

e. Prizes pertaining to certain types of bonds;

f. Proceeds from the granting of the right to hunt, fish or trap.

Deductions from Total Net Income

From the total of the net amount of income derived from the categories listed above, some expenses are deductible under certain conditions. These deductible expenses are:

a. Cost of insuring real and personal property;

b. Certain interest paid;

c. Support payments.

Minimum Taxable Income

The individual income tax is not due when the total taxable income is under:

B.Fr.25,000* for taxpayers with no dependents
" 30,000 " " " 1 "
" 35,000 " " " 2 "
" 40,000 " " " 3 "
" 60,000 " " " 4 "
" 60,000 to which is added B.Fr.30,000 for each dependent after the fourth.

Note: The taxpayer himself is not included in the number of dependents.

B. Tax Rate

1. Income under B.Fr.160,000

The tax is graduated according to a scale and ranges from B.Fr.300 to B.Fr.28,300.

2. Income over B.Fr.160,000

B.Fr.28,300 for income amounting to B.Fr.160,000

27.5% for that part of income between B.Fr.160,000 and B.Fr.200,000
30 % " " " " " " " 200,000 " " 300,000
35 % " " " " " " " 300,000 " " 400,000
37.5% " " " " " " " 400,000 " " 500,000
40 % " " " " " " " 500,000 " " 750,000
42.5% " " " " " " " 750,000 " " 1,000,000
45 % " " " " " " " 1,000,000 " " 3,000,000
50 % " " " " " " " 3,000,000 " " 5,000,000
55 % " " " " " above B.Fr.5,000,000

Note 1 In no case must the total tax exceed 50% of the taxable income;

Note 2 That part of the tax which corresponds to income derived from occupations — other than salaries and wages — is in principle increased by 15% of the tax if the tax is not paid in advance, at the latest within 15 days after the first semester of the taxable year. It is increased by 7½% only for tax payments made within 15 days after the end of the taxable year. No increase applies to that

*Parity: $1.00 = B.Fr.50

part of the tax which corresponds to "crédit d'impôt", the "précompte professionnel", or the "précompte mobilier", or to the estimated amount of tax withheld abroad (see further).

C. Deductions for Dependents

These deductions computed on the tax itself are:

5% for taxpayers with 1 dependent
10% " " " 2 dependents
20% " " " 3 "
30% " " " 4 "
50% " " " 5 "
70% " " " 6 "
90% " " " 7 "
100% for taxpayers with more than 8 dependents

Note 1 No reduction is applicable to the amount of tax which corresponds to that part of the taxable income exceeding B.Fr.250,000 increased by B.Fr.25,000 for each dependent after the fourth.

Note 2 Members of the taxpayer's family are regarded as dependents if they have not earned a net income exceeding B.Fr.20,000 during the taxable year.

D. System of Tax Prepayments

Tax prepayments called "précomptes" are collected on the various sources of income, namely real property, personal property, remunerations (salaries, wages, fees, pensions, and compensations), and on income from miscellaneous sources. These prepayments are credited against the single tax on the total individual income.

1. Tax Prepayment on Real Property Income ("Précompte Immobilier")

This prepayment is computed on the cadastral income of real estate located in Belgium. Its rate amounts to 3% as far as the part levied by the national government is concerned. However, provinces and municipalities collect an additional real estate tax which, as a rule, brings the actual prepayment rate up to about 20%.

2. Tax Prepayment on Personal Property Income ("Précompte Mobilier")

Personal property income of Belgian or foreign origin is subject to a tax prepayment of 15%, which is withheld by the income debtor or by the first Belgian intermediary.

In the case of dividends for instance, assuming corporate profits for distribution of 100, a stockholder would in fact receive a dividend of 70 since the corporate income tax standard rate is 30%. However, half of this tax or 15 is regarded as a tax credit for the stockholder, and the personal property prepayment, computed thus on a gross dividend of 85, amounts to 85 x 15% = 12.75.

A supplementary personal property income tax prepayment ("précompte de contrôle") amounting to 15% of the net dividend paid out to the stockholder must in some cases be withheld and is also credited against the single individual income tax and any possible excess over the tax is refunded.

3. Tax Prepayment on Remunerations ("Précompte Professionnel")

A prepayment is withheld at the source by the debtor of the income on remunerations such as salaries, wages, pensions, and compensations of companies' directors or auditors. The amount of prepayment in the case of wages and salaries is determined by official tables (see Moniteur Belge, Dec. 5, 1962). Any possible payment in excess of the individual income tax is refunded.

E. Foreign Earned Income

Income of foreign origin is taxable when received by a Belgian resident. Several rules apply to such income. However, their application may be modified by international conventions for the prevention of double taxation. Income exempted from taxation in accordance with the provisions of a tax convention is, nevertheless, taken into account to determine the rate of the individual income tax.

1. Income from Real Property

In the case of income derived from real property located abroad, that part of the tax corresponding to such an income is reduced by half.

2. Income from Personal Property

A prepayment of 15% is levied on such income including dividends and other income from invested capital, interest, and royalties when income enters Belgium. This income is subject to the individual income tax. However, in addition to the 15% "précompte mobilier", another 15% deduction may be taken on income already taxed abroad.

3. Income from Occupation

Such income is taxable in Belgium. However, the tax corresponding to this income is reduced by half, when it has already been taxed abroad.

III. LEGAL ENTITY INCOME TAXATION

The Belgian State, Belgian provinces and municipalities, and Belgian non-profit organizations are subject to the legal entity income tax.

A. Taxable Base

It consists of the total income derived from capital, personal property and real property.

B. Tax

The legal entity income tax corresponds to the payments made as "précompte immobilier" (real estate income tax prepayment), "précompte mobilier" (personal property income tax prepayment), and to the "crédit d'impôt" (income tax credit).

IV. NON-RESIDENTS INCOME TAXATION

Individuals who are not residents of Belgium, companies and partnerships which do not have their head office nor their main establishment in Belgium, and foreign states or their political subdivisions are subject to the non-resident income tax.

A. Taxable Base

It consists of the total income produced or collected in Belgium. (It should be pointed out that in the case of non-residents who possess a dwelling in Belgium, the total amount of taxable income must not be less than twice the "cadastral" income of that dwelling.)

B. Tax

The taxation varies according to the following categories:

1. Profits of a branch of a foreign company are taxed at a single rate of 35%.

2. The tax rate is the same as that of the individual income tax in the case of an individual possessing a dwelling or deriving an income in Belgium as an active partner, or as a director performing an actual and permanent function in a Belgian corporation or in a Belgian branch of a non-resident company, or as a member of a partnership, if taxation is based on the individual income of the partners.

3. In the case of an individual whose income in Belgium is derived only from real estate, capital and personal property, a profession, or from various other sources, the tax corresponds to the "crédit d'impôt" (tax credit), "précomptes" (prepayments), or possible "compléments de précomptes" (supplementary prepayments).

4. In the case of individuals who only receive compensations as a company's director or auditor, salaries or wages from Belgian sources, the tax rate corresponds to that of the individual income tax. Should these taxpayers derive also an income from Belgian sources as under 3, the tax applicable to this income would correspond to the prepayments or possible supplementary prepayments.

Belgian Industrial Information Service
50 Rockefeller Plaza
New York 20, New York

January 1963

APPENDIX B

The Belgian "precompte mobilier" should be regarded as a tax on dividends within the meaning of Article 10 of the Draft Double Taxation Convention on Income and Capital and within the meaning of the revised Article VIII of the Income Tax Convention between the United States and Belgium.

Generally, the limitation or reduction in the rate of tax applicable to dividends paid by a company which is a resident of a foreign country to a United States person should not be judged by the standards as to whether or not such tax is a tax on the shareholder within the meaning of section 901, as opposed to section 902. Apparently Article VIII (2) of the United States - Belgian Income Tax Convention is the only Treaty which specifically states that /Belgium/ the other contracting State will not impose "any tax similar to that withheld at the source on dividends under United States law in the case of nonresident aliens and foreign corporations." Certainly, it seems that there are taxes on dividends which although they fall within the test of being similar to the United States tax on dividends nevertheless they are a tax on dividends contemplated by Article 10 of the Draft Convention and similar articles.

The "precompte mobilier" is imposed only when dividends are declared and imposed at the time they are declared. It is not imposed on the profits of the company which are later distributed as dividends.

The memorandum "The New Belgian System of Taxation", made available to the National Foreign Trade Council through the courtesy of the Belgian Industrial Information Service on Page 2 reviews the "precompte mobilier" under the heading "Taxation of Dividends". In connection with the taxation of individuals, it stated specifically "tax prepayments called precomptes" are collected on various sources of income ***. These prepayments are credited against the single tax on the total individual income. Under the heading "Tax Prepayment on Personal Property Income ("Precompte Mobilier") it is stated "personal property income of Belgian or foreign origin is subject to a tax prepayment of 15%, which is withheld by the income debtor or by the first Belgian intermediary" (Page 12, "The New Belgian System of Taxation)".

The fact that the tax (the "precompte mobilier") is on the dividend rather than on the company is indicated by the comments on Article 10 of the Draft Double Taxation Convention on Income and Capital. Specifically, the table set forth on Page 98 of the Draft Double Taxation Convention on Income and Capital, Report of the O.E.C.D. Fiscal Committee, 1963, indicates that the taxation borne by shareholders, both resident and non-resident is 15 percent of 85, e.g., 15 percent of 100 less the company tax of 30 percent plus 15 percent of the company tax, which is added back because the shareholder receives a credit based on it.

"The New Belgian System of Taxation" states that there is a single tax on corporations and a single tax on shareholders. The rate of the single tax on the company is generally 30 percent. The "precompte mobilier" is separate and distinct from this tax and is not imposed on the company. Thus, it may be distinguished from the personal property tax (the taxe mobiliere under the old law) which the Belgians asserted was imposed on corporate profits, (see "The Belgian System of Taxation in its relation to Corporations", Ministere des Affaires Etrangeres et du Commerce Exterieur, December, 1959, Table 1).

The Belgian shareholder is allowed to take a deduction from his taxable income in the case of companies and a credit against his tax in the case of individuals. Calculations seem to indicate that the deduction allowed to companies achieves the same result as though the company were required to take into its income the "gross dividend" and were allowed to credit against its tax the same type of credits allowed to an individual. The deduction apparently is allowed in the case of a company because company tax is generally fixed at 30 percent, apparently it can not be allowed in the case of individuals because individual income is subjected to taxation at varying rates of tax. The fact that a shareholder is granted credit for taxes paid strengthens the statements made in several places that the tax is on the dividend and as such should be subjected to a limitation or reduction.

Probably one of the more difficult problems from a practical point of view will be that the Belgians will contend that their corporate rate is comparatively low and that if they granted a reduction in the rate applicable to the "precompte mobilier" the income will not be subject to sufficient taxation. As a matter of conjecture it would seem that if the Belgian company tax were at a rate comparable to the U. S. corporate tax and their "precompte mobilier" at a rate comparable to our withholding tax on non-resident shareholders there might be less hesitancy on the part of the Belgians than may be anticipated under existing conditions. It may be pointed out to the Belgians, however, that the

United States in conceding the non-applicability of its corporate rate to certain income which might otherwise be subject to the corporate rate is "giving up" a greater rate than Belgium is "giving up".

APPENDIX C

Article XII (2) should be amended to specifically indicate which Belgian taxes will be allowed as a deduction and which as a credit and whether or not the deductions or credits will be allowed as taxes on the shareholder under section 901 (b), or on the company under section 902 IRC. In this connection, it is urged that the treaty provide that the "precompte mobilier" be regarded as a tax on the shareholder rather than on the company.

Attached is a calculation which demonstrates that the net dividend payable to a United States shareholder after deduction of Belgian and United States taxes is less if the "precompte mobilier" is regarded for U.S. tax credit purposes as a tax on the Belgian company rather than a tax on the U.S. shareholder.

As indicated in Appendix B, the Belgian tax system put into effect in November, 1962 intended to impose on the company a single tax at the rate of 30 percent. Further, in that memorandum it was emphasized that in official descriptions of the Belgian law it has been stated that the "precompte mobilier" is imposed on the shareholder.

The desirability of clearly agreeing at the time the treaty is concluded what deductions will be granted would tend to eliminate elements of future conflict and misunderstanding which may arise at a later time.

DIRECT AND INDIRECT TAX CREDIT - PRECOMPTE MOBILIER

Following is an example comparing the treatment of 'precompte mobilier' as a tax on the shareholder to which a "direct" credit is allowed for purposes of U. S. tax with the treatment of the 'precompte mobilier' as a tax on the company for which an "indirect" credit is allowed.

In the attached example, A is a U. S. corporation which owns 100% of the stock of B, a Belgian corporation. B earns $100 of which it distributes one-half.

	Taxable Income of B		100
	Corporate Income Tax		30
	Net Income After Tax		70
	Gross Dividend Declared by B to A		35
	Precompte Mobilier (15% x 85/70 x 35)		6.375
	Net Dividend Received by A		28.625
	Direct Credit for U. S. Tax Purposes		
(Gross-Up)	Dividend Taxable to A in U.S. (35 ÷ .7)		50.0
	U. S. Tax (@ 50% rate)		25.0
	Foreign Tax Credit		
	Direct	6.375	
	Indirect	15.000 (35/70 x 30)	
		21.375	21.375
	Net U. S. Tax Payable		3.625
	Indirect Credit for U. S. Tax Purposes		
(Gross-Up)	Dividend Taxable to A in U.S. (28.625 ÷ 63.625)		44.99
	U. S. Tax (@ 50% rate)		22.495
	Foreign Tax Credit		
	Indirect (44.99 - 28.625)		16.365
			6.130

Senator GORE. The committee will adjourn.
(Whereupon, at 10:20 a.m., the committee was adjourned.)

○