TAX CONVENTIONS WITH THE PHILIPPINES AND FRANCE

HEARING

BEFORE THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

NINETIETH CONGRESS

SECOND SESSION

ON

TAX CONVENTION WITH THE PHILIPPINES
(EXECUTIVE D, 89TH CONGRESS, FIRST SESSION)

TAX CONVENTION WITH FRANCE
(EXECUTIVE N, 90TH CONGRESS, FIRST SESSION)

APRIL 30, 1968

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TAX CONVENTIONS WITH THE PHILIPPINES AND FRANCE

TUESDAY, APRIL 30, 1968

UNITED STATES SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m. in room 4221, New Senate Office Building, Senator J. W. Fulbright (chairman) presiding.

Present: Senators Fulbright, Sparkman, Pell, and Carlson.

The CHAIRMAN. The committee will come to order.

The Committee on Foreign Relations is meeting this morning to receive testimony on the Income Tax Convention with the Philippines signed at Washington on October 5, 1964, and the Income Tax Convention with France signed at Paris on July 28, 1967.

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

Mr. Surrey, I believe you have a prepared statement.

STATEMENT OF HON. STANLEY S. SURREY, ASSISTANT SECRETARY OF THE TREASURY

Mr. SURREY. Yes, Mr. Chairman.

If it is agreeable to the committee, I could summarize the important aspects of this statement and then submit the statement for the record.

The CHAIRMAN. Yes. That is quite agreeable. We will put the entire statement in the record at the end of your testimony.

Mr. SURREY. Thank you, Mr. Chairman.

We have two conventions before us, one with the Philippines and one with France. These conventions are different in nature, and I will discuss them separately.

CONVENTION WITH THE PHILIPPINES

First, the convention with the Philippines: The convention with the Philippines has pretty much the so-called standard clauses in it that appear in most of our international treaties. With respect to the question of the jurisdiction of the country to tax in which income arises, this treaty with the Philippines adopts the rules which most countries have adopted in their international tax conventions. For example, in the case of business by an American company done through branch operations in the Philippines, not through a Philippine corporation, those operations do not become taxable unless there is sufficient presence of the U.S. corporation through a permanent establishment in the Philippines.

In addition, the Philippines state that it will not discriminate under their tax system against Americans who are engaged in receiving income from the Philippines, or who own shares of stock in Philippine corporations.

The Philippines will give exemption from tax to Americans who are temporary sojourners in the Philippines, such as businessmen who go there for a short period of time, and teachers or students who go there for specified periods of time. The Philippines will give up its tax in such cases.

Reciprocally, the United States does so also.

Many of the rules in the treaty, so far as the United States is concerned, largely confirm what would be our jurisdiction anyway.

The Philippine treaty does not contain clauses that I would characterize as investment clauses, clauses which go to the question of what should be the rates of tax in the source country. By the source country I mean the country where the income arises. This is the country from which a company pays dividends, pays interest, pays royalties, or pays fees to taxpayers in the other country.

WITHHOLDING RATES

In many of our treaties, certainly all of our treaties with the industrialized countries, of Western Europe, and Japan and Australia, both countries lower their withholding rates on investment income that leaves the country.

The Philippines did not desire to reduce their withholding rates. Their withholding rates run between 20 and 30 percent, and they felt for the time being that it was not appropriate for them to make changes.

This is the first treaty negotiated by the Philippines, and, consequently, one can understand an attitude of moving cautiously and seeing what the developments will be. The Philippines were desirous of entering into a treaty with the United States, desirous of adopting the standard rules which govern international transactions, but not desirous at this time of lowering the rate imposed by their tax system on dividends, interest or royalties leaving the Philippines and coming to the United States.

Of course, most of this traffic is one way. Dividends, interest and royalties move from the Philippines to the United States—they do not move from the United States to the Philippines. We do not have the same situation as between industrialized countries—with the traffic going both ways—with the interests that are mutual. Consequently, you will not find any of the investment clauses in this treaty. Equally, on the part of the United States, there is no clause extending the investment credit to the Philippines in this treaty. That was in large part because of the absence of any desire for investment clauses on the part of the Philippine Government. Consequently, both governments took a first step, which both governments feel is constructive, to enter into a tax treaty containing the standard clauses and leave it for the future course of events to determine whether the treaty should be modified to enter into the sphere of investment income.

So, both governments feel there is a constructive step here, and both governments would like to see the convention ratified.

As I understand, the Philippines are working toward ratification this year, and we would urge approval of this convention upon this committee.

Let me turn to the convention with France.

The CHAIRMAN. I wonder if I could ask you a question or two about this one before you leave it?

Mr. SURREY. Yes; that would be helpful.

DETERMINATION OF A PERMANENT PRESENCE

The CHAIRMAN. What constitutes a presence? You said a permanent presence. How do you determine whether a U.S. company has a presence there?

Mr. SURREY. Largely the degree of presence turns on the application of the so-called permanent establishment clause.

For example, to take extremes, if an American corporation is selling goods into the Philippines, getting orders in the United States, filling those orders in the United States and selling goods to the Philippines—the fact that its goods are going to the Philippines is not sufficient presence there to warrant a tax by the Philippine Government on the profit of those sales. That would be the absence of presence.

On the other hand, suppose that the American corporation has a branch office in the Philippines; they have inventory, employees, salesmen actively engaged in this office in the Philippines, in securing orders in the Philippines. That would be a large degree of presence, and that would warrant the imposition of a tax by the Philippines on the profits of that establishment.

The CHAIRMAN. But only on that establishment?

Mr. SURREY. Only on that establishment; yes, sir.

The CHAIRMAN. So if, say, General Motors had an establishment there, the tax would not be on all of General Motors sales, just on what arises from the sales in that country?

Mr. SURREY. What arises from the income that is attributable to that permanent establishment. The activities of that permanent establishment largely would be the sales there.

The CHAIRMAN. I think that would be difficult to determine, would it not? It would depend on the internal bookkeeping of the companies as to how they price at their branch office, would it not?

Mr. SURREY. There are difficulties associated with that, and those difficulties in international arrangements are handled by the so-called arm's length doctrine. In other words, the treaty provides that the relationships between the two shall be judged for tax purposes on an arm's length basis.

The same problem could arise, for example, if the United States corporation had a subsidiary in the Philippines, and the American parent sold goods to the subsidiary which, in turn, sold in the Philippines.

The CHAIRMAN. Yes.

Mr. SURREY. That price will determine the degree of profit, as you have pointed out, in the Philippines. We have an internal provision in our law that gives our Commissioner of Internal Revenue authority to look at that price and see that it is a fair price so that at least from the standpoint of the United States the goods are not sold at too low a price. We can adjust that price, if necessary.

Equally the Philippines, in their internal law, would be concerned with that, and the treaty, in effect, is an effort to harmonize what may be the competing claims of the two governments by their agreeing that the price should be an arm's length price. And if there is a dispute about that, the authorities of the two Governments should consult with each other to see what would be a fair and arm's length price and, therefore, giving the appropriate tax to each of the two jurisdictions.

DEDUCTION FOR CONTRIBUTIONS TO NONPROFIT ORGANIZATIONS

Senator CARLSON. Mr. Surrey, I notice in article 18 of this convention that the treaty would permit U.S. residents to receive a deduction for contributions to nonprofit organizations in the Philippines if those contributions are used within the Philippines and if the organization is one that has qualified under the Internal Revenue Code as a tax-exempt organization.

This is a provision, as I understand it, which is not usually included in these treaties. What is the reason?

Mr. SURREY. It is not usually included, Senator Carlson. It has been included, and one can understand that I suppose, in the Canadian treaty.

It is designed both to facilitate the making of contributions where they are ordinarily made in situations of this nature and to indicate the general spirit of encouragement, I would say, on the part of the United States for such contributions.

If American organizations which are disposed to carry on charitable activities in the Philippines desire to do so, they can work it out under present law. In other words, if an American wants to support church activities in the Philippines, he can work out the arrangements by having a contribution first made to an American organization, and then that American organization can spend the contribution in the Philippines.

This clause permits the direct contribution by the United States person desirous of giving assistance to the Philippine charitable organization to make it directly to the Philippine charitable organization without, in all cases, going through this roundabout way. It would be of assistance to Americans who live in the Philippines and feel they have some obligations to support local activities of a charitable, educational or religious nature.

It has not been generally used in conventions before, but various Government agencies have told us that it would be a helpful gesture by the United States if this were done, but a gesture that really would not involve the United States in loss of revenue because, as I said, the mechanics can be arranged under present law.

This is to make the mechanics easier, and for that reason we have included this clause in our recent treaties, especially with the less-developed countries.

Senator CARLSON. Mr. Surrey, I certainly do not object to that provision. I was just wondering why, in view of the fact we were doing it for the Philippines and for Canada, it would not be to the advantage of the promotion of good will that we include it in other treaties. That is my only thought.

Mr. SURREY. We do offer this clause now to other governments who are interested in having the clause in the treaty. We would make it a standard clause in that regard.

Senator CARLSON. That is all.

EFFECT OF A MOST-FAVORED-NATION CLAUSE

The CHAIRMAN. How does a most-favored-nation clause affect this treaty? If you give it to the Philippines, would it be considered effective in all other treaties?

Mr. SURREY. The most-favored-nation doctrine does not apply in tax treaties.

The CHAIRMAN. I see.

Mr. SURREY. The concession made by the United States does not necessarily have to be given to any other country. It depends on the particular treaty arrangement itself.

Now, necessarily one tries for uniformity and consistency of patterns; also one is concerned about the attitude of the other government. But we are not bound to have our treaties written the same way.

CREATION OF TAX-EXEMPT FOUNDATIONS

The CHAIRMAN. Would this treaty enable American citizens to create personal tax-exempt foundations in the Philippines the way they do in this country? It has become sort of customary here that if you make money you create a foundation so you do not have to pay taxes on it; isn't that correct?

Mr. SURREY. Well, without passing on whether it is customary, it is correct that there are sums going into foundations in the United States.

The CHAIRMAN. Some. How many tax-exempt foundations do we have in the United States? Aren't there several thousand?

Mr. SURREY. I think more than that.

The CHAIRMAN. 15,000, 20,000?

Mr. SURREY. I would roughly put it at around 25,000. I would like to be able to correct the figure if required, but I think it is around 25,000.

The CHAIRMAN. Have you ever made a study of how much the Government has lost through the creation of tax-exempt foundations?

Mr. SURREY. There is material available and, as you are aware, the Treasury Department has submitted to the tax committees of the Congress recommendation in the foundation field to deal with what the Treasury feels are the abuses in this area, and should be corrected. This would permit the philanthropic activities and other appropriate activities of the foundations to exist, but would correct what it feels are serious, very serious, abuses in the foundation area.

Those recommendations have been made by the Treasury, and the Treasury would welcome any assistance by the Congress.

I have two gentlemen before me who are on the Finance Committee, and the Treasury would welcome any assistance by the Finance Committee in securing it.

The CHAIRMAN. I think you have let it get out of hand. You have built up such a constituency in their favor that I do not believe the Congress would be able to do anything about it.

Mr. SURREY. No, I think you will find it the other way. I think you would tend to find that the sound core of American foundations would approve of the recommendations that we made from an operational standpoint.

There would not be from the real basic structure of the American foundations any opposition—the recommendations are designed to divorce the mingling of business and philanthropy, for example, and our major, well-run foundations do not do that. They are designed to see that large sums are not accumulated in foundations rather than being spent for the philanthropic purposes for which they are created, and attempt to bring them back to, I think, the basic reasons why the U.S. Government does this, which is the encouragement of philanthropy.

But I certainly agree with you that there are serious abuses. I would hope that we would have the ability in this Government and the Congress to correct those abuses.

The CHAIRMAN. I remember a very slight change that was suggested in the Finance Committee not long ago, but there was tremendous pressure against doing anything about it.

Mr. SURREY. Yes; I remember that, too, Senator, and there was a change made at that time, but the result of that discussion was the request that we make a study of this area.

The change had come up without essentially any background study having been made, and the differences of opinion at that time led to a change in the law, not a major revision, but some change in the law, and a request to the Treasury Department that we make a study and submit it. That study is there, and we would certainly urge the tax committees to take that study and proceed with it, and I would venture the guess that substantial progress would be made.

The CHAIRMAN. It may not be proper at this time to go into that matter other than to say that it does raise a question in my mind about our extending this practice by treaty until the question of foundations in this country is under control.

GROWTH OF TAX-EXEMPT FOUNDATIONS

But I am interested in your estimate as to how much money is today held in tax-exempt foundations?

Mr. SURREY. Yes.

The CHAIRMAN. In dollars.

Mr. SURREY. I do not have the amount at my fingertips.

The CHAIRMAN. It is very substantial. The Treasury report estimated that in 1962 foundation assets were around $16 billion. Is that correct?

Mr. SURREY. Oh, yes; substantial. It has not been growing relative to the growth of the economy; that is, if you ask the question, have foundations been able to secure unto themselves a greater proportion of the economic wealth of the country than they had 10 or 15 years ago, the answer would be no.

The CHAIRMAN. You said that you do not allow them to grow. I thought I saw in the paper the other day a statement that the Ford Foundation has about three times as much capital today as it did when it was founded. It is growing very substantially, is it not?

Mr. SURREY. Yes. What I meant was if one looks at the total amount of wealth that is in foundations in relation to the wealth of the coun-

try, the country having grown in the meantime, the growth of foundation assets is not greater than the growth of assets. For example, if you take the shareholdings on the New York Stock Exchange of foundations 10 or 15 years ago, that proportion of the shareholdings the foundations have of stock on the New York Stock Exchange and other exchanges would not differ relatively today.

Now, in absolute terms, there has been an increase. This is largely due to two reasons, Senator. One, the appreciation in value of assets that has occurred in the United States; and, second, in some foundations accumulating their income and not distributing it. It is that latter part which we would certainly disagree with.

The CHAIRMAN. But they are doing that.

Mr. SURREY. Well, some—it varies. Many foundations have a general practice of distributing their current income, not their increases in capital but their current income, and our recommendations, for example, if you are interested in the matter, would be that a foundation should distribute its current income to charity. That is the whole purpose. The purpose is to be a conduit for charity; and, second, if it invests in stocks whose capital value appreciates and the company never pays a dividend, the foundation nevertheless must distribute at a rate that is roughly equivalent to what academic and other institutions of a comparable nature earn on their investment, so that there should be no accumulation of these funds.

So, I think, we certainly would come down to the same place you do, that there is no sense at all in the accumulation of funds in a foundation which was organized to assist charity.

The CHAIRMAN. Many of the purposes they serve are very questionable, whether it is charity or not.

Mr. SURREY. Yes, that is——

The CHAIRMAN. We have discussed cases of that kind. I did not mean to prolong my discussion but I did not realize that we had begun to extend the concept into foreign countries through treaties. I do not know whether this is a good idea or not.

Mr. SURREY. It is not an extension. It could be done today. There is nothing that would keep a person from establishing a foundation in the United States which would be of assistance to the Philippines—a foundation in the United States that controlled the direction of the activities. There is nothing that prevents that today. This treaty does not extend the American law in net effect.

CHARITABLE CONTRIBUTION PROVISION IN OTHER TREATIES

The CHAIRMAN. Is this same provision in the proposed treaty with Israel?

Mr. SURREY. No; it is not.

The CHAIRMAN. Why not?

Mr. SURREY. Israel, the Israeli Government, is not interested in it.

The CHAIRMAN. Why not?

Mr. SURREY. I think, in large part, as I said, it is an operational matter. Any American can contribute to an organization, the interest of which organization includes or consists of charitable activities abroad. If it were not for that, for example, a great deal of our religious activity abroad could not be supported. So there is no diffi-

culty in the funds going abroad. It is a matter of operational convenience from time to time.

In Canada, the way it arose I suppose is that large numbers of Americans living in Canada, close to the border and associated with charitable activities and philanthropic activities in Canada, felt in the natural course that they should make their contributions to Canadian institutions, just as Canadians might make them to U.S. activities because of close ties. And so, as a matter of convenience, people were permitted to make contributions directly, subject to the limitations of their home country, in our case the 30-percent limit. And in the same way in the Philippines—with our ties to the Philippines, it seemed a natural extension to let people—many Americans live in the Philippines—to make these contributions, or to permit those having lived in the Philippines for a long time, and then coming back to the United States and having an interest in schools there, or churches or the like, to continue that interest. The Philippine Government was interested in this. The Israeli Government, I would suppose as a guess, receiving large funds from the United States in this regard——

The CHAIRMAN. They do now.

Mr. SURREY. I think they do now.

The CHAIRMAN. How much, do you know?

Mr. SURREY. I cannot give you the amount. I mean I do not have it with me.

The CHAIRMAN. Can you estimate? It is substantial?

Mr. SURREY. I cannot—I will try to get the facts and put them in, if you would like.

(The information requested is not available because under section 6033(a) of the Internal Revenue Code, religious organizations and publicly supported charitable organizations, are not required to file information returns containing such data.)

The CHAIRMAN. Is it as much as $100 million a year?

Mr. SURREY. I would doubt that.

The CHAIRMAN. If it applies in the Philippines or in Israel, then the deduction is taken as against taxes paid to the Government here, is it not?

Mr. SURREY. That is right. But I am indicating today if there is an organization whose interest is in the Philippines for example, if I contribute funds to an American religious organization to be used in the Philippines, I get a deduction for that today.

The CHAIRMAN. It is under that law that you get a deduction if you contribute to one operating in Israel?

Mr. SURREY. That is right. American organizations may qualify whose purpose in organization relates to activities in Israel. I can contribute to this American organization, and get a deduction today without a treaty.

The CHAIRMAN. So, in effect, the taxpayers are subsidizing the gifts, are they not, to the extent of the tax deduction? Is that correct?

Mr. SURREY. Yes, sir; with the same general effect as our charitable contribution clause under our income tax laws.

The CHAIRMAN. Do the pending treaties with Brazil or Thailand have a section similar to the one in the Philippine treaty?

Mr. SURREY. They do.

The CHAIRMAN. They do?

Mr. SURREY. Yes.

The CHAIRMAN. Is it proposed to have them in all future treaties with countries that want them?

Mr. SURREY. I would think so, from our standpoint up to now.

You see, the organization has to be an organization that is charitable by our standards and charitable by their standards. It has to be an organization which meets the requirements of philanthropy under both laws.

CONTROLLING CHARITABLE CONTRIBUTIONS

The CHAIRMAN. Mr. Surrey, I have read, and I remember your mentioning before the committee, that a lot of these foundations which have qualified as charitable organizations have turned out not to be charitable but really for the benefit of the man who founded it. He uses it and continues to use it for his own purposes and for political purposes——

Mr. SURREY. No.

The CHAIRMAN. And for personal purposes.

Mr. SURREY. No; organizations of that kind would not qualify under our law. In other words, some of the matters which I think have concerned a number of people in this country that charitable organizations were going afield in their activities——

The CHAIRMAN. That is right.

Mr. SURREY. Propagandist activities, intervening in political life——

The CHAIRMAN. That is right.

Mr. SURREY. Those we feel we have sufficient present authority to handle.

The CHAIRMAN. You have had great difficulty in dealing with one or two that I know of. It takes forever to do anything about it.

Mr. SURREY. Yes, it took a long time; let me put it that way.

The CHAIRMAN. All right.

Mr. SURREY. I do not think it now takes such a long time.

The CHAIRMAN. And you have 25,000 which is an almost impossible number for you to handle.

Mr. SURREY. On that I would differ because I remember our discussions on this point.

The CHAIRMAN. Yes.

Mr. SURREY. And they were several years ago.

The CHAIRMAN. That is right.

Mr. SURREY. At that time we were in the course of carefully investigating a number of organizations that were either suspected or accused or whatever word one wants to use, of activities not consistent with philanthropy. There has been an investigation of those, and I think most of those have been removed from the list.

The CHAIRMAN. You think so?

Mr. SURREY. Yes, I think so; and I would be willing to check on any about which there might be a difference of opinion on in that regard.

That is not a matter, Senator, on which, in our report on foundations we asked for any new authority. I do not think that is a basic problem in this area.

The CHAIRMAN. I am only bringing this out to at least clarify in my own mind whether or not we should give very serious consideration

to whether it is wise or not to expand this practice through treaty into every country in the world. I think this could get to the point, if encouraged, where there is nobody left to pay any taxes in this country but a few hard working men on a salary who cannot form a foundation. Everybody else finds a way to get around it.

Mr. SURREY. I do not think the treaty provision relates to the foundation area. I think this relates to organizations of the kind you would typically find aiding the schools, aiding the churches, and aiding the charities of these countries.

The CHAIRMAN. I won't pursue it any longer.

PROVISION IN TREATIES WITH OTHER COUNTRIES

Is this the first treaty besides the one with Canada where this kind of provision has been included? Have any others had this provision?

Mr. SURREY. Canada was the first, and then, I think, Thailand, the Philippines, Brazil; it is not in Israel and it is not in France.

I think you will tend to find this provision, Senator, more in treaties with countries in which we have established a tradition, partly growing out of religious activities, partly growing out of the efforts to extend assistance in cultural fields; you would find it in treaties of that nature. I think those would be the countries that would be interested.

It also tends to be of some use—and you can see the elements of fairness involved in this—if you get American citizens living in a country and a natural disaster occurs in that country, let us say, an earthquake or a flood; there is a natural feeling that there should be assistance to that country, and I think a proper attitude of making a contribution, just as one would feel in the United States under similar circumstances. An American who was living abroad and feels that natural inclination to assist under those terms, should have an ability to say that that is a charitable contribution under our law.

It is things of this nature which one had in mind in extending these clauses in these countries. It tends, as I say, to come up more in the less developed areas. I have not found any industrialized country which has interested itself, really, in this clause.

The CHAIRMAN. I won't pursue the matter. I did not realize it, but actually, this is, in effect, a kind of private foreign aid. We substitute an individual judgment about how to aid a country rather than the judgment of our Government. Maybe that will be all that is left.

Mr. SURREY. It is an effort made to counter polarization in institutional activity.

TIME LIMITATION FOR SOJOURNERS

The CHAIRMAN. Did you say that the students and other sojourners, there for a short time, will not be subject to tax in the Philippines? What is the time limitation in that connection?

Mr. SURREY. It is hard to say that there is a general practice. My recollection is, in the Philippine treaty they draw the line for sojourners, at least for business visitors, at 90 days. That is a shorter time than we would prefer. We would prefer something like 180 days.

So, as I say, these differ. In the case of students my recollection is it is 2 years.

The CHAIRMAN. Two years.

Mr. SURREY. Two years.

The CHAIRMAN. Businessmen, 90 days.

Mr. SURREY. Businessmen, 90 days; teachers, 2 years. In some cases students can get up to 5 years.

The CHAIRMAN. Specially?

Mr. SURREY. Under special circumstances. The amounts involved are not large that they can earn in a foreign country.

The CHAIRMAN. I know.

Senator Sparkman, do you have any questions?

INVESTMENT TAX CREDIT PROVISION IN BRAZIL TREATY

Senator SPARKMAN. I want to digress a little and move to another matter which may not be involved. Is investment tax credit involved in this treaty?

Mr. SURREY. It is not involved in this treaty, Senator Sparkman, because of the general disinclination of the Philippine Government to——

Senator SPARKMAN. I saw that. I think you said something about that in your statement.

Mr. SURREY. Yes; and, therefore, the investment credit is not involved in this treaty.

Senator SPARKMAN. We do have another treaty pending before us, the one with Brazil, in which the investment tax credit provision is included and it is proving to be a problem in our consideration of that treaty. Some of the members object to it in its present form.

The objection has been raised, for instance, that we have control over the investment tax credit in this country, and we exercised that control in 1966 by suspending it and then putting it on again—in 1967, I think it was. But if we include that provision in a treaty, we lose control of it so far as dealing with a particular country is concerned. Is there merit in that contention?

Mr. SURREY. No, Senator, there is not. There is merit, I think, in the feeling that one should not lose control of it. But there is a provision in the Brazilian treaty which expressly provides that, if there are changes in the credit in the United States, those changes come into force as respects the operation of the credit under the treaty itself without any further negotiation with Brazil.

So that, for example, if there ever were an occasion to suspend the credit in the United States, then that very act of suspension in the United States would equally be a suspension in the Brazilian treaty.

Now, that may trigger off certain reactions on the Brazilian side, and certain clauses in the Brazilian treaty involving concessions by Brazil would be suspended if Brazil desires them to be suspended. But insofar as keeping the two credits in tandem, the way the Brazilian clause is written, they are kept in tandem. If it were terminated in the United States, it would be terminated for Brazil, and that would not require any further action, either legislation or negotiation, by the United States.

Senator SPARKMAN. Did you testify on the Brazil treaty?

Mr. SURREY. Yes, sir.

Senator SPARKMAN. Did you make that point clear?

Mr. SURREY. Well, I was going to say "Yes," but I feel perhaps not, at this point.

Senator SPARKMAN. I do not remember it, but I do know that in the discussion in the committee this question that I have just posed was raised.

Mr. SURREY. Well, then, the answer is "No," I did not make it clear. As I say, I thought I had. It is in the documents.

RESERVATION REGARDING TAX CREDIT PROVISION IN BRAZIL TREATY

Senator SPARKMAN. In fact, there has been proposed a reservation with reference to the investment tax credit. Have you seen that proposed reservation?

Mr. SURREY. I was recently asked to consider the technical aspects of a form of reservation language. I have seen that; yes.

Senator SPARKMAN. Do you have any comment on the advisability or not of our adding the reservation in the event we take up the treaty for ratification?

Mr. SURREY. I have the feeling, Senator Sparkman, it would be very helpful for the United States to have a treaty with Brazil. I think it would be in the interest of the relationships of our two countries, and in the interest of the United States in maintaining a competitive position in Brazil, which competitive position is seriously under attack, in a sense, by Western Europe and Japan.

In other words, the industrialized countries of the world have recognized the potential of Latin America for growth. They are engaged in negotiating treaties to complement their commercial and other activities, and it would be very much to the interest of the United States and to the interest of teachers and students and the like going to Brazil to have these arrangements with Brazil. Therefore, any steps that would be conducive to concluding a negotiation with Brazil would be very helpful. Any arrangements that would facilitate the concluding of the treaty with Brazil would be quite useful, even though that treaty with Brazil might not have the full scope it would have if it were ratified the way it was presented to you.

What I am saying is, if we could have a treaty with Brazil that has a scope as close as one can come to what would be the full scope, it would be very helpful. And if there are impediments to full implementation of that treaty, then the suggestion that I have seen, from a technical standpoint, may offer a way of moving forward that would permit both Governments to achieve a treaty.

Senator SPARKMAN. If I understand clearly what you are saying, if you were acting on it, you would take it just as it is presented, and not feel that the reservation would be hurtful?

Mr. SURREY. I think it is a fair statement.

Senator SPARKMAN. Is that a fair statement?

Mr. SURREY. Yes; I think the treaty we presented, sent to you, is a good, sound treaty. It would be extremely useful for the United States to have.

If that cannot be achieved, for one reason or another, then the reservation I have seen, I think, will permit us to secure a treaty with Brazil that we would still approve and would be useful.

Senator SPARKMAN. I would say to you, Mr. Surrey, I am not stating my own views because actually I am in favor of the treaty.

Mr. SURREY. Yes.

Senator SPARKMAN. As it is?

Mr. SURREY. Yes.

Senator SPARKMAN. But we have run into opposition in the committee. I was hopeful that the reservation might be helpful in getting the treaty through. It was my plan to present the reservation to the treaty when it comes up, because I believe it will be helpful.

Mr. SURREY. One has to look at these things not only from the eyes of the United States, but from the eyes of the other country to the treaty. I think the Brazilians would feel about the treaty we presented the same way you feel—it would be the best treaty under all circumstances.

Senator SPARKMAN. Yes.

Mr. SURREY. If one cannot achieve the best treaty, I think both countries should strive to achieve a treaty.

Senator SPARKMAN. Thank you very much.

Thank you, Mr. Chairman.

CONCURRENCE OF COMMITTEE REQUIRED

The CHAIRMAN. In that connection, am I correct that the reservation would simply mean that if the investment tax credit is extended here in the United States, it is not automatically extended to Brazil but that it would take the approval of the committee?

Mr. SURREY. As I recall it, the clause that was indicated to me would involve the committee within the traditions of other clauses in present treaties that involve the concurrence, in effect, under our procedures, of this committee.

The CHAIRMAN. That is what I mean.

Mr. SURREY. That is my understanding.

The CHAIRMAN. As it presently is the credit must be extended to Brazil if it is extended to domestic companies; is that correct?

Mr. SURREY. Yes; as it exists in domestic operations.

The CHAIRMAN. Are there any other questions on the treaty with the Philippines?

Senator SPARKMAN. No. I think it was a very good presentation on the Philippines treaty.

Mr. SURREY. Shall I go ahead?

TREATY WITH HONDURAS

The CHAIRMAN. For the record, I am told Honduras is another country with which we have a treaty containing that charitable provision, is that correct?

Mr. SURREY. Well, I do not recall, and it may be correct. But in any event, we do not have a treaty with Honduras.

The CHAIRMAN. We do not?

Mr. SURREY. Well, we did. But the treaty with Honduras has been terminated.

The CHAIRMAN. I see. Proceed, Mr. Surrey.

CONVENTION WITH FRANCE

Mr. SURREY. The second convention that you have before you is of a different kind entirely. It is a convention with France.

It is a revision of an existing convention. Our first convention with France was signed in 1939 and took effect in 1945. There have been protocols since that time to reflect changes in the laws of both countries, but it was felt by both France and the United States that there should be a complete revision of the French treaty, and that the method of proceeding by protocol and patching it up had outlived its usefulness. So, consequently, both countries engaged in a complete reexamination of this treaty.

Both countries proceeded in the light of the so-called OECD model tax convention which is, as the term implies, a model suggested by the OECD for all its member countries, so that in the negotiations between them as much uniformity as possible can be achieved. The member governments of the OECD are attempting to accommodate to that model as far as possible.

This treaty with France is, therefore, built around the OECD treaty, and would be the model that we would use insofar as the standard clauses and the technical aspects and the like are concerned in our negotiations with other European countries that desire their treaties brought up to date.

In part, a large number of the clauses that appear in the French treaty have previously been incorporated by amendment in the treaties with the United Kingdom and Germany, so that many of these clauses have already been passed upon by this committee in the protocols that were approved.

WITHHOLDING TAXES ON DIVIDENDS AND INTEREST

But now in the French treaty there has been a complete revision. The treaty is quite an important one because there are a number of changes with respect to the investment clauses of the treaties and, as I indicated earlier, whatever might be the results with less developed countries, the developed countries are interested in bringing down the weight of their withholding taxes so as to make for a freer exchange of capital.

Now, for example, in this treaty with France, the withholding tax on dividends going from a subsidiary corporation to a parent corporation was fixed before at 15 percent. We withheld 15 percent on a dividend paid by a U.S. subsidiary to a French parent, and France withheld 15 percent on dividends on a French subsidiary to the U.S. parent.

This treaty reduces that to 5 percent, which will facilitate the repatriation of earnings from France to the United States insofar as our subsidiaries are concerned.

The rate of withholding tax on interest has been reduced in this treaty from 15 to 10 percent, which again I think is more conducive to investment activities——

The CHAIRMAN. On interest, you said?

Mr. SURREY. On interest; yes.

WITHHOLDING TAX ON ROYALTIES

On royalties, the change moved in the other direction. The rate of withholding on royalties in the previous French treaty had been at zero percent. But in this treaty it was raised to 5 percent on, I would say, the initiative of the French Government.

The CHAIRMAN. Why it that? What was the reason for that?

Mr. SURREY. Well, I think, on the whole, from their standpoint they looked upon it in nearly every respect as a revenue matter. There are very large industrial royalties that move from France to the United States, and very little in the way of royalties, relatively very little, moving from the United States to France.

The CHAIRMAN. What are these royalties for?

Mr. SURREY. These would be royalties on patents.

The CHAIRMAN. I see.

Mr. SURREY. Patents or trade processes.

The CHAIRMAN. Not natural resource royalties?

Mr. SURREY. No. These are so-called industrial royalties.

Senator CARLSON. Are motion pictures included?

Mr. SURREY. No; not motion pictures. It was here the other way around. The French position in effect resulted in a zero rate of tax on motion picture royalties, because they agreed that they would regard motion picture royalties as so-called industrial or commercial profits. There is another clause in the treaty that says that no industrial or commercial profits can be taxed by France unless there is a permanent establishment in France, and our motion picture companies do not have permanent establishments in France. They have no "presence" in France within the meaning of the earlier discussion with the chairman. Consequently, under this provision of the treaty, such motion picture royalties are not taxed by France. This is a clause the motion picture people feel is quite an important precedent and would like to see it in all our treaties. We would, too. It is not easy to get other governments to agree, however, but it is appropriate, and in our view, a helpful clause.

Cultural royalties are also exempt from withholding tax, copyright royalties, and the like. It was on the industrial royalty side, in which there has been a very large growth, that the French were concerned.

On our part we felt that the reduction in the rate of withholding tax from 15 to 5 percent on dividends was in our interest. All treaties result from negotiation; we think the result here is favorable and, therefore, these clauses fell into shape that way.

BRANCH PROFITS TAX

I think there are a large number of matters that one could go into, but they are set forth in the statement. There is one matter I might mention. France has a so-called branch profits tax. Let us assume an American concern has a branch business in France. It is a real business. It is not operated as a subsidiary. It has an office. It has a staff. It has employees. It has activities. This branch pays the regular French corporate tax, which happens to be 50 percent. In addition, it pays a second tax, a so-called branch profits tax, so that the branch bears not only the regular corporate tax but it bears another tax on

its profits, somewhat analogous to the tax that France would impose on the dividends of a French subsidiary if the activity had been in subsidiary form, although the tax is higher than the tax that would be imposed on dividends.

We thought the branch profits tax of the French was too high, and we did negotiate a considerable reduction in that tax.

In the converse situation, if a French corporation operated in the United States in branch form, we would impose our regular 48-percent tax. We have no basic additional tax on branch profits in the United States. But instead, if a French corporation gets the predominant amount of its earnings from a branch in the United States, when it distributes those earnings as dividends to shareholders of the French corporation, we will impose a tax on that act of distribution. It is the way we, in effect, levy a branch profits tax.

We think it is appropriate for us to levy this tax, which is, in a sense, and has acquired the terminology, although not technically accurate, a "second dividend tax." We think that is appropriate to have in countries which themselves have a branch profits tax and, consequently, you will find in this treaty that second dividend clause although you might not find it in other treaties with industrialized countries where they do not have a branch profits tax.

But it is an arrangement to enable us to balance off the method that the French have of taxing us—this is a method of taxing the French doing business in the United States so that reciprocally we come out the same.

If the French would give up their branch profits tax we would give up the second dividend tax but they do not do it and, therefore, we think we should be reciprocal.

EXCHANGE OF INFORMATION ON TAX LAWS

One other matter I think I should mention, and this is a provision that is new—article 30 of the treaty—is a provision that first obligates us to exchange information on changes in our tax laws, so that each of us can keep up to date on internal changes that may affect the treaty.

Then, in addition, the treaty provides that if as a result of these changes that have occurred and the like, it seems advisable to adjust some provisions of this convention without affecting its general principles, the necessary adjustments may be agreed upon between the contracting states by notes to be exchanged through diplomatic channels or in any other manner in accordance with their respective constitutional procedures.

This is to enable us, if there are minor changes in the French law, or minor changes in our law, or minor changes in treaty policy or interpretations, or difficulties in interpretation, to accommodate the treaty to those problems through an exchange of notes, and the pattern we would follow is the pattern that now exists with respect to the extension of a treaty to the territories of the two countries.

Under the traditional clauses the treaties generally apply only to the geographical or continental aspects of a country. But, by agreement between the two countries, they may be extended to the territories of the countries, and this extension is by an exchange of notes.

The extension, if it is made, need not extend the treaty in full but could make modifications in the treaty that are appropriate to the extension.

Under this practice before any extension we submit the exchange of notes to this committee, and await any objections of the committee to it. It is that procedure which is contemplated in this treaty and would be followed under article 30.

I think article 30 of the treaty would enable us to keep our treaties up to date in a rational fashion with respect to minor and technical problems that arise over time as tax laws change and interpretations change.

I think that ends my presentation on this other than to say the French have ratified this treaty, and so the coming into force of the treaty now depends upon the United States.

(The full statement of Mr. Surrey and the technical explanations submitted by the Treasury Department follow:)

STATEMENT ON THE UNITED STATES INCOME TAX CONVENTIONS WITH THE PHILIPPINES AND WITH FRANCE, APRIL 30, 1968

Mr. Chairman and members of the committee, I am pleased to appear before you in support of two income tax conventions, one with the Philippines and the other with France. The convention with the Philippines was signed in October 1964 and the convention with France was signed in July 1967, and I propose to discuss the two conventions in the order in which they were signed.

CONVENTION WITH THE PHILIPPINES

In broad outline, the tax convention with the Philippines is a somewhat truncated version of the pattern established in previous conventions. It contains the permanent establishment principle, under which an enterprise of one country is not subject to tax in the other on industrial or commercial profits unless it has a permanent establishment in that other country. And in the determination of the business profits of a permanent establishment, provision is made for the allowance of a deduction for expenses, wherever incurred, which are allocable to the permanent establishment in deriving income subject to tax. The definition of a permanent establishment in the treaty has been the subject of some misunderstanding which I believe has been resolved to the satisfaction of interested groups, and I shall return to this matter in a few moments.

Nondiscrimination

Among the important provisions of the treaty is one which guarantees against nondiscrimination. Under the convention a citizen of one country who is resident in the other may not be subject to heavier taxes in the country in which he resides than citizens of that country who reside there. Similarly, a corporation organized under the laws of one country but owned by residents of the other must be treated for tax purposes in the same way that a corporation owned by citizens of the taxing state would be treated. Finally, where a firm in one country has a branch in the other country, it may not be subject to heavier taxes than a similar business in the latter state.

Related Parties

Where transactions take place between related parties under conditions which differ from those that would prevail between unrelated parties, the convention provides that there may be a readjustment of income between the two entities so that the proper amount of income will be subject to tax in the respective states. This provision is implemented by another provision in the treaty dealing with consultations between the competent authorities of the two countries which authorizes them to reach agreement on the same allocation of income and expenses.

Investment Income

Typically, the conventions to which the United States is a party contain articles dealing with investment income which provide in varying degrees for a reduction

in withholding taxes on such investment income. Some treaties provide for reciprocal exemption at the source of some forms of investment income, such as dividends, interest and royalties. The convention with the Philippines is confined in this respect to a provision dealing with interest received by the Government of one of the contracting states, or a wholly owned instrumentality, from sources within the other state. In such cases, the interest is exempt from tax at the source.

As a general proposition, the Philippine Government did not favor incorporating any provisions in the treaty which would reduce the revenue currently derived by the Philippines from taxes on investment income flowing to U.S. residents. The general U.S. attitude with respect to investment income was that the Philippines should consider reducing its taxes on investment income in those cases where the amount of Philippine tax was in excess of the tax that would be imposed in the United States on the same income. In other words, we sought adjustments in Philippine tax so as to eliminate excess foreign tax credits to the extent that they occurred. Such adjustments would, in our view, have improved the tax climate in the Philippines for investment from the United States. Since the Philippines did not feel able to make such adjustments in view of their budgetary problems, we on our side did not include other provisions in the convention which, in our opinion, would have helped to promote U.S. investment in the Philippines. I have reference here primarily to the investment credit with which this Committee is familiar.

Tax-exempt Transfers

The Philippines did incorporate a provision which should facilitate investment under which it grants tax exemption to the gain that might be said to accrue to an American firm which transfers property to a Philippine corporation in exchange for stock. Following the transfer, the American firm, together with any other persons making similar transfers, must own at least 80 percent of the voting stock of the transferee corporation. A similar exemption is already provided for under our internal law but a transaction of this type would be subject to tax in the Philippines. The treaty eliminates this tax.

Income from Personal Services

The convention contains the customary articles dealing with personal service income earned by persons who are resident in one country and go to the other for limited periods of time. An individual who is a resident of one contracting state and temporarily goes to the other to perform personal services will be exempt from tax in the latter state if he is present there for less than 90 days and his earnings do not exceed $3,000. This rule is subject to some other qualifications and corresponds to a provision in our Internal Revenue Code. Teachers who are residents of one country and go to the other at the invitation of a university or other accredited educational institution to teach or engage in research will be exempt from income tax in the host country for a period up to two years.

The convention also contains provisions designed to promote the movement of students and trainees between the two countries. Thus, a resident of one state who goes to the other for the primary purpose of study or to secure training necessary to qualify him in the practice of a profession or to do research as the recipient of a grant will be exempt from tax in the host state with respect to gifts from abroad, a grant, allowance, or award, as well as income from personal services performed in the host country provided the amount of income thus earned does not exceed $2,000 a year. In the case of a person who must secure specialized training to qualify for the practice of a profession, such as a physician for example, he may earn up to $5,000 a year.

Charitable Contributions

The convention also provides that the United States will allow a deduction to its citizens and residents for charitable contributions made to nonprofit institutions organized in the Philippines, provided those contributions are used within the Philippines and provided that the organization qualifies as a tax-exempt organization under the United States Internal Revenue Code. The organization must also be exempt from tax in the Philippines. The amounts which may be deducted are limited in the same way as if the contribution were made to a United States charitable institution.

Effective Date and Administrative Provisions

As in other conventions, the treaty with the Philippines will become effective on January 1 of the year following exchange of instruments of ratification. The

convention will remain in effect indefinitely but may be terminated afer five years.

There are, finally, the usual admnistrative cooperation provisions such as those dealing with exchanges of information and assistance in collection in cases where persons erroneously obtained an exemption granted by the treaty.

I should like now to revert to the matter of the permanent establishment which I mentioned earlier. On the occasion of the hearing held on the income tax convention with Thailand, a representative of the United States Steel Corporation, Mr. Hearne, appeared and expressed concern about some aspects of the definition of a permanent establishment contained in the Thai treaty. The language he found troublesome was identical to that contained in the Philippine treaty. As a result of these comments, we met with Mr. Hearne to discuss his interpretation of the treaty provisions. The outcome was a letter to Senator Gore, Chairman of the Subcommittee which conducted the hearing, in which Mr. Hearne indicated that in the light of our discussions and the principles intended to be followed in our subsequent treaties, which I confirmed in a letter to him, the objections which he had stated were eliminated. The discussions were in terms of the Thai treaty, but in reality it was the provisions in the Philippine treaty which were of interest to him. I should add that in our conversations with Mr. Hearne, I indicated that the language which he considered to be troublesome would not be used as a precedent for other treaties, such as the treaty with Brazil which was then under negotiation. In this regard, it should be noted that the Brazilian income tax convention, which is pending before your Committee, does not contain the language which concerned Mr. Hearne.

I want to urge your Committee to take affirmative action on the pending convention with the Philippines. I think it is a useful addition to the series of income tax treaties that we have with many other countries in the world, and is likely to contribute to better trade and investment relations between the Philippines and the United States.

CONVENTION WITH FRANCE

The pending income tax convention with France is a completely revised version of one of our earliest tax conventions which was signed in 1939 and took effect on January 1, 1945. That document was later modified three times to reflect changes in policy both in France and in the United States. The convention presently before you is essentially a new convention, embodying a comprehensive revision of many of the provisions included under the existing arrangements and the introduction of some provisions not previously included, and reflects the fact that both parties to the agreement has introduced major tax changes in the last decade. In France, a fiscal reform of 1959 substantially altered the French income tax structure, particularly as it affects personal income, and a 1965 law introduced a partial integration of the corporate and personal income taxes so that part of the corporate tax is now treated in France as a withholding tax on the income of the shareholders. Included in these reforms have been important changes in the taxes on the income derived from France by nonresidents.

On our side the tax changes of 1962 and 1964 and the Foreign Investors Tax Act of 1966 have to be taken into account in any treaty arrangements. In addition, the experience in developing an OECD draft model income tax convention has provided new insights into the problems to be resolved in such conventions. The pending convention with France is the first complete convention between the United States and another OECD country since publication of the draft model and reflects variations felt necessary by both parties to accommodate the OECD provisions to the interaction of the two income tax systems.

Some of the changes introduced by the new treaty are more formal than substantive; for example, the names of taxes covered had to be changed, along with the reference to Alaska and Hawaii as territories, and a new article has been added providing for periodic exchanges of texts of statutes, regulations and rulings on tax matters. Other modifications are intended to facilitate administration of the treaty. Since the accompanying technical memorandum touches on each article of the convention, I will call your attention only to the more significant changes to be found in the new convention; these affect the taxation of investment income, business income and personal service income.

Investment Income

Dividends

As a result of a 1965 law, the French income tax structure has undergone changes of wide dimensions, both internally and in their impact on international investment. The French corporate tax has been imposed at a 50 percent rate for many years and until the 1965 change, had been applied in much the same way as our corporate tax. In order to improve the domestic capital market and generate interest in French securities, the French tax law was changed so that one-half of the corporate tax is now regarded as having been paid on behalf of the domestic shareholder in the company. This part of the corporate tax is treated as if it were a withholding tax on the shareholder.

Consequently, resident shareholders in French companies include one-half the corporate tax in their gross income and receive a tax credit against their personal tax liability equal to one-half of the tax paid by the corporation. If the credit exceeds the shareholder's tax liability he is entitled to a refund. This tax credit is not available to nonresident shareholders nor is it granted to French residents on dividends from foreign corporations. Under the new French system, U.S. shareholders are not any worse off, in absolute terms, than before its introduction, but they are at a disadvantage relative to French shareholders, and it is our expectation that in due course France will act to eliminate or mitigate this relative disadvantage.

Meanwhile, France has agreed on the basis of reciprocity to lower to 5 percent the withholding tax on dividends received by a U.S. corporation from a French corporation, of which it owns at least 10 percent of the shares, compared with 15 percent in the present treaty and 25 percent under its statute. However, the rate on portfolio dividends paid to nonresidents remains 15 percent as under the existing treaty. The inflow of dividends to the United States from France has been rising in recent years [1] and should be further stimulated by this reduction in French tax. The rate reduction will increase the inflow of dividends by more than 11 percent even without any change in dividend policy, and the lowering of the overall French tax liability on French source dividends will make dividends remittances to the United States more attractive.

Interest

The withholding tax rate on interest paid to nonresidents is limited by the existing treaty to 15 percent, reciprocally. Under the new treaty it has been reduced to 10 percent (except that interest on French bonds issued before January 1, 1965 will be taxed at 12 percent). The French statutory rate of withholding tax payable by nonresidents is 25 percent while the U.S. statutory rate is 30 percent.

Royalties

The mutual withholding tax exemption of royalties flowing from one country to another has been replaced in the new convention by a more limited provision. Copyright royalties will continue to enjoy tax exemption at the source, but a 5 percent withholding tax will apply to other royalties. This compares with statutory rates of 24 percent of the net royalty in France, and 30 percent of the gross royalty in the United States. The net royalty in France is defined as net of a presumed expense deduction of 20 percent. Consequently, the effective French tax rate is 19 percent of gross royalties. Although the rate reduction on the French side is smaller than on the U.S. side, the benefit of this provision is enjoyed principally by U.S. residents as the flow of industrial royalties is substantially one-sided. It was on this ground that the French were insistent upon terminating the existing exemption for such royalties.

Real Property Rentals

Article 5 of the new convention assures to U.S. residents who derive income from real property located in France that they will be subject to French tax on the net amount of such income, computed as for residents of France, rather than a tax on the gross amount. A similar guarantee applies to French residents with real property in the United States. This treatment of non-residents' real property income corresponds to the current law of both countries, but the treaty provides assurance that it will not be subject to statutory change during the life of the treaty.

[1] United States receipts of direct investment dividends from France rose sharply in 1965. For 1963–66 the gross figures are: $30 million, $28 million, $50 million, and $52 million.

Branch Profits

In addition to corporate tax, foreign corporations operating in France through a branch in that country are subject to an additional tax designed to compensate for the inability of the French to collect a withholding tax on dividends paid by the foreign corporation out of the profits earned in France. The statutory base for this branch tax is the entire amount of branch profits net of the corporate tax, and the statutory rate is 25 percent. Since the corporate tax rate is 50 percent, the combined statutory tax on branch profits is 62.5 percent. Under the existing U.S. treaty, the tax base is reduced to three-fourths of the branch profits after French corporate tax, so that the combined rate is reduced to 59 percent. Under the new treaty, the base for this tax on French branches of U.S. corporations is reduced to two-thirds of the after-tax profits of the branch and the rate is reduced to 15 percent. A distribution of two-thirds of after-tax profits approximates the rate of distribution typical of subsidiaries and thus brings into line the tax base for the two types of business organization. In addition, the treaty specifies that the French tax on capitalization of profits (droit d'apport majoré) no longer applies to branches of U.S. corporations. Since the French impose a tax on branch profits in anticipation of their distribution as dividends, it was inconsistent to impose, as well, a tax based on profits that were not distributed and the French therefore agreed to give up the latter tax on U.S. branches.

On our side, the U.S. tax on dividends paid by a foreign corporation has been restricted, so that instead of applying whenever the corporation derives 50 percent of its gross income through a permanent establishment in the United States, it will apply to a French corporation's dividends only when 80 percent of the corporation's gross income was so derived.

Business Profits

Profits derived from France by a U.S. company are taxable in France only if attributable to a permanent establishment which the company maintains in France, and conversely for a French company deriving profits from the United States. Although this has always been a fundamental postulate of income tax conventions, it has been refined from time to time as experience has been gained. The new convention with France continues to apply this principle, but it has been modified along the lines of the definition of a permanent establishment worked out in the OECD. The result is that an American firm would be able to engage in a wider range of activities in France without being considered to have a permanent establishment there and consequently without becoming subject to French tax. The treaty also contains a special rule under which an American firm that insures French risks would not be regarded as having acquired a taxable status in France if the insurance is secured through a broker or general commission agent. Reinsurance premiums would not be taxable in any event.

The definition of profits in the new treaty no longer includes all income received by a corporation which has a permanent establishment in the country in question. To the extent that dividends, interest, royalties, capital gains and real property rentals are not "effectively connected" with such a permanent establishment, they are not atributed to it and qualify instead under the special provisions applicable to those items of income. This new approach is consistent with the 1966 Revenue Act. An important innovation in this respect is that film rentals are considered to be commercial or industrial profits, rather than royalties, so that a firm in one country receiving film rentals from the other will be subject to tax in the source country only if it has a permanent establishment there and the film rentals are "effectively connected" with the permanent establishment.

Personal Service Income

The tax treatment of income from personal services is one of the important improvements introduced by the new convention. The distinction in the present treaty between those engaged in the practice of a liberal profession and employees has been replaced by a more precise distinction between self-employed persons and employees, to the significant benefit of self-employed persons resident in one country who have occasion to perform services during a temporary stay in the other country. For example, a U.S. consultant who performs services in France during a visit there of not more than six months during any taxable year will now be free of French income tax liability on the income earned for those services. A doctor who treats a patient while in France, perhaps to attend a convention, or on vacation, or to study firsthand a new medical technique, will not become liable to French income tax. (In both these cases, liability would attach, however, if the person maintained a fixed place of business (fixed base)

in France for at least six months during the tax year.) These and similar cases may now involve liability to tax, with the discouraging effect which results from requiring temporary visitors to be familiar with and comply with foreign tax laws.

Another specific situation which has been improved by the new convention is the exchange of teachers, students and trainees. Under the present convention a problem of interpretation arose with respect to teachers, who were considered by the United States to be members of a "liberal profession" while France considered them not to be engaged in a "liberal profession" because they were employees. Under the first interpretation a French resident could come to the United States to teach for two years without incurring liability for U.S. income tax; under the second he would be taxable in the United States as a consequence of staying here more than six months in a taxable year. Eventually, the U.S. position was chosen as the preferable interpretation. The new convention sets out the treatment of teachers in a separate article, specifying exemption in the host country for a two-year period for teachers invited by an accredited institution of that country. The treatment of students is more generous under the proposed convention than under the present one because the new rule permits them to earn up to $2,000 a year free of U.S. tax liability. A new provision dealing with apprentices permits residents of either country to earn up to $5,000 a year serving apprenticeships in the other. In each case the benefit is allowed for a stay for a limited time period.

A new article provides that social security payments shall be taxable only by the paying state.

Nondiscrimination

Another improvement in the new convention extends the present nondiscrimination rule to all taxes imposed at all levels, not just national income taxes. This expanded provision is included in the OECD draft and in all recent U.S. conventions.

Effective Date

The new convention will enter into force one month after the exchange of instruments of ratification and will remain in force until either state gives six months' notice of termination before the end of any calendar year after 1969.

I would like, finally, to mention Article 30 which deals with exchanges of official information. In our recent treaties we have undertaken an obligation to exchange with our treaty partner one another's tax laws. Various arrangements already exist for exchanges of information on treaties. Such exchanges will help us keep abreast of developments in the field of domestic as well as international tax policy and to ascertain the extent to which changes in laws or treaties affect the operation and objectives of our tax treaties. This is a constructive and valuable type of cooperation.

As a corollary to such exchanges of information, the pending treaty also provides that the two signatories may make appropriate adjustments in the convention if, by reason of changes in the taxation laws in either country, such modifications in the convention appear necessary and are consistent with the general principles incorporated in the convention. The concept of taxation laws is intended to be construed broadly and to include not only changes in statutes or their interpretation but also changes in tax treaties.

I can illustrate how this provision might be applied by reference to some of our recent treaties. In our conventions with Germany and the United Kingdom, authority has been given to the competent authorities of the two signatories to reach agreement on a uniform allocation of income between related enterprises and to give effect to such an agreement by adjusting taxes and making refunds where appropriate. Refunds may be made even if the statute of limitations otherwise bars them. Many of our other treaties empower the competent authorities to reach agreement on allocations of income but they do not authorize a tax refund if this involves an extension of the statutory period for refunds. Consequently, a full measure of equity may not always be achieved. However, if these other treaties contained the language of Article 30, the implementation of the agreement on uniform allocation could then be effectuated. The effectuation would be carried out by an exchange of diplomatic correspondence as is now used in extension of tax treaties to dependent territories. In several treaties there is a provision permitting an extension of their scope to the overseas territories of the other country with such modifications in the conventions as may be necessary. Such extensions and modifications are undertaken only after submission of the proposed exchange of correspondence to this Committee.

In concluding my remarks on the French treaty, I want to emphasize that while the proposed convention is an entirely new document, its newness consists largely in the modernization of various provisions to reflect changes in the tax systems of the two parties and developments in the concepts governing international tax relationships. The treaty has benefitted from the continuing discussion between ourselves and other countries of the issues and problems dealt with in such an agreement. It is not a new convention in the context of our policy in other conventions. For the most part this convention with France embodies the views developed over the years and implemented in the various agreements we have entered with other industrial countries. Recently most of these agreements have been partial, designed to amend rather than to replace an existing convention. In the French case the major revisions in French income taxes necessitated a thorough redrafting. As a consequence the new convention with France will serve as the reference guide in future negotiations with European countries. Thus, a new convention with Belgium is necessary due to important recent changes in Belgian tax law. Negotiations are also continuing with Portugal and Spain. The French convention by virtue of its completeness and recent date will be a useful standard for these negotiations, from which variations appropriate to accommodate the treaties to differing national tax structures can be made.

Technical Explanation of Proposed United States-France Income Tax Convention—April 30, 1968

ARTICLE 1. TAXES COVERED

This article designates the taxes of the respective States which are the subject of the proposed convention. With respect to France, the taxes included are the Tax on Income of Physical Persons and the Complementary Tax. Also specifically included are any withholding tax, prepayment (*precompte*) or advance payment with respect to such taxes. The proportional tax and the progressive tax have been repealed and are not included in the taxes covered by the convention. Also covered with respect to France are the Corporation tax and the tax on Stock Exchange transactions.

With respect to the United States, the taxes included are the United States Federal income tax, including surtax, imposed by Subtitle A of the Internal Revenue Code. The United States excess profits tax and the documentary taxes on sales or transfers of shares of stock or bonds, both of which are no longer imposed, are eliminated from taxes covered by the proposed convention. However, the convention applies to any documentary taxes on sales of shares or certificates of stock or bonds which are subsequently enacted.

The convention also applies to taxes substantially similar to those taxes specified which are subsequently imposed in addition to, or in place of, the existing income taxes. For purposes of Article 24 (Nondiscrimination) the convention applies to taxes of every kind which are, or may be, imposed by the respective States, at the national, state, or local level.

ARTICLE 2. GENERAL DEFINITIONS

This article sets out definitions of certain of the basic terms used in the proposed convention and provides that any undefined term shall, unless the context otherwise requires, have the meaning which it has under the laws of the Contracting State (hereinafter a reference to a State is to a Contracting State unless otherwise specified) imposing the tax. Geographical France is extended to include the overseas departments, *viz.* Guadaloupe, Guyane, Martinique, and Reunion. These departments are treated by France as part of Metropolitan France and in general their tax systems are the same as that of France.

ARTICLE 3. FISCAL DOMICILE

This article sets forth rules for determining fiscal domicile or residence for purposes of the proposed convention. Fiscal domicile or residence is important because in general only a resident of one of the States may qualify for the benefits of the convention. This article is patterned generally after the fiscal domicile article of the model convention prepared by the Fiscal Committee of the Organization for Economic Cooperation and Development (hereinafter referred to as the OECD model convention or the OECD draft).

A resident of one of the States is a corporation of that State (as defined in Article 2) or any person (other than a corporation) who is a resident of that

State for purposes of its tax. However, in the case of the United States, a person acting as a partner or a fiduciary is a resident only to the extent that the income derived by such person in that capacity is taxed as income of a resident. Under United States law, the residence of a partnership or trust is not relevant for tax purposes since a partnership or trust is ordinarily not taxed as such. Under the proposed convention, income received by a partnership or trust will not qualify for the benefits of the convention unless such income is subject to tax in the United States. Thus, in effect, the status of income which is subject to tax only in the hands of the partners or beneficiaries will be determined by the residence of such partners or beneficiaries. The provision is nonreciprocal because of the absence of similar problems under French law which, for example, subjects all income of a French partnership to French tax.

An individual who is a resident of both States under the general rules employed by such States for determining residence will be deemed a resident of the State in which he has his permanent home, his center of vital interests, or his habitual abode. If the issue is not settled by these tests, the competent authorities will settle the matter by mutual agreement. The order in which the tests are applied has been altered from that found in the OECD model convention and a test of nationality has been omitted.

A resolution of the issue of residence under this article will control for all purposes of the convention including the savings clause of Article 22(4).

ARTICLE 4. PERMANENT ESTABLISHMENT

This article defines the term "permanent establishment." The existence of a permanent establishment is, under the terms of the proposed convention, a prerequisite for one State to tax the industrial or commercial profits of a resident of the other State. The concept is also significant in determining the applicability of other provisions of the convention, such as Articles 9 (Dividends), 10 (Interest), 11 (Royalties), and 12 (Capital Gains).

The definition of "permanent establishment" is a modernized version of the definition found in the existing convention. The new definition is taken from the OECD model convention except as noted below. As modified the term "permanent establishment" means "a fixed place of business through which a resident of one of the Contracting States engages in industrial or commercial activity." Illustrations of the concept of a fixed place of business include a seat of management, a branch, an office, a factory, a workshop, a warehouse, a place of extraction of natural resources, or a building site or construction or assembly project which exists for more than 12 months. As a general rule, any fixed facility through which industrial or commercial activity is conducted will be treated as a permanent establishment unless it falls within one of the specific exceptions described below. It should be noted that this convention uses the term "seat of management" where the OECD model convention and prior agreements to which the United States is a party used the term "place of management"; both terms are translations of the French term "un siege de direction" and it is believed the translation found in this convention is the more accurate. Prior agreements in which the term "place of management" appears will be interpreted therefore as if the words "seat of management" had been used.

Under the specific exceptions a permanent establishment does not include—

(1) Use of facilities for storage, display, or delivery of goods or merchandise belonging to the resident;

(2) Maintenance of a stock of goods belonging to the resident for the purpose of storage, display, or delivery, or for processing by another person; or

(3) The maintenance for a fixed place of business for the purpose of furnishing certain services to the resident. These services include purchase of goods and collection of information. Also included are advert sing, the supply of information, the conduct of scientific research, or any similar activities which have a preparatory or auxiliary character.

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

Notwithstanding the other provisions of this article, a person will be considered to have a permanent establishment if he engages in business through an agent, other than our independent agent described below, who has and regularly exercises authority to conclude contracts in the name of such person unless the agent only exercises such authority to purchase goods or merchandise. In addition, a permanent

establishment will be considered to exist if an agent maintains substantial equipment or machinery for a period of 12 months or more. This latter rule is not included in the OECD model convention but parallels the rule that a building site or construction project which exists for more than 12 months is a permanent establishment.

The proposed convention also provides that a resident of one State will not be deemed to have a permanent establishment in the other State if such resident is engaged in a trade or business in such other State through an independent agent such as a broker or general commission agent, if such agent is acting in the ordinary course of its business. The determination of whether a resident of one State has a permanent establishment in the other State is to be made without regard to any control relationship between such resident and a resident of the other State or a person which engages in industrial or commercial activity in that other State (whether through a permanent establishment or otherwise).

An insurance company will have a permanent establishment in one State if the company receives premiums from or insures risks in that State. The rule does not apply if the business is conducted through an independent agent of the type described in the preceding paragraph. This is a change from the existing convention which provides that an insurance company of one State is considered as having a permanent establishment in the other State as soon as such company receives premiums or insurance risks in the other State. A principal consequence of the change is that the receipt of reinsurance premiums in respect of risks located in a State will not in and of itself give rise to a permanent establishment in that State. Moreover, even if an insurance company which is a resident of one State has a permanent establishment in the other State, reinsurance premiums will not be taken into account in determining taxable profits in the latter State. See the exchange of letters accompanying the proposed convention. The OECD model convention does not expressly deal with the receipt of insurance premiums.

ARTICLE 5. INCOME FROM REAL PROPERTY

This article sets forth a source rule for income from real property and provides an election to be taxed on a net basis with respect to such income. Thus, a resident of one State may be subjected to tax in the other State on income from real property and natural resource royalties if the property or natural resource is located in such other State. However, such resident may elect for any taxable year to compute the tax on such income on a net basis. The income referred to in this article includes gain from the sale or exchange of property generating such natural resource royalties but does not include interest on mortgages and similar instruments; the latter type of income is covered by Article 10 (Interest).

The existing convention contains a similar provision. However, questions have been raised as to the scope of the net basis election, that is, whether such election applies only to income described in this article or to all income from sources within the United States. The proposed convention clarifies the matter by specifically providing that the election is limited to the income described in this article. This change is applicable for taxable years beginning after January 1, 1967, and is made without prejudice to positions taken by taxpayers or the Internal Revenue Service as to the correct interpretation of Article 7 of the existing convention.

This article sets forth the same general rule as that found in the OECD model convention except that the model convention does not include a net basis election.

ARTICLE 6. BUSINESS PROFITS

This article conforms to the rule contained in the existing convention that industrial or commercial profits of a resident of one State are taxable in the other State only to the extent such profits are attributable to a permanent establishment located in such other State.

In determining the proper attribution of industrial or commercial profits, the permanent establishment is to be treated as an independent entity and considered as realizing the profits which would be realized if the permanent establishment dealt with the resident of which it is a permanent establishment on an arm's length basis. Expenses wherever incurred which are reasonably connected with profits attributable to the permanent establishment, including executive and general administrative expenses, will be allowed as deductions by the State in which the permanent establishment is located in computing the tax due to such State.

The mere purchase of goods or merchandise in a State by the permanent establishment, or by the resident of which it is a permanent establishment, for

the account of such resident will not cause attribution of profits to such permanent establishment. This rule, which has the effect of exempting such income from tax in such State, conforms to existing United States statutory law. (See section 862(a)(6) of the Internal Revenue Code.)

The term "industrial or commercial profits" is defined by setting forth several examples of activities which constitute the active conduct of a trade or business, including agricultural activities, the furnishing of personal services, the rental of tangible personal property and insurance activities and rents and royalties from motion picture films. The term also includes investment income but only if the right or property giving rise to the income is effectively connected to a permanent establishment. Income received by an individual as compensation for personal services either as an employee or in an independent capacity is not treated as industrial or commercial profits.

An exchange of letters accompanying the proposed convention records the understanding that the notes, minutes, and arrangements relating to income taxes which were entered into between the French Government and the United States Government in connection with prior tax conventions and protocols are considered abrogated, including in particular those of 1955 relating to United States motion picture companies. The motion picture companies will be taxed in accordance with French tax law and the rules of the proposed convention. However, it is understood that the abrogation of the arrangements will not entail any important tax consequences.

This article is substantially similar to the business profits article of the OECD model convention except that the model convention does not contain a definition of industrial and commercial profits.

ARTICLE 7. SHIPPING AND AIR TRANSPORT

This article provides that, notwithstanding the rules of Article 6 concerning industrial or commercial profits, a resident of one State will be exempt from tax in the other State on income derived from the operation in international traffic of ships or aircraft registered in the former State. This article does not contain the provision of the existing convention exempting shipping profits from the business license tax (*patent*). However, it was agreed in an exchange of letters accompanying the proposed convention that the license tax levied in France on behalf of local governments would not apply to United States airlines and shipping companies if French airlines and shipping companies were not subject to State (as distinct from Federal) income taxes in the United States.

ARTICLE 8. RELATED PERSONS

This provision corresponds in purpose and scope to section 482 of the Internal Revenue Code of 1954 and confirms the power of each government to reallocate income in cases in which a resident of one State is related to a resident of the other State if such related persons impose conditions between themselves which are different from conditions which would be imposed between independent persons. A similar provision is included in the existing convention and in the OECD model convention.

ARTICLE 9. DIVIDENDS

The existing convention provides that dividends derived from sources within one State by a resident of the other State not having a permanent establishment in the former State will be subject to tax in the fomer State at a rate not in excess of 15 percent.

The proposed convention continues the 15-percent rate with respect to dividends on portfolio investments but provides a maximum rate of 5 percent with respect to intercorporate dividends if the recipient owns 10 percent or more of the stock of the paying corporation and, generally, if not more than 25 percent of the gross income of the paying corporation consists of dividends and interest.

The proposed convention abandons the "force of attraction" concept by providing that the reduced rates of tax on dividends are denied only if the recipient has a permenent establishment in the State of source and the shares with respect to which the dividends are paid are effectively connected with such permanent establishment. In such a case, the dividends may be taxed as industrial and commercial profits under Article 6 of the proposed convention.

The elimination of the force of attraction principle will make uniform the rate of tax levied on dividend income by a resident of one State from sources within the other State unless such income is effectively connected to a permanent estab-

lishment in the State of source. Income which is so effectively connected may be taxed at the normal rates applicable to such income in the State of source. The policy reflected in the abandonment of the force of attraction principle is embodied in the Foreign Investors Tax Act of 1966 and also in the recent revisions of the German, Dutch, and United Kingdom conventions.

The proposed convention also sets forth a source rule under which dividends paid by a corporation of one State are treated as from sources within that State and dividends paid by any other corporation are treated as from sources outside that State. However, dividends paid by a corporation foreign to the United States are treated as from United States sources if, during the previous 3 years, the corporation had a permanent establishment in the United States and more than 80 percent of such corporation's income was taxable to such permanent establishment. This source rule conforms to United States statutory law except that, under section 861 (a)(2)(B) of the Code if more than 50 percent of a foreign corporation's income is effectively connected with United States business, a pro rata share of such corporation's dividends are treated as from sources within the United States. Thus, the United States ability to tax is more limited under the convention source rule than under the statutory source rule.

In the absence of a convention, France withholds tax at a rate of 25 percent on dividends paid to nonresidents of France. In the United States, the corresponding rate is 30 percent. Under a recent revision of French internal law (Law No. 65–566, July 12, 1965), a dividend paid by a French corporation to a shareholder resident in France entitles the shareholder to a tax credit (*avoir fiscal*) equal to 50 percent of the dividend. The tax credit system is based on the assumption that the profits from which the dividend was paid have borne corporation tax at the normal rate of 50 percent. In the event that dividends are paid from profits which have been taxed at less than the normal 50-percent rate, French law requires that the corporation pay to the French treasury a prepayment of tax (*precompte*) equal to the amount of the tax credit (*avoir fiscal*) available to the shareholder as a result of his dividend receipt less the corporate tax paid. However, a shareholder not resident in France (for example, a shareholder resident in the United States) is not entitled to the tax credit. In view of these facts, the proposed convention provides that in cases in which the prepayment (*precompte*) is levied with respect to dividends paid by a French corporation to a United States resident, such resident will be entitled to a refund of the prepayment. It is understood that, after agreement with the United States on this matter, France unilaterally extended this relief to residents of all countries with which France has tax conventions; this is an interim arrangement pending amendment of those conventions.

The dividend article of the proposed convention is patterned generally after the OECD model convention except as follows: With respect to qualification for the 5-percent intercorporate dividend rate, a 10-percent ownership requirement is substituted for the 25-percent ownership requirement of the OECD draft. The 10-percent rule conforms to the United States concept of direct investment especially as expressed in section 902 of the Internal Revenue Code. The proposed convention also limits to 25 percent the amount of passive income which may be derived by a corporation paying dividends which qualify for the intercorporate dividend rate. This provision, which is included in most conventions to which the United States is a party but which is not found in the OECD draft, reflects the policy that the reduced rate should not be made available to dividends paid by certain holding companies. Dividends and interest from 50 percent or more owned subsidiaries are not considered passive income. The OECD draft contains a definition of the term "dividends" which has been omitted from the proposed convention and the proposed convention includes a source rule, described above, which is not found in the OECD draft.

ARTICLE 10. INTEREST

The existing convention provides that interest derived from sources within one State by a resident of the other State not having a permanent establishment in the former State will be subject to tax in the former State at a rate not in excess of 15 percent.

The proposed convention reduces the maximum rate of tax to 10 percent on interest on bonds, notes, debentures, or any other form of indebtedness from sources within one State and paid to a resident of the other State. A special rule permits the French to tax interest on bonds issued before January 1, 1965, at a maximum rate of 12 percent.

As noted above in connection with the dividend article, the proposed convention abandons the force of attraction principle. Thus, the reduced rates of tax applicable to interest apply unless the recipient has a permanent establishment in the State of source and the indebtedness giving rise to the interest is effectively connected to such permanent establishment. In such a case, the interest may be taxed as industrial and commercial profits under Article 6.

Interest is defined generally as income from any kind of debt-claim or any income treated as interest under the tax law of the State of source. In cases in which excessive interest is paid by reason of a special relationship between the payor and the recipient, the provisions of the interest article do not apply to the excess part of the payments. Excess interest payments may be taxed as dividends under Article 9.

Interest is from sources within a State when the payor is that State, a political subdivision, a local authority, or a resident of that State. However, if the payor has a permanent establishment in the State of source in connection with which the interest is paid or incurred and the interest is deducted in computing the profits of such permanent establishment, such interest will be deemed to be from sources within that State. The United States Internal Revenue Code also provides generally that the residence of the payor determines the source of interest income. There is, however, an exception to this rule in the case of foreign corporations doing business in the United States. However, this exception is not expressly related to the existence of a permanent establishment in the United States or the deductibility of the interest expense but rather on whether 50 percent or more of the foreign corporation-payor's gross income was effectively connected with its United States business for the 3-year period preceding the year of payment of the interest.

The proposed convention also provides that interest received by one of the States or any wholly owned instrumentality of that State (which is not subject to income tax by such State) is exempt from tax by the other State.

In the absence of a convention, France withholds tax at a rate of 25 percent paid to a nonresident not having a permanent establishment in France. If a nonresident has a permanent establishment in France, interest attributable to such permanent establishment is not subject to withholding but is subject to tax in France at the rates normally applicable to industrial and commercial profits. The 25-percent withholding rate is a result of a recent revision of French law (Law No. 65–997 of November 29, 1965, effective January 1, 1966). Before adoption of the new law, interest was taxed at different rates depending on the nature of the debt (in some cases interest was exempt from tax if paid to creditors not resident in France).

The interest article of the proposed convention is substantially identical to that found in the OECD model convention except that the OECD draft does not contain an exemption for interest received by the governments of the two States.

ARTICLE 11. ROYALTIES

The existing convention provides that industrial and artistic royalties derived from sources within one State by a resident of the other State not having a permanent establishment in the former State are exempt from tax in the former State.

The proposed convention continues the exemption for artistic, literary, and scientific royalties but permits tax to be levied at a maximum rate of 5 percent on other royalties. As defined in this article, the term royalties includes knowhow and also gains from the sale or exchange of the intangible property but only if payment is contingent on productivity, use, or disposition of the property. If the payments are not contingent, the capital gains article applies.

The provisions of this article do not apply if the recipient of a royalty has a permanent establishment in the State of source and the right or property giving rise to the royalty is effectively connected to such permanent establishment. In such case, the royalty may be taxed as industrial and commercial profits under Article 6. Thus, the force of attraction principle is also abandoned with respect to royalties.

Royalties paid for the use, or right to use, property (as defined in this article) in a State (whether or not a contracting State) are treated as from sources within that State. This source rule corresponds to that found in section 861(a)(4) of the Internal Revenue Code.

If excessive royalties are paid by reason of a special relationship between the payor and recipient, the provisions of the royalties article do not apply to the

excess part of such payments. Excess royalty payments may be taxed as dividends under Article 9.

In the absence of a convention, France withholds tax at a rate of 24 percent on all royalties paid to a nonresident not having a permanent establishment in France. The withholding tax is imposed on the net royalty after the allowance of a deduction for expenses (generally, the allowance is equal to 20 percent of the gross royalty). If a nonresident has a permanent establishment in France, royalties attributable to such permanent establishment are not subject to withholding but are subject to tax in France at the rates normally applicable to industrial and commercial profits.

Royalties paid directly to the inventor are exempt from turnover tax in accordance with the terms of an agreement (*proces-verbal*) dated August 4, 1955. Since this agreement does not relate to income taxes, it is not considered terminated by the exchange of letters accompanying the proposed convention and discussed under Article 6 above.

This article is substantially identical to the royalties article of the OECD model convention except that the OECD draft contains an exemption for royalties whereas the proposed convention exempts only literary, artistic, and scientific royalties and provides for a reduced rate of 5 percent for other royalties. Moreover, the exemption provided for royalties by the OECD draft would extend to film royalties whereas much the same result is reached under the proposed convention by treating such royalties as industrial and commercial profits under the proposed convention. See the explanation of Article 6. The OECD draft does not contain a source rule for royalties.

ARTICLE 12. CAPITAL GAINS

The existing convention provides that gains derived in one State from the sale or exchange of stock, securities, or commodities by a resident of the other State not having a permanent establishment in the former State are exempt from tax in the former State.

The proposed convention broadens the exemption by extending the preferential treatment to gain from the sale or exchange of any capital asset. However, the exemption does not apply if (1) the gain arises out of the sale or exchange of property described in Article 5 (Income from real property) or of shares in a real property cooperative or a corporation the principal assets of which are real property; (2) the recipient has a permanent establishment to which the property giving rise to the gain is effectively connected; (3) the recipient is an individual who maintains a fixed base to which the property giving rise to the gain is effectively connected; or (4) the recipient is an individual present in the State from which the gain is derived for a period or periods in excess of 183 days during the taxable year. Gains which are effectively connected to a permanent establishment may be taxed as industrial and commercial profits under Article 6. Gains on real property are subject to the provisions of Article 5 which permits taxation of such gains by the State in which the real property is situated.

The French do not tax capital gains of individuals on the casual sale of nonbusiness assets, including real property. However, in 1963, in order to discourage speculation in French real estate, a regime was adopted under which gains by individuals (including nonresidents) from the sale of real property held less than 5 years are subject to tax at a 50-percent rate. In view of its purpose, the French are not disposed to grant relief from this tax in double taxation conventions. Business enterprises are subject to tax on gain from the sale of business assets held for over two years (long-term gain) at a rate of 10%. On distribution of such gains as dividends an additional 40% tax is payable. Other gains (short-term gains) are taxable at the regular 50% rate which may be paid over a five year period.

Although different in form, this article produces the same result as the capital gains article of the OECD model convention with the exception that the proposed convention adds the fixed base and 183-day rules as a qualification for exemption of capital gains.

ARTICLE 13. BRANCH PROFITS

The existing convention provides that the French may impose a branch profits tax on permanent establishments maintained by United States corporations in France. Under French law the measure of the tax is the total after-tax profits actually derived by such establishments and the rate of tax is 25 percent. Thus, the effective rate of the branch profits tax is 12.5 percent of total profits. Under

the present convention the base is lowered to three-fourth of after-tax profits, so that the effective rate is 9 percent of total pre-tax profits.

Under the proposed convention, the base on which the French branch profits tax is imposed is limited to two-thirds of the profits after corporate tax of the permanent establishment and the rate is limited to 15 percent. Thus, the effective rate under the proposed convention is 10 percent of after-tax profits or 5 percent of total (pre-tax) profits.

Under the existing convention, a question had arisen as to whether profits realized by a French permanent establishment of a United States corporation and incorporated into its capital were subject to a capitalization tax (*droit d'apport majore*). The proposed convention makes clear that capitalization tax does not apply in such a case.

The proposed convention also provides that the United States may tax dividends paid by a French corporation to a person who is not a citizen, resident, or corporation of the United States only if the French corporation has a permanent establishment in the United States, and more than 80 percent of its income is taxable to such permanent establishment, for the previous 3 years. This provision, for which there is no counterpart in the existing convention, preserves the right of the United States to tax dividends paid by a French corporation most of the business of which is connected with the United States. This provision relaxes the rule found in the Internal Revenue Code under which a nonresident alien is subject to United States tax on dividends received from a foreign corporation only if more than 50 percent of such corporation's income is connected with its United States business for the previous 3 years. See section 861 of the Internal Revenue Code.

The United States also reserves the right to impose its personal holding company tax except in cases in which a French corporation is wholly owned by one or more individual residents of France. The United States may not impose its accumulated earnings tax on a French corporation unless such corporation is engaged in trade or business in the United States through a permanent establishment at some time during the taxable year. The limitations on the right of the United States to tax in these cases are not substantially greater than those found in the Internal Revenue Code.

ARTICLE 14. INDEPENDENT PERSONAL SERVICES

The existing convention distinguishes between income from the performance of personal services and income from the exercise of a liberal profession. The latter is taxable in the State of source if the professional activity is exercised there from a fixed center. On the other hand, personal service income is exempt from tax in the State of source only if the individual deriving such income is present in that State for not more than 183 days and the services are performed for a resident or corporation of, or a permanent establishment situated in, the other State.

The proposed convention discards the concept of liberal profession but substitutes a distinction between independent and dependent personal services. The latter are discussed under Article 15. Generally income from independent activities may not be taxed in the State in which such activities are exercised. However, such income will be subject to tax in the State of source if the recipient is present in, or maintains a fixed base in, that State for more than 183 days during the taxable year.

Independent activities means all activities carried on for his own account independently by a person who recieves the proceeds or bears the losses arising from such activities. Commercial, industrial, or agricultural activities are not considered independent activities, and the income therefrom is taxed as industrial or commercial profits under Article 6.

This article produces the same result as the independent activities article of the OECD model convention except that a 183-day rule is added as a qualification for exemption of personal service income in the State of source.

ARTICLE 15. DEPENDENT PERSONAL SERVICES

Generally, income from labor or personal services may be taxed in the State in which such labor or personal services are performed. However, such income will be exempt from tax in the State of source if the recipient (1) is present in such State for not more than 183 days, (2) the remuneration is paid by an employer who is not a resident of such State, and (3) the remuneration is not borne by a permanent establishment which the employer has in such State. Thus, the

rule applicable to labor or personal service income is the same as that contained in the existing convention except for two restrictions. First, for example, income from services performed in France for a United States permanent establishment of a French corporation will no longer be exempt from tax in France, and second, the requirement that the burden of the compensation must not be borne by a permanent establishment of the State of source has been added.

The proposed convention also adds a rule that income from personal services performed aboard ships or aircraft registered in one State and operated by a resident of that State will not be taxed in the other State so long as such services are rendered by a member of the regular complement of the ship or aircraft.

This article of the proposed convention is substantially identical to the OECD model convention except that, in case of services rendered aboard ships or aircraft, the concept of registration and operation has been substituted for effective management. See also Article 7 (Shipping and air transport).

ARTICLE 16. GOVERNMENTAL FUNCTIONS

The existing convention exempts compensation, including pensions, paid by one State or a political subdivision thereof to individuals residing in the other State (other than citizens of such other State).

The proposed convention continues the exemption but adds a specification that the compensation be paid in connection with the discharge of functions of a governmental nature by a national of the State making payment. Compensation paid in connection with industrial or commercial activity carried on by a State or its political subdivision is treated the same as compensation paid by a private employer; the provisions of Articles 15 (Dependent personal services), 19 (Private pensions and annuities), and 20 (Social security payments) apply.

The proposed convention also adds a special rule dealing with compensation paid in the discharge of governmental functions to an individual who is a national of both States. The savings clause (Article 22(4)) applies to such individual but such compensation will be treated as income from sources within the State making such payments. In general, this clause establishes the rule that the government paying compensation to its nationals has the primary right to tax such compensation even if the recipient is also a national of the other State. Moreover, by reason of the above-described source rule, a qualifying recipient will be allowed a foreign tax credit against the tax imposed by the State of source.

This article of the proposed convention is identical to the OECD model convention except for the addition of the requirement that the recipient of exempt compensation be a national of the State making payment and the addition of a special rule dealing with dual nationality.

ARTICLE 17. TEACHERS

The existing convention does not contain a separate article dealing with teachers. The United States treated members of the academic profession as being engaged in a liberal profession and exempt from tax in the United States unless they maintained a fixed center in the United States. The French, however, took the position that no employee could be considered a member of a liberal profession. Since most teachers are employed by educational institutions, this position had the effect of denying the benefits of the convention to teachers. In order to assure reciprocity, on March 23, 1964, the United States altered its interpretation of the liberal profession article to conform to the French position and French teachers visiting the United States became subject to tax (Revenue Ruling 64–92, C.B. 1964–1 (Part 1), 599). This result was unacceptable to the French who suggested that, with respect to teachers, both countries adopt the interpretation formerly held by the United States. See the exchange of letters accompanying the proposed convention. On November 28, 1966, the Internal Revenue Service published a ruling, effective as of March 23, 1964, that reinstated the former interpretation with respect to teachers.

As noted above, the proposed convention discards the concept of liberal profession. Visiting teachers are treated in a separate article which provides a reciprocal exemption from tax for personal service income from teaching or research. Such exception applies if the teacher is invited by the Government, a university, or other accredited educational institution to teach or engage in research activities, or both, at a university, or other accredited educational institution. However, the exemption does not apply to income from research undertaken not in the public interest but primarily for the private benefit of a specific person or persons. If the

visit exceeds a period of 2 years, the exemption applies to the income received by the visiting teacher before the expiration of such 2-year period.

The OECD model convention does not contain a separate article dealing with teachers.

ARTICLE 18. STUDENTS AND TRAINEES

Under the existing convention remittances received from within one State by students of such State residing in the other State for the purpose of study are exempt from tax by the latter State. The OECD model convention includes a similar provision.

The proposed convention expands the exemption available to students by providing that a resident of one State visiting the other State for the purpose of studying at a university or other accredited institution, securing training for qualification in a profession, or studying or doing research as a recipient of a grant, allowance, or award, is exempt from tax in the host State on:

(1) Gifts from abroad for his maintenance or study;

(2) The grant, allowance, or award; and

(3) Income from personal services performed in the host State not in excess of $2,000 (or its equivalent in francs) for any taxable year.

These exemptions continue for such period of time as may be reasonably or customarily required to effectuate the purpose of his visit but in no event may an individual have the benefit of this article and Article 17 (Teachers) for more than a combined total of 5 taxable years.

Furthermore, a resident of one State, employed by or under contract with a resident of that State, who visits the other State for the purpose of studying or acquiring technical, professional, or business experience in exempt from tax in the host State on income not in excess of $5,000 (or its equivalent in francs) from personal services rendered in such State. In order to qualify for the exemption, the visiting individual must study at a university or accredited educational institution in the host State, or receive his experience from a person other than his employer or contractor or a 50-percent or more owned subsidiary of his employer or contractor.

ARTICLE 19. PRIVATE PENSIONS AND ANNUITIES

The existing convention provides that private pensions and annuities derived from sources within one State by an individual resident of the other State are exempt from tax by the former State.

The proposed convention continues the existing rule by providing that pensions and other similar remuneration paid in consideration of past employment and annuities received by a resident of a State will be taxable only in that State. However, pensions arising out of the performance of governmental functions are taxable by the State making payment when paid to a national of that State. The proposed convention also provides that alimony paid to a resident of a State will be taxable only in that State.

The term "annuities" is defined as a stated sum paid periodically, under an obligation to make payments in return for consideration (other than services rendered) and "pensions" is defined as periodic payments made after retirement in consideration for, or as compensation for injuries received in connection with, past employment.

The effect of this provision is the same as that of the OECD model convention.

ARTICLE 20. SOCIAL SECURITY PAYMENTS

This article provides that social security payments paid by one State to an individual who is a resident of the other Contracting State will be taxed, if at all, by the payor State. Neither the existing convention nor the OECD model convention contains a comparable provision.

ARTICLE 21. RULES APPLICABLE TO PERSONAL INCOME ARTICLES

This article extends the benefits of the personal services income articles (Articles 14 through 18) to reimbursed travel expenses. However, such reimbursed expenses will not be taken into account in computing the maximum amount of exemptions specified in Article 18 (Students and trainees). If an individual qualifies for the benefits of more than one of the provisions of Articles 14 through 18, he may choose the provision most favorable to him, but he may not claim the benefits of more than one article in any one taxable year.

ARTICLE 22. GENERAL RULES OF TAXATION

The general rules of taxation applicable under the proposed convention are as follows:

Any income from sources within a State to which the convention is not expressly applicable will be taxable by that State in accordance with its own law. For example, because income from prizes or awards is not covered by the convention, such income will be taxed in accordance with the internal law of the State from which such income is derived. The existing convention does not contain an express statement of this general rule. The OECD model convention differs with respect to this provision and instead provides that income of a resident which is not expressly mentioned will be taxable only in the State of residence. Thus, the OECD draft limits jurisdiction to tax such income to the State of residence of the recipient whereas the proposed convention permits the State of source to tax such income.

Another general rule of taxation is that a resident of one State may be taxed by the other State only on (1) industrial or commercial profits attributable to a permanent establishment located in that other State, and (2) other income sources within that other State, subject to the limitations of the convention. The jurisdictional rules of the proposed convention parallel those set forth in section 872(a) of the Code, relating to nonresident alien individuals, and section 882 (b), relating to foreign corporations engaged in trade or business in the United States, as amended by the Foreign Investors Tax Act of 1966. The OECD draft does not contain a comparable provision.

Under the existing convention, as applied by the United States using the principle of the force of attraction, all income of a resident of France having a permanent establishment in the United States was attributed to the permanent establishment and subject to tax at ordinary rates. As a result of the changes in United States statutory law made by the Foreign Investors Tax Act of 1966 investment income from sources within the United States ceased to be taxed at ordinary rates but is subject to withholding tax at the statutory 30-percent rate or, if applicable, the reduced rates of tax provided in the convention. The effect of the proposed convention is to conform the treaty to the principles introduced into our statutory law by that Act.

The proposed convention also continues the general rule of taxation that the convention does not affect in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded by the laws of a State in the determination of tax imposed by that State, or by any other agreement between the States. Even though the OECD model convention does not contain a comparable provision, this rule reflects the well-established principle that the convention will not have the effect of increasing the tax burden on residents of the signatory countries. This rule represents the position of the United States under all conventions to which it is a party. It is understood that, under French law, when an income tax convention recognizes the right of France to establish a tax which is not levied pursuant to French laws, the provisions of the convention may take precedence over French internal law. However, it is also understood that it is not the intent of the French Government to levy taxes on residents of the United States or France which would not have been levied in the absence of the proposed convention. This understanding is set forth in an exchange of letters accompanying the proposed convention.

The proposed convention also contains the traditional savings clause under which the United States reserves the right to tax its citizens and residents as if the convention had not come into effect. However, the savings clause does not apply in several cases in which its application would contravene the policies reflected in the convention. Thus, the savings clause does not affect the benefits relating to social security payments, relief from double taxation, or nondiscrimination. Moreover, the savings clause will not deny the benefits of the convention to teachers or students (or the benefits arising under Article 21 from the rules applicable to the personal service articles) unless such persons are citizens of the United States or have immigrant status in the United States.

With respect to Articles 16 (Governmental functions) and 21 (Rules applicable thereto), the proposed convention contains a rule, not found in any other convention to which the United States is a party, that the savings clause will not operate to deny the benefits of those articles to (1) an individual who is not a citizen of the United States and does not have immigrant status in the United States, or (2) an individual who has immigrant status in the United States but has elected to claim the benefits of Articles 16 and 21 and has agreed that the

time during which those benefits are available to him will not be counted as a period of residence or presence for purposes of naturalization under the immigration and nationality laws of the United States. The purpose of this provision is to accommodate certain French citizens who are employed by the French government in the United States and who are present in the United States on immigrant visas. The principal reason for denying the benefits of the governmental functions article to persons having immigrant status is that it is deemed inappropriate for persons to obtain benefits generally limited to foreign nationals while, at the same time, acquiring the right to become naturalized citizens of the United States. See section 247 (b) of the Immigration and Nationality Act (8 U.S.C. 1257(b)). Under these circumstances, the waiver of the latter right eliminates the policy objections to granting French citizens the benefits of the governmental functions article.

The savings clause is nonreciprocal in form principally because the French impose tax on the basis of residence rather than citizenship. However, the French have reserved the right to tax the personal service income of public entertainers which is derived from sources within the United States, even though such income might otherwise be exempt from French tax under Article 14 or 15. The French will, of course, allow a credit for the United States tax imposed on such income under the provisions of Article 23.

Any transaction in stock, securities, or commodities which originates in one State and is executed through a stock or commodities exchange in the other State will be exempt (as under the existing convention) from any stamp or similar tax in such other State. The effect of this provision is that transactions originating in the United States will continue to be exempt from the French tax on stock exchange transactions. As previously noted under Article 1 (Taxes covered), the analogous tax imposed by the United States, the documentary stamp tax, has been repealed.

ARTICLE 23. RELIEF FROM DOUBLE TAXATION

Under the existing convention, the United States provides relief from double taxation by allowing a credit for French tax in accordance with rules set forth in section 131 of the Internal Revenue Code of 1939.

The proposed convention employs the same method of avoiding double taxation in providing that credit will be allowed for French tax paid but not in excess of the portion of United States tax which net income from French sources bears to total net income. No specific reference is made to the Internal Revenue Code. The effect of this omission is to make clear that modifications in United States law after the effective date of the convention which concern the foreign tax credit will not be barred by the proposed credit article if such modifications do not contravene the general principles of the convention. It will be noted that the proposed credit article employs a per-country limitation. However, this will not affect the right of United States taxpayers to elect the overall limitation under section 904 of the Internal Revenue Code. See Article 22 (3) of the proposed convention and the accompanying explanation.

In the case of France, double taxation will generally be avoided by an exemption method. That is, income which is taxable in the United States by reason of the convention will be exempt from French tax. However, in cases in which income is taxable in both States, France will allow a resident of France a tax credit corresponding to the amount of tax levied in the United States but not in excess of the amount of French tax levied on the income. The method of avoiding double taxation employed by the French is the exemption-with-progression system. Thus, even though income is exempt from, or subject to a reduced rate of, French tax, such income may be taken into account in determining the effective rate of tax applicable to the total income taxable under French law.

Under the existing convention, the French may apply section 164 of the General Tax Code to United States citizens residing in France. Under that provision, such persons are taxed on either an amount equal to 5 times the rental value of their abode or abodes in France or on their actual income from French sources, whichever is greater. The French have agreed to surrender this right under the proposed convention and to forego the imposition of tax according to an "imputed" income based on the rental value of the abode or abodes. Although the provision is reciprocal in form, the United States has never imposed such a tax.

ARTICLE 24. NONDISCRIMINATION

The existing convention provides that citizens or corporations of one State will not be subjected to more burdensome taxes in the other State than are imposed on the citizens or corporations of such other State.

The proposed convention substitutes a modernized nondiscrimination article which bans discrimination by one State against the citizens of the other State or permanent establishments of residents or corporations of the other State. However, the nondiscrimination article will not prevent a State from according special treatment to its own residents on the basis of civil status or family responsibilities. Nor will the provision prevent the French from imposing a branch profits tax, subject to the limitations of Article 13, and the United States from imposing a comparable tax burden on the income of permanent establishments maintained by residents of France in the United States. At present, the United States does not impose a comparable tax burden such as, for example, a branch profits tax.

As noted under Article 1 (Taxes Covered) the ban on discrimination extends to all taxes without regard to subject matter and whether imposed at the national, State, or local level.

This article is substantially similar to the nondiscrimination article of the OECD model convention except that the OECD draft includes a provision concerning stateless persons which has been omitted from the proposed convention. Moreover, the OECD draft article does not specifically deal with branch profits taxes.

ARTICLE 25. MUTUAL AGREEMENT PROCEDURE

This article modernizes the mutual agreement procedures found in the existing convention by adopting the provisions of the recent amendments to our treaties with the Netherlands, the United Kingdom, and the Federal Republic of Germany. It provides for the administrative review of taxpayer claims. Thus, when a resident of one State considers that action of the other State has resulted, or will possibly result, in taxation contrary to the provisions of the convention, such resident may present his case to the competent authority of the State of which he is a resident. This remedy is in addition to any remedy provided by the national laws of either State.

This article also contemplates that the competent authorities of the two States will endeavor to settle by mutual agreement any difficulties or doubts arising as to the application of the convention. Some particular areas with respect to which the competent authorities may consult are the attribution of industrial and commercial profits to a permanent establishment, the allocation of income between a resident and a related person under Article 8, and the determination of source of particular items of income.

In implementing the provisions of this article, the competent authorities may communicate with each other directly and meet together for an exchange of oral opinions if such a meeting seems desirable.

In cases in which the competent authorities reach agreement with respect to a particular matter, taxes will be imposed and refunds or credits allowed, in accordance with such agreement. This provision permits the issuance of a credit or refund notwithstanding procedural barriers otherwise existing under a State's law, such as the statute of limitations. Traditionally, tax conventions have contained mutual agreement procedures of the type described above but in some cases such provisions have not removed barriers, such as the statute of limitations or the finality of previous assessments, which might preclude the implementation of any such agreement.

The new provision will apply only where agreement has been reached between the competent authorities but such provision will apply in the case of any agreement after the convention goes into effect even though the agreement may concern taxable years prior thereto. Similar provisions were included in protocols to the German, Dutch, and British conventions which have been approved by the Senate and ratified.

ARTICLE 26. EXCHANGE OF INFORMATION

This article provides for a system of administrative cooperation between the competent authorities of the two States and specifies conditions under which information may be exchanged to facilitate the administration of the convention and to prevent fraud and the avoidance of taxes to which the convention relates.

The mutual exchange of information called for by these provisions is presently in effect in most of the conventions to which the United States is a party and is substantially similar to the mutual agreement procedure contained in the existing convention between the United States and France.

ARTICLE 27. ASSISTANCE IN COLLECTION

This article provides for limited mutual assistance in the collection of taxes and is substantially identical to the comparable provision of the existing convention. The assistance provided for will not be accorded with respect to citizens, corporations, or other entities of the State from which assistance is requested.

Each State will assist the other in the collection of taxes to which the convention relates and also interest, cost, and additions to such taxes and fines not being of a penal character according to the laws of the State requested. Hence, revenue claims of a State which have been finally determined and the documents establishing such fact will be accepted for enforcement by the other State and collected by that other State in accordance with the laws applicable to the enforcement and collection of its own taxes. In addition, the State to which application is made will take such measures of conservancy (including measures with respect to transfer of property of nonresident aliens) as are authorized by its laws where the revenue claims presented to such State have not been finally determined.

ARTICLE 28. DIPLOMATIC AND CONSULAR OFFICERS

This article preserves the existing fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

ARTICLE 29. TERRITORIAL EXTENSION

This article provides a method for extending the convention to overseas territories of the French Republic the taxes of which are substantially similar to the taxes to which the convention applies. Provisions for the termination of any such extensions are also specified.

Extension to overseas territories may be accomplished by the States through an exchange of notes or in any manner in accordance with their constitutional procedure. Such extension will take effect from the date and be subject to such conditions contained therein.

The extension may be terminated with respect to any territory by one of the States through written notice given to the other State at any time after the expiration of a period of 1 year from the effective date of the extension. The termination will take effect on or after the first of January following the date of such notice. In addition, unless otherwise agreed by both States, the termination of the convention under Article 32 will also terminate the convention with respect to any territory to which it was extended under this article.

ARTICLE 30. EXCHANGE OF OFFICIAL INFORMATION

This article specifically provides that the competent authority of each State will advise the competent authority of the other State of any addition to or amendment of tax laws which concern the imposition of taxes which are the subject of this convention. It is further provided that the competent authority of each State will exchange the texts of all published material interpreting the present convention under the laws of the respective States, whether in the form of regulations, rulings, or judicial decisions.

In addition, it is provided that adjustment of some of the provisions of the convention may be made without affecting its general principles by an exchange of notes or in any other manner in accordance with the constitutional procedure of the respective States. For example, if changes were made in the tax law of one of the States which did not affect the general principles of the convention but which nonetheless made appropriate an adjustment of the provisions of the convention, such adjustment could be accomplished by an exchange of notes.

ARTICLE 31. ENTRY INTO FORCE

This article provides for the ratification of the proposed convention and for the exchange of instruments of ratification. The convention will enter into force one month after the date of exchange of such instruments. However, the provisions of the convention will be effective:

In the case of France:

(1) As respects withholding taxes, to any proceeds payable and transactions completed on or after the date on which the convention enters into force;

(2) As respects other income taxes, to taxes which are levied for the assessment year 1967; and

(3) As respects the tax on stock exchange transactions, the date on which the convention enters into force.

In the case of United States:

(1) As respects the rate of withholding tax, to amounts received on or after the date on which the convention enters into force; and

(2) As respects other income taxes, to taxable years beginning on or after January 1, 1967.

The entry into force of the proposed convention will terminate the Conventions of July 25, 1939; October 18, 1946; and June 22, 1956, as well as the Protocol of May 17, 1948. Moreover, as noted in an exchange of letters with respect to income taxes accompanying the proposed convention, the entry into force of such convention will also abrogate all notes, minutes, and arrangements relating to income taxes entered into between the United States and France in connection with such conventions or protocol. See, in particular, the explanation of Articles 6 (Business Profits) and 11 (Royalties).

ARTICLE 32. TERMINATION

The convention will continue in effect indefinitely, but may be terminated by either State at any time after the year 1969. A State seeking to terminate the convention must give notice at least 6 months before the end of the calendar year.

If the convention is terminated, such termination will be effective:

In the case of France:

(1) As respects withholding taxes, on January 1 of the year following the year in which notice is given;

(2) As respects other income taxes, for any year of assessment beginning on or after January 1 of the year next following the year in which notice is given; and

(3) As respects the tax on stock exchange transactions, for any transactions occurring on or after January 1 of the year following the year in which notice is given.

In the case of the United States:

(1) As respects withholding taxes, on January 1 of the year following the year in which notice is given;

(2) As respects other income taxes, for any taxable year beginning on or after January 1 of the year following the year in which notice is given; and

(3) As respects taxes referred to in paragraph (2) of Article 1, for any transactions occurring on or after January 1 of the year following the year in which notice is given.

TECHNICAL EXPLANATION OF PROPOSED UNITED STATES-PHILIPPINES INCOME TAX CONVENTION—APRIL 30, 1968

ARTICLE 1. TAXES COVERED

Article 1 designates the taxes of the respective States which are the subject of the convention. Generally, the provisions of the convention concern only the United States Federal income tax, including surtax, imposed by Subtitle A of the Internal Revenue Code (but not including the accumulated profits tax or the personal holding company tax) and the Philippine income tax imposed by Title II of the National Internal Revenue Code (but not including their accumulated profits tax or their personal holding company tax). The convention also applies to taxes substantially similar to those taxes specified which are subsequently imposed in addition to, or in place of, the existing income taxes. For purposes of the nondiscrimination provisions of Article 6, however, the convention applies to taxes of every kind which are, or may be, imposed by the respective States, whether imposed at the national, state, or local level.

ARTICLE 2. GENERAL DEFINITIONS

This article sets out definitions of certain of the basic terms used in the convention and provides that any term not otherwise defined will, unless the context requires otherwise, have the meaning which it has under the laws of the State imposing the tax.

ARTICLE 3. GENERAL RULES OF TAXATION

The general rules of taxation applicable under the convention are as follows:

(a) A resident or corporation of one of the States will be taxable by the other State only on income derived from sources within that other State and only in accordance with any limitations set forth in the convention. In determining the source of income for this purpose, each State will apply the rules of source contained in the laws of that State, except that rules on the source of income from the performance and furnishing of personal services are set forth in Article 5.

(b) Income from sources within a State to which the provisions of the convention are not expressly applicable will be taxed by such State in accordance with its own law. Thus, for example, because prizes and awards are not expressly covered by the convention, some income will be taxed by the State from which such income is derived in accordance with the internal law of such State.

(c) No provision of the convention will be construed so as to restrict in any manner any exclusion, exemption, deduction, credit, or other allowance presently or subsequently accorded (1) by the laws of one of the States in determining the tax imposed by that State or (2) by any other agreement between the two States This provision reflects the policy of the United States under all conventions to which it is a party.

(d) With specified exceptions, both States reserve the right to tax income of their individual citizens or residents or domestic corporations as if the convention had not come into effect. A "savings clause" of this nature is a standard feature of the income tax conventions to which the United States is a party and applies in the case of an individual citizen or resident or a corporation of the taxing State even though such individual or corporation may also be considered a resident or corporation of the other State. The exceptions to this reservation of authority preserve certain benefits allowed by each State which are specifically intended to apply to persons who are individual citizens or residents or domestic corporations of that State. Thus, the "savings clause" does not apply to deny an individual citizen or resident or a domestic corporation of a State the benefit of the tax credit provisions of Article 4 or the nondiscrimination provisions of Article 6. In the case of the United States, the "savings clause" does not affect the right of an individual citizen or resident or a domestic corporation to deduct charitable contributions made to Philippine organizations pursuant to the terms of Article 18. In the case of both States, the "savings clause" does not apply to deny the benefits of Article 14 (relating to visiting teachers), Article 15 (relating to visiting students or trainees), Article 16 (relating to governmental payments), or Article 17 (relating to rules of application concerning the previous Articles) to qualified individuals unless such qualified individual is a citizen of, or has immigrant status in, the State which is obligated to give the tax benefit.

ARTICLE 4. RELIEF FROM DOUBLE TAXATION

This article provides that each State will allow a tax credit for the appropriate amount of income taxes paid to the other State although the Philippines is required to allow the credit only to its residents and corporations. Both the United States Internal Revenue Code and the Philippine National Internal Revenue Code contain similar provisions allowing citizens, residents, and domestic corporations (and, in the case of the United States, nonresident alien individuals and foreign corporations on income effectively connected with a trade or business in the United States) a tax credit for foreign income taxes paid.

The amount of the credit allowed by the United States is based upon the full amount of income taxes paid to the Philippines and is computed under sections 901 through 906 of the Internal Revenue Code. In applying such sections of the Code, the tax imposed by Title II of the National Internal Revenue Code of the Philippines, not including the tax on improperly accumulated earnings or the personal holding company tax, will be considered to be an income tax.

Similarly, a resident or corporation of the Philippines will be allowed a credit against the Philippine income tax imposed by Title II of the National Internal Revenue Code (except the tax on improperly accumulated earnings or the personal holding company tax) for the appropriate amount of income taxes paid to the United States. Such credit is based on the full amount of the income tax paid by such persons to the United States, and is to be computed under the provisions of the National Internal Revenue Code. In applying those provisions, the United States income tax, including surtax, imposed by subtitle A of the Internal Revenue Code (other than the tax on improperly accumulated earnings and the personal

holding company tax) will be treated as an income tax and the similar credit requirement of section 30(c)(3) of the Philippines National Internal Revenue Code will be deemed satisfied with respect to taxes paid to the United States.

ARTICLE 5. SOURCE OF INCOME

This article provides that for purposes of Article 3 (relating to the general rules of taxation) and Article 4 (relating to the allowance of a foreign tax credit) the following rules of source apply to income from personal services. Income from the performance of personal services (including private pensions and annuities paid in respect of such services) or the furnishing of personal services will be treated as income from sources within the State in which such services are performed. Income earned by a member of the regular complement of a ship or aircraft from the performance of personal services aboard a ship or aircraft operated by a resident or corporation of the Philippines will be considered income from Philippine sources. Income earned by such a person from the performance of personal services aboard a ship or aircraft registered in the United States and operated by a resident or corporation of the United States will be considered income from United States sources.

Each State will apply its internal law in determining the source of other items of income.

It should also be noted that the source rules do not extend the benefits of this treaty to persons other than residents or corporations of the two States. Generally, the rules are applicable only to residents or corporations of either State, and, therefore, are not applicable in determining the source of personal services income of residents of other States.

ARTICLE 6. NONDISCRIMINATION

This article provides that the United States and the Philippines will not discriminate in their taxes against their residents who are citizens of the other State nor against permanent establishments within their jurisdiction owned by citizens or corporations of the other State. This does not prevent either State from imposing whatever tax it desires on citizens of the other State, resident within its border, so long as the taxes imposed on such residents are no more burdensome than the taxes imposed on resident citizens of the State imposing the tax. Furthermore, this article does not require a State which grants personal allowances or deductions only to its residents to grant such allowances or deductions to nonresidents who are citizens of the other State.

A corporation of one State, the stock of which is completely or partly owned by citizens or corporations of the other State, may not be subjected to more burdensome taxes than a corporation owned wholly by citizens or corporations of the former State.

The provisions of this article apply to state and local as well as national taxes.

ARTICLE 7. BUSINESS PROFITS

This article provides that a resident or corporation of one State will not be subject to tax in the other State on industrial or commercial profits derived from sources within such other State unless such resident or corporation has a permanent establishment, as defined in Article 8, in such other State. The term "industrial or commercial profits" is defined to mean income derived from the active conduct of a trade or business, including profits from manufacturing, mercantile, agricultural, fishing and mining activities, and income from the furnishing of personal services. Such term does not include income from the performance of personal services by an individual, dividends, interest, royalties, income from the rental of personal property, income from real property, insurance premiums, or gains derived from the sale or exchange of capital assets.

Where a resident or corporation of one State is engaged in a trade or business in the other State and maintains a permanent establishment in such other State, such other State is to allow as deductions in computing the income subject to tax all ordinary and necessary expenses, wherever incurred, which are allocable, to the reasonable satisfaction of the competent authority of such other State, to income from sources within that State. For purposes of this article no profits are to be deemed to be derived from sources within a State merely by reason of the purchase of goods or merchandise.

The general effect of this article is to replace the engaged-in-trade-or-business test with the permanent establishment test in both the United States and the

Philippines in the process of determining whether industrial or commercial profits (as defined in the convention) derived by nonresident alien individuals resident in the other State and foreign corporations created or organized in the other State are to be subject to tax.

ARTICLE 8. DEFINITION OF PERMANENT ESTABLISHMENT

This article defines the term "permanent establishment". The existence of a permanent establishment is, under the terms of the convention, a necessary prerequisite to one State's authority to tax the industrial or commercial profits (as defined in the convention) of a resident or corporation of the other State.

The term "permanent establishment" means "a fixed place of business through which a resident or corporation of one of the Contracting States engages in trade or business". The convention illustrates the concept of a fixed place of business with the following examples: a branch; an office; a store or other sales outlet; a workshop; a factory; a warehouse; a mine, quarry, or other place of extraction of natural resources; or a building site, or construction or installation site, which exists for more than 3 months. As a general rule, any fixed facility through which business is conducted will be treated as a permanent establishment unless it falls within one of the specific exceptions described below.

The specific exception paragraph provides that a permanent establishment does not include one or more of the following:

Subparagraph (a) provides that facilities used by a resident or corporation of one State in the other State for the purpose of storing, displaying, or delivering goods or merchandise belonging to such resident or corporation will not constitute a permanent establishment. This permits a resident or corporation of one State to own or lease storage facilities or facilities for the display or delivery of its goods so long as the facilities are not used by the resident or corporation for storing, displaying, or delivering goods of another person.

Subparagraph (b) provides that the maintenance of a stock of goods or merchandise does not constitute a permanent establishment so long as the goods or merchandise belong to the resident or corporation of the other State and are stocked for purposes of storage, display, delivery, or any combination of those purposes. Thus, a resident or corporation of one State is permitted to maintain in the other State a stock of goods, and also have facilities for, storing, displaying, or delivering such goods without having a permanent establishment in that other State.

Subparagraph (c) provides that the maintenance of a stock of goods or merchandise in one State by a resident or corporation of the other State will not be considered a permanent establishment of such person if the stock of goods or merchandise is maintained for the purpose of being processed by another person.

Subparagraph (d) provides that if a resident or corporation of one State maintains a fixed place of business in the other State for the purpose of purchasing goods or merchandise, and/or the collection of information, for itself, the fixed place of business will not be considered a permanent establishment.

Subparagraph (e) provides that a resident or corporation of one State is not to be considered to have a permanent establishment in the other State if such person has a fixed place of business in such other State which is maintained for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character in the business of such person.

These exceptions are cumulative and, for example, a facility used solely for one, several, or all of these purposes generally will not be considered a permanent establishment under the convention.

A resident or corporation of one State is considered to have a permanent establishment in the other State if such resident or corporation engages in business in the other State through an agent who either: (1) has authority to conclude contracts in the name of his principal and regularly exercises that authority in the other State, unless the exercise of the authority is limited to the purchase of goods or merchandise; or (2) regularly secures orders in the other State for the resident or corporation; or (3) maintains in the other State a stock of goods or merchandise belonging to his principal from which he regularly makes deliveries or fills orders. However, these rules will not apply where a resident or corporation of one State carries on its business in the other State through an agent who is a bona fide

broker, general commission agent, forwarding agent, indentor, or other agent of independent status acting in the ordinary course of its business. For this purpose, an agent who acts exclusively (or almost exclusively) for the resident or coproration or for that resident or corporation and any other person controlling, controlled by, or under common control with such resident or corporation, will not be considered to be an agent of independent status.

Whether a corporation of one State has a permanent establishment in the other State will be determined without regard to any control relationship between it and any corporation organized or engaged in trade or business in the other State. Therefore, a Philippine subsidiary of a United States corporation may be considered an independent agent of the United States corporation and not its permanent establishment if it otherwise qualifies as an agent of independent status acting in the ordinary course of its business.

A resident or corporation of one State is deemed to have a permanent establishment in the other State if the resident or corporation provides the services of public entertainers (referred to in Article 13(3)) in the latter State. Thus, for example, a United States corporation or resident who employs, or otherwise provides the services of, an entertainer and furnishes the services of that entertainer in the Philippines will be considered to have a permanent establishment in the Philippines.

If a resident or corporation of one State maintains a permanent establishment in the other State at any time during the taxable year, the permanent establishment is considered to have existed for the entire taxable year.

ARTICLE 9. RELATED PERSONS

This provision corresponds in purpose and scope to section 482 of the Internal Revenue Code of 1954 and confirms the power of each government to reallocate income in cases in which a resident of one State is related to a resident of the other State if such related persons impose conditions between themselves which are different from conditions which would be imposed between independent persons.

Article 19 provides for consultation between the competent authorities of the two States for the purpose of effecting a uniform allocation of income in accordance with the purpose of this article.

ARTICLE 10. INTEREST

This article provides that interest received by the Government of one State, including any agency or instrumentality wholly owned by such Government, is to be exempt from tax in the other State. The convention does not otherwise limit the tax which may be imposed by either State on interest derived from sources within it.

ARTICLE 11. INCOME FROM REAL PROPERTY

This article provides that a resident or corporation of one State subject to tax in the other State on income from the rental of buildings or from real property which is improved with buildings, including gains derived from the sale or exchange of such property, or on royalties in respect of the operation of mines, quarries, or other natural resources, may elect for any taxable year to compute the tax on such income on a net basis. A similar provision appears in many tax conventions to which the United States is a party and, under the Foreign Investors Tax Act of 1966, has been made part of United States internal law.

This article applies on a reciprocal basis and permits, for example, a resident or corporation of the United States deriving income from the specified activities in the Philippines to elect to be taxed on such income as though such resident or corporation were engaged in business in the Philippines.

ARTICLE 12. GAINS UPON TRANSFERS TO CONTROLLED CORPORATIONS

This article provides that a resident or corporation of one State will not recognize any taxable gain in the other State from a transaction involving the transfer of property to a corporation in exchange for stock in such corporation. In order to qualify for this nonrecognition treatment, the resident or corporate transferor, or such person together with any other persons making similar transfers as part of the same transaction, must own immediately after such transaction stock in the transferee corporation possessing at least 80 percent of the total combined voting power of all classes of stock in such corporation and at least 80 percent

of the total number of all other shares. In addition, where the transferee corporation is a Philippine corporation, the transferred property must be recorded on the books of account of such corporation at a value not exceeding the value at which such property was recorded on the books of account of the transferor. The definition of the term "property" for purposes of this article is to be made under the laws of the respective States.

Article 12 is similar in purpose to section 351 of the U.S. Internal Revenue Code which permits tax-free transfers to controlled corporations (including a controlled foreign corporation if a prior ruling is obtained from the Internal Revenue Service.)

However, under Philippine tax law, if the transfers are considered to take place in the Philippines, the gain is presently subject to Philippine tax. Thus, in the absence of the Convention, while the incorporation of a Philippine branch of a United States company could be accomplished tax free under United States tax law, it is taxable in the Philippines. The combination of section 351 and Article 12 could eliminate both United States and Philippine tax in such cases.

ARTICLE 13. INCOME FROM PERSONAL SERVICES

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

(1) Such person is physically present in such other State for not more than 90 days, in the aggregate, during the taxable year for which the exemption is claimed;

(2) Such income from personal services is not deductible in computing the profits of a permanent establishment of a resident or corporation of the former State subject to tax in the latter State;

(3) In the case of employment income, the services are rendered as an employee of a resident or corporation of the former State; and

(4) The aggregate income received during the taxable year does not exceed $3,000 (or its equivalent in Philippine pesos).

For purposes of this provision the term "income from personal services" includes employment income and income earned by an individual from the performance of personal services in an independent capacity. Employment income, for purposes of the test described in (3) above, includes income from services preformed by officers and directors of corporations. Income from personal services performed by partners for third persons generally will be treated as income from the performance of services in an independent capacity but a salary or other fixed amount paid by a partnershlp to an active partner, if similar payments are not made to inactive partners, will be considered to be income from employment by the partnership, and therefore subject to the test in (3) above.

In the case of visiting public entertainers, such as musicians, actors, or professional athletes, deriving personal services income from their activities in the host State as such the host State may nevertheless tax such income if it exceeds $100 (or its equivalent in pesos) for each day the individual is present in the host State (or the total amount of $3,000).

A special rule is also provided for income from personal services derived by individuals who are employed on board ships or aircraft. In the case of a ship or aircraft operated by a Philippine resident or corporation, any individual employed on such ship or aircraft as a member of the regular complement of such ship or aircraft, is not subject to United States income tax on his income from the services rendered on such ship or aircraft unless he is a citizen or resident of the United States. In the case of a ship or aircraft registered in the United States and operated by a resident or corporation of the United States the income derived from the performance of personal services thereon by any individual who is a member of the regular complement of such ship or aircraft will be exempt from the Philippine income tax unless such individual is a citizen or resident of the Philippines. For example, a sailor working on a vessel operated by a resident or corporation of the Philippines, who is a citizen and resident of Spain, will be exempt from United States tax with respect to the compensation he receives for his services as a sailor.

ARTICLE 14. TEACHERS

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

period of 2 years, this exemption applies only to the income received by the visiting teacher before the expiration of such 2-year period.

ARTICLE 15. STUDENTS AND TRAINEES

This article provides that a resident of one State visiting the other State for the purpose of studying at a university or other accredited educational institution, securing training for qualification in a profession or professional specialty or studying or doing research as a recipient of a grant, allowance, or award (from a governmental, religious, charitable, scientific, literary, or educational organization) is exempt from tax in the host State on:

(1) Gifts from abroad for his maintenance or study;

(2) The grant, allowance, or award; and

(3) Income from personal services performed in the host State not in excess of $2,000 (or its equivalent in pesos) for any taxable year. This exemption is increased to $5,000 (or its equivalent in pesos) if the student is training for qualification in a medical profession or medical specialty, including any physician, medical technologist, nurse, pharmacist or other persons under the Exchange Visitors Program.

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

Furthermore, a resident of one State, employed by or under contract with a resident or corporation of that State, who visits the other State for a period not in excess of one year for the purpose of studying or acquiring technical, professional, or business experience, is exempt from tax in such other State on income from personal services rendered there not in excess of $5,000 (or its equivalent in pesos). In order to qualify for the exemption, the visiting individual must study at a university or accredited educational institution in the host State, or receive his experience from a person other than the resident or corporation by which he is employed or under contract.

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

ARTICLE 16. GOVERNMENTAL SALARIES

This article exempts from tax in one State any wages, salaries, and similar compensation, and pensions, annuities, or similar benefits if: (1) Such amounts are paid by or directly out of public funds of, the other State or a political subdivision thereof; (2) such amounts are paid to an individual who is a national of such other State; (3) such amounts are paid for services rendered to such other State or to any of its political subdivisions in the discharge of governmental functions; and (4) such individual is not a citizen of, or have immigrant status in, the former State.

ARTICLE 17. RULES APPLICABLE TO PERSONAL SERVICE ARTICLES

This article provides that for purposes of determining the applicability of the exemption from tax relating to personal service income contained in Article 13 (income from personal service), Article 14 (teachers), Article 15 (students and trainees), and Article 16 (governmental salaries) reimbursed travel expenses will be considered income from personal services but will not be taken into account in determining the maximum income exemptions in Article 13 and 15. If an individual qualifies for the benefits of more than one of the provisions of Article 13, 14, or 15 he may choose the provision most favorable to him but he may not claim the benefit of more than one such article in any one taxable year.

ARTICLE 18. DEDUCTION FOR CHARITABLE CONTRIBUTIONS

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

(1) The Philippine organization has qualified as a nonprofit organization under section 27(e) of the National Internal Revenue Code of the Philippines;

(2) The contributions are used entirely within the Philippines; and
(3) The Philippine organization has qualified as a tax-exempt organization under section 501(c)(3) of the Internal Revenue Code;

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

ARTICLE 19. CONSULTATION AND TAXPAYER CLAIMS

This article provides that the competent authorities of the two States are authorized to: (1) Settle by mutual agreement all questions of interpretation or application of the convention; (2) resolve any matters concerning the relation of this convention to any convention concluded by either State with third countries; (3) consult on amendments to expand the present convention; (4) consult with a view to reaching a fair and equitable apportionment of industrial or commercial profits between a resident or corporation of one State and its permanent establishment in the other State; and (5) consult on the matter of the proper allocation of income between a resident or corporation and a related person as provided in Article 9, including adoption of appropriate procedures for effectuating any such apportionment or allocation agreed upon.

When a citizen, resident, or corporation of one of the States considers that the action of the other State has resulted, or will possibly result, in taxation contrary to the provisions of the convention, such citizen, resident, or corporation may present his case to the competent authority of the State of which he is a citizen, resident, or corporation. If the competent authority considers the claim meritorious, it will attempt to come to an agreement with the competent authority of the other State with a view to avoidance of taxation contrary to the terms of the convention.

ARTICLE 20. EXCHANGE OF INFORMATION

Article 20 provides for a system of administrative cooperation between the competent authorities of the two States and specifies conditions under which information may be exchanged to facilitate the administration of the convention. Under this provision the competent authorities of the two States shall exchange such information as is necessary for the carrying out of the convention and of the domestic laws of the States concerning the taxes covered in the convention insofar as the taxation thereunder is in accordance with the convention. A similar provision is included in most of the conventions to which the United States is a party.

ARTICLE 21. ASSISTANCE IN COLLECTION

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

ARTICLE 22. EXCHANGE OF LEGAL INFORMATION

This article specifically provides that the competent authority of each State will advise the competent authority of the other State of any addition to or amendment of tax laws which concern the imposition of taxes which are the subject of this convention. The text of any pertinent new statutes or amendments of existing statutes are to be exchanged at least once a year. It is further provided that the competent authority of each State will exchange the texts of all published material interpreting the present convention under the laws of the respective States, whether in the form of regulations, rulings, or judicial decisions.

ARTICLE 23. EFFECTIVE DATES AND RATIFICATION

This article provides that the convention will be ratified and the instruments of ratification exchanged at Manila as soon as possible.

The convention will be effective for taxable years beginning on or after January 1 of the year immediately following the date of exchange of the instruments of

ratification. After the convention comes into effect it will continue in effect indefinitely. Either State may terminate the convention after the expiration of 5 years from the date the convention first becomes effective but 6 months' prior notice of termination is required. If the convention is so terminated, it will cease to be effective with respect to taxable years beginning on or after the first day of January immediately following the expiration of the 6-month notice period.

The CHAIRMAN. Senator Carlson, do you have any questions?

EXTENSION OF FRENCH TREATY

Senator CARLSON. Just one thought on the last statement you made about how you can extend these treaties to territories controlled or owned by a nation such as France. This is done through diplomatic channels, is that correct?

Mr. SURREY. That is correct. That is an exchange of notes through diplomatic channels.

Senator CARLSON. I would assume that is all right.

Mr. SURREY. It has been going on for a great many years.

The CHAIRMAN. You mean it is applied to their possessions?

Mr. SURREY. Yes; possessions and the like. In other words, it may become, as a particular possession may become industrialized or have a great deal of activity. Those having activities in that possession may desire that the treaty be extended to the possession of that treaty country. We can then, by an exchange of notes between that country and the United States make an appropriate extension. In the United States that could occur from time to time also.

The CHAIRMAN. Yes.

Senator Sparkman.

OBJECTIONS TO TREATIES?

Senator SPARKMAN. Two very brief questions: Do you know of any objections to any of these treaties?

Mr. SURREY. I have had none presented to me, Senator. There were, as my statement indicates, initially some problems that arose out of the definition or the words of the permanent establishment clause with the Philippines. This was 2 or 3 years ago, and I think in major part it was a misunderstanding as to how we interpreted that clause, and whether, in view of the difficulties of interpretation that did arise, whether we would continue to use the language in future treaties.

We have not used the language in future treaties because of these difficulties of interpretation, and it was correspondence on this point between Senator Gore and those who had the problem, and I think I could submit that correspondence for the record because I think it would be helpful. (The correspondence referred to appears on p. 62.) I think it clarifies the interpretation we had in mind, and I think it removes all problems with the Philippines.

With respect to France, I personally have heard no objections. Quite the contrary, I think most organizations have written to us urging as prompt a ratification as possible of the French treaty in view of the reduction by France of its withholding rate from 15 to 5 percent.

That reduction is quite favorable to connect on with the repatriation of earnings from French subsidiaries to the United States in the context of our recent regulations with respect to direct investment abroad.

Those regulations put a stress upon increased repatriation. So in that regard ratification of the treaty would be of assistance to American corporations operating in France.

EFFECT OF TREATIES ON U.S. DOMESTIC TAXES

Senator SPARKMAN. Do the provisions of either one of these conventions have any effect whatsoever on United States, State, or local taxes?

Mr. SURREY. No, sir; they do not. They do not affect State or local taxes.

Senator SPARKMAN. That is all, Mr. Chairman.

Mr. SURREY. Except for the nondiscrimination clause. The nondiscrimination clause does apply—we do apply the nondiscrimination clause. Insofar as the reduction of rates, state and local taxes are not affected.

Senator SPARKMAN. That is all.

The CHAIRMAN. Senator Pell.

Senator PELL. Thank you, Mr. Chairman.

Mr. Surrey, with regard to the French convention, I think it is excellent and I intend to support it. With regard to the Philippine one, as I understand it, the investment tax credit provision is not included.

Mr. SURREY. That is correct.

Senator PELL. I intend to support that.

DISCLOSURE OF ASSETS—BRAZIL TREATY

I would like to revert for a moment to the Brazilian tax convention and raise one question here which has not been raised before. I would like your comment on it.

As you know, I have had reservations with regard to the investment tax credit. The point I wanted to raise, though, has come up in a memorandum that was sent to me by a New York banker. I would like to read it into the record and then get your comment.

Latin Americans have always been afraid of tax treaties with the United States which would disclose to their governments their assets in this country. In the past, we have been able to assure them of banking secrecy as far as their governments were concerned. However, this situation now seems about to change.

Some time ago, I was told by a wealthy Brazilian citizen, politically prominent in that country, that a tax convention was being considered. I looked into it and saw that the proposed Brazilian Tax Convention in its Article 25 provides for an exchange of information between the contracting countries. I understand the Letter of Submittal, in its reference to Article 25, simply states that this is a customary exchange of information provision to prevent fraud or fiscal evasion.

Lately, I have received other queries on this matter from citizens of other Latin American countries who are afraid treaties with their countries will follow the treaty with Brazil. All are unanimous in saying they will have to move their property to a country where there will be no risk of disclosure. The reason given, which I can easily understand, is that a tax convention could quickly become an effective political tool for oppression and confiscation of property.

I do not believe such a tax convention is in our best interest, since, as a rule, only individuals who favor the U.S. keep their property here. The reason these individuals need secrecy for their property abroad is not to avoid the usually small taxes Latin countries assess their citizens, but to make sure they have a source of income to fall back on either when they are forced to take political positions against strong governments or dictatorships, or as protection against another Cuba. Such conventions have great merit, but they are definitely premature with Latin America. If the real concern of the Brazilian government is to

prevent tax evasion, there are many measures it can take at home which will be more effective. In short, I believe the present military government of Brazil hopes to use this convention to threaten or silence some members of their opposition and to force support from influential individuals.

As successive governments in Latin America tend to oscillate like a pendulum in their political ideologies, I think it would better serve this country's interests not to alienate individuals who, by being men of property, are our staunchest friends.

Whether this convention will be approved or not is being closely watched by many Latin Americans. If approved, the majority will have to move their property elsewhere.

I recognize this memorandum overstates a certain viewpoint, but it seems to me to be of particular merit at this time when we are worried about our balance of payments. I wondered if you had any comments upon it.

EXCHANGE OF INFORMATION IS TRADITIONAL

Mr. SURREY. Well, I think it certainly overstates the attitudes of a foreign government. If that were the motivation of foreign governments they would be knocking on our doors for tax treaties, and I do not find that. I find a very cautious attitude with respect to entering into tax treaties, and I think that general cautiousness is clearly contrary to the thrust of the whole letter. And of course the letter completely overlooks the real advantages of tax treaties to the countries involved.

Now, the exchange of information is traditional in tax treaties. It exists even with countries that, I suppose, have citizens who might have the same concern, who would like to keep capital abroad.

I think if you talk to the French, you would find it is one of the problems that the French Government has always had. But we have traditionally had an exchange of information with France, and no one has ever complained about it.

We have an exchange of information clause with all treaty countries. The exchange of information is designed to facilitate the legitimate revenue activities of countries. In other words, we like to know which of our American citizens have income abroad. Any government would like to know that. It is proper and in the interests of avoiding worldwide tax avoidance.

The exchange of information proceeds largely in a sense on an automatic basis, where the information is available.

In connection with the French treaty, we would automatically give information to France on the payments leaving the United States to French addressees, dividends, interest, royalties, and the like; we automatically send them that information and they automatically send that information to us. We do not supply such information on U.S. citizens; just on money going to persons with a French address who are not U.S. citizens.

Now, beyond that, if France wanted special information from us we would want to know why they wanted special information. They would have to give us the reason.

If the French or any government would say to us, "Will you please give us the tax return of John Jones and tell us what is in his tax return," we would say, "No."

Senator PELL. I would hope so.

Mr. SURREY. We would say, "Why are you interested in that tax return?"

Now, they may go on to say that John Jones has claimed that he has paid a certain amount, or something of that nature, and, "What can you tell us about whether he has paid a certain amount."

We are very careful. For most countries we get no more, I would say, than two or three requests a year for that kind of information.

FOREIGN INVESTMENT IN THE UNITED STATES

Could I just add a word on balance of payments? The United States is not actively seeking investment from less developed countries in the United States. We do not make it a goal of national policy that Brazilians invest in the United States, and you can well understand and sympathize with our position.

So that, consequently, if, even if, a treaty were to result in some capital leaving from the United States, that would be just one of the byproducts of a regular policy, just as, when the Congress removed the exemption from interest on bank deposits in the United States. The Ways and Means Committee thought that there should be a rational taxation of bank deposits and if that resulted in less deposits from less developed countries, that was all right.

I think, in the nature of things, Senator, these provisions do not discourage any investments. You tend to find the investment gets channeled to the United States, but it comes in a different way. It may come through Switzerland rather than directly from a foreign country.

Senator PELL. But all things being equal, and agreeing with you that we do not want to encourage Brazilians to invest in developed nations, if they are going to have their money outside of Brazil, we would just as soon it be in the United States as in Switzerland, would we not?

Mr. SURREY. Yes; but what I am saying is if it is in the United States it may remain here by way of a third country.

For example, let me illustrate in another way, since you are interested in the point. We granted by treaty very favorable treatment to income going to the Netherlands Antilles. The Netherlands Antilles is a tax haven country or was a tax haven country for the rest of the world, and Latin Americans, people from other nations, who desired to invest in the United States invested through the Netherlands Antilles because it was the cheapest way taxwise.

We had lowered our rates of tax to 15 percent for dividend income going to a Netherlands Antilles address. There were Netherlands Antilles addresses but they were just makeweights for investments in the United States by Latin Americans and others through the Netherlands Antilles.

We thought that was improper and in a protocol with the Netherlands we said we will not provide our lowered rates of tax, except to people who are residents of the Netherlands or the Netherlands Antilles. There was a lot of talk that this would result in a great disinvestment in the United States and the like. The protocol was approved and there was no disinvestment in the United States.

BRAZILIAN FUNDS IN THE UNITED STATES

Senator PELL. I would like to continue more specifically on the point I am raising with respect to article 25 of the Brazilian Tax Convention.

Do you have any estimate of the amount of Brazilian funds in the United States, or if you cannot tell me now, will you supply that for the record?

Mr. SURREY. I cannot estimate the amout of funds in the United States if those Brazilian funds are held in Swiss banks.

Senator PELL. I see, coming in through Switzerland?

Mr. SURREY. My best estimate is that a large part may be so invested and if so I cannot estimate that. All we would know is they are Swiss addresses.

In other words, there are two questions. What do people want? Most of all I think they would like to have their money in the United States. You can earn a lot on investments in the United States, and you always cannot earn it so well in the rest of the world. So, consequently, they want their money in the United States for investment and safety, and then they want secrecy, too. Both can be accomplished today.

We would not want to give them preferred rates of tax, and if they openly have Brazilian addresses, we think that Brazil, as a country desiring to stabilize its revenue system, is entitled to information.

TAX CONVENTION WITH SWITZERLAND

Senator PELL. We do not have any tax convention of this sort with Switzerland and Liechtenstein?

Mr. SURREY. We have with Switzerland, yes.

Senator PELL. With a provision for the exchange of information like article 25?

Mr. SURREY. Yes. Now, the information might not be the most informative. In other words, all we may know is that dividends have been paid to such and such a Swiss bank.

Senator PELL. You mean a numbered Swiss account under international law, because under international law the convention would prevail, and they would be obligated to furnish you this information? Certainly not.

Mr. SURREY. Switzerland, if it pays income to an American addressee, we can get that information.

Senator PELL. What?

Mr. SURREY. That is right. I will check that and make sure of it, but that is my understanding.

Senator PELL. Excuse me, would you repeat that so that I may understand it?

Mr. SURREY. I think it would work this way: If a Swiss corporation makes a direct payment to an American stockholder, we would get that information. If a payment of interest on a Swiss bond to an American holder were made we would get that information. If there were a payment of capital out of a Swiss bank account we would not get that information. We would not get information on a payment of income to a Swiss bank account.

Senator PELL. Let me be, perhaps, more practical. If some securities were held in the name of a numbered Swiss account, and they received a dividend, would you receive that information?

Mr. SURREY. Not of a Swiss bank account, no, we could not.

Senator PELL. That is the point I'm driving at. But under this kind of a convention, if you had this kind of agreement with Switzerland, you would receive the information if you asked for it?

Mr. SURREY. No. I do not think so, because the income payment has been made to a Swiss numbered account. After that then it is a payment—in other words, let me put it this way: Let us suppose you have an account with a U.S. bank, and you have asked that bank to act as a custodian for you, and that U.S. bank has received dividends from abroad.

Now, we get information that dividends have gone to the Chase Manhattan Bank, if that is the account you use. The British would tell us that, the Swiss would tell us that.

But what happens thereafter when that payment is made by Chase to somebody else that is not a payment of income, that is just a payment out of the account.

EFFECT OF ARTICLE 25 OF BRAZIL TREATY

Senator PELL. Let me try to rephrase my question. If the Brazil treaty is approved, what change in information procedures will come into effect under article 25 from the viewpoint of the United States vis-a-vis the Brazilian authorities?

Mr. SURREY. If payment is made by an American corporation to a Brazilian address, and it is not to a U.S. citizen, we would send that information to Brazil the way we send it to any other country.

Senator PELL. But if the Brazilian Government, under this treaty, asked for information concerning General So and So on what dividends have gone into his account in a certain bank, wouldn't you, under this treaty, be obligated to reply?

Mr. SURREY. No. We probably would not even know it. In other words, let us assume that General So and So had a Swiss bank account.

Senator PELL. No; let's say he has a regular account in, for instance, the Chase Manhattan Bank.

Mr. SURREY. Who is the addressee?

Senator PELL. The addressee is the Brazilian General.

Mr. SURREY. If he has an account in his own name——

Senator PELL. In his own name in the Chase Manhattan Bank that he stashed away in case the government changed abruptly, would you have to report it?

Mr. SURREY. Not if stashed away.

Senator PELL. No, but stashed away dividends coming in.

Mr. SURREY. If interest is paid.

Senator PELL. Right; if interest or dividends are paid.

Mr. SURREY. Yes; if interest or dividends are paid by the Chase Bank to a Brazilian address and it is not to a U.S. citizen.

Senator PELL. I think this is like becoming a bit of an international "Big Brother," is it not?

Mr. SURREY. Well, let me give you the title of a tax convention. All our conventions are approved by this committee, and the treaty generally starts "A Convention between the United States of Amer-

ica" and the foreign country "for the avoidance of double taxation and the prevention of fiscal evasion." This is one of the purposes of all our conventions, whether or not all have the same title. The treaty world works both ways. It says we shall, the two governments shall, get together to relieve their citizens of double taxation and the two governments shall get together to prevent fiscal evasion.

I think that is appropriate, so that I would say from the very start of this whole thing these treaties have had this double-barreled purpose, which has been recognized throughout.

Now, there are a great many benefits that flow from these treaties to taxpayers who want to conduct their commercial relations, their industrial relations, their business relations in other parts of the world, and they get many benefits.

The counterpart is those who want to avoid the laws of their countries do not get benefits.

Senator PELL. Thank you.

The CHAIRMAN. Is there anything further on the French treaty you wish to say?

Mr. SURREY. I do not think so, Senator.

WITHHOLDING RATES UNDER FRENCH TREATY

The CHAIRMAN. I wanted to ask one question, although I do not know that it is very significant. You said the treaty would reduce the amount withheld by the French on a payment by a French subsidiary of an American corporation. How does that compare to the withholding of a payment by a French corporation to a private American stockholder? Supposing I own a share of stock in a French company, do they withhold, and if so, how much?

Mr. SURREY. Their normal withholding rate is 25 percent. Under this treaty, and as under the past treaty, the rate is 15 percent.

The CHAIRMAN. 15 percent. When a French subsidiary pays to an American parent it is now reduced to 5 percent?

Mr. SURREY. It is now reduced to 5. In all these treaties generally you will find that in many cases the rate of tax between the parent and subsidiary is lower than the so-called rate of tax on portfolio investment.

The CHAIRMAN. That is normal.

Mr. SURREY. Yes; that is normal.

There is still another tax to be paid when the American corporation distributes to its shareholders.

RULES GOVERNING INSURANCE COMPANIES IN FRENCH TREATY

The CHAIRMAN. There is one other question. There are special rules for determining when an insurance company will be considered as having a permanent establishment in a country. What are these rules and who proposed their inclusion in the French treaty?

Mr. SURREY. As I recall, the treaty with France deals with the difficult question of activities by American insurance companies reinsuring French risks, and the treaty indicates that such American insurance companies will not be subject to tax in France.

The CHAIRMAN. Not be subject?

Mr. SURREY. Not be subject.

The CHAIRMAN. That is the purpose of it?

Mr. SURREY. That is the purpose of it.

The CHAIRMAN. And that was inspired by the American Government?

Mr. SURREY. It is a clause which we think is appropriate, and the French, already having extended that clause in a treaty with another country, we thought it appropriate to extend it to the U.S., and the French had no objections.

PROBLEMS WITH U.S. DOMESTIC TAXES

The CHAIRMAN. I believe there have been problems with the French regarding the taxing of French airlines or shipping companies by individual states in the United States, is that correct? I think the notes accompanying the treaty indicate that.

Mr. SURREY. The French thought that there conceivably might be problems in that regard.

The CHAIRMAN. I thought there already had been. Haven't there already been problems of that kind?

Mr. SURREY. I am advised that as far as we know, we did not have them, there may have been problems that arose at one time with some other countries, but we do not recall those problems with the French. The French delegation, maybe they had experienced some problems, and they asked that the treaty extend directly to state and local taxes.

We had said that in most cases, most of our state and local governments really do not intend to extend their jurisdiction and, consequently, the matter would be discussed if it ever did arise, and it was unnecessary to put a direct limitation on the state and local governments within the treaty.

So that, consequently, I think, I suppose it would be fair to say, we persuaded the French not to be overly concerned on that matter and not to include a direct clause in the treaty.

The CHAIRMAN. I see. So you are not worried about that?

Mr. SURREY. Not so far yet. We do not have any particular concern.

RATIFICATION OF TREATIES URGED

The CHAIRMAN. Do you have anything else to say?

Mr. SURREY. No; except other than to urge that this treaty be ratified as soon as possible, since having been ratified by the French Government, and since the treaty is in our interests, it would be helpful if it could come into effect. In a rough sense we are losing a very small amount of revenue, the longer it takes to ratify this treaty.

The CHAIRMAN. Has the Philippine Treaty been ratified by the Philippines?

Mr. SURREY. No. I think they are in the same position as we are of urging the ratification at this session of their legislature.

The CHAIRMAN. I see.

Mr. SURREY. The President of the Philippines said he would do so.

The CHAIRMAN. I see.

Thank you very much, Mr. Surrey.

The next witness is Mitchell B. Carroll of New York City.

STATEMENT OF MITCHELL B. CARROLL, ATTORNEY AT LAW, NEW YORK CITY

Mr. CARROLL. Mr. Chairman and Senator Sparkman, I am Mitchell B. Carroll, an attorney in New York City. It has been very interesting to me to hear Mr. Surrey speak about the treaty with France because back in 1930 we had the negotiation of our first treaty with France, and I happen to have been one of the negotiators. It is appropriate to bring it up at the present time, not with regard to anything that France is doing at the present time that is contrary to what has happened in the past, but because in this treaty with France there is a clause that has apparently been used as a model in arriving at a reciprocal clause in the treaty with Brazil in which Senator Sparkman is interested.

TAXING JURISDICTION

The reason I am bringing it up is because, as we read the treaty with Brazil, the United States is to share with the Brazilian Government its jurisdiction in collecting taxes from dividends paid by American corporations.

In other words, under the treaty with Brazil, if an American corporation has a permanent establishment in Brazil, and derives 85 percent of its income from sources in Brazil, Brazil is given the right, so it appears, to collect a tax on the dividends distributed in the United States to American shareholders.

Now, the very purpose of our first treaty with France was to prevent an incursion into our tax jurisdiction in the United States by France. The French dividend tax that had been designed to reach foreign corporations with branches in France had been extended to apply to foreign corporations with subsidiaries in France. The French officials applied it on such a large scale that the amounts became considerable, so considerable, that pressure was brought upon the Treasury and the State Department to sent representatives to France to solve the problem. I happened to have been one of those who was sent to France, and we solved it by getting the French to agree to withdraw their fiscal arm from the United States and apply their taxes only on a territorial basis.

In the case of an American corporation with a subsidiary in France they would apply the tax on dividends distributed by the French company, and on any amount they could prove had been diverted from the French subsidiary to the American parent. I do not know of any case where that has been done.

In the case of an American corporation with a branch in France there was, first, the profit tax, and then the dividend tax on presumed dividends equal to three-fourths of the profits realized by the branch.

In this treaty of 1967 those same basic ideas are preserved; that is to say, France does not reach out to tax a parent company in the United States either on dividends that it distributes or on profits or anything of the kind. It limits its jurisdiction territorially.

TAXING AUTHORITY UNDER BRAZIL TREATY

Now, we do not understand, Mr. Chairman, why Brazil should be authorized under the proposed treaty to impose a tax on dividends dis-

tributed in the United States by American corporations to their American shareholders in this country. I think that in the interest of sound international tax law that should be abandoned for two reasons, very important reasons.

The CHAIRMAN. Would you illustrate specifically how that works? How does Brazil impose a tax on an American corporation distributing income to its American shareholders having no connection with or being in Brazil?

Mr. CARROLL. Well, it is in the treaty. In the first place, article 5(b) says, in substance, that dividends paid by a U.S. corporation shall be treated as income from Brazil if the American corporation has a permanent establishment in Brazil and derives more than 85 percent of its gross income from sources in Brazil.

The CHAIRMAN. I see.

Mr. CARROLL. Then you turn over to a later article——

The CHAIRMAN. What is the difference between that and taxing the permanent establishment in Brazil the same amount?

Mr. CARROLL. Under the Brazilian law today, the tax administration of that country first subjects a branch or a permanent establishment in Brazil of an American company to a profits tax, and then to a dividend tax on the part of the profits earned in Brazil that are credited to a head office in the United States.

Now, the language of this treaty apparently says that dividends distributed by the American company itself in the United States shall be treated as income from sources in Brazil. Then you turn over to another article, and it seems to indicate that Brazil will have a right to collect taxes on that distribution in the United States. In other words, under Brazilian law as it is today, the levy is purely territorial, imposed by Brazil on dividends distributed in Brazil or profits of a branch in Brazil of an American corporation.

But apparently under the treaty they would give the jurisdiction to Brazil to impose the tax in the United States.

EXTRATERRITORIAL PROVISION IN FRENCH TREATY

The CHAIRMAN. Mr. Carroll, were you primarily to testify against the Brazilian treaty or were you interested in the Philippine treaty?

Mr. CARROLL. No. I was going to speak about the French treaty, but I got into the subject of the treaty with Brazil because of the way in which the French treaty unilaterally recognizes the right of the United States to collect a tax on dividends distributed in France by French companies, and the power to tax is being applied reciprocally in the treaty with Brazil.

As far as the treaty with France is concerned, except for this extraterritorial provision which provides this dangerous precedent for the treaty with Brazil, we think it should be ratified and approved.

The CHAIRMAN. Do you have a reservation to propose?

Mr. CARROLL. Yes. The reservation would be to eliminate these extraterritorial provisions to which I have alluded.

The CHAIRMAN. Have you a specific proposal to submit for the record?

Mr. CARROLL. Yes. Here is a document, if I may submit it for the record.

The CHAIRMAN. That will be printed in the record.
(The prepared statement of Mr. Carroll follows:)

STATEMENT ON THE INCOME TAX CONVENTION WITH FRANCE OF JULY 28, 1967, PRESENTED BY MITCHELL B. CARROLL*

American corporations with French subsidiaries would welcome the prompt ratification of the Income Tax Convention with France, signed July 28, 1967, in order that they may benefit from the reduction from 15 percent to 5 percent in the French tax withheld from dividends (Art. 9 (2) (b)) and also from other provisions.

By way of exception, however, the attention of the Committee is drawn to certain provisions which depart from the generally accepted principle of territoriality of jurisdiction over income from sources in one country derived by taxpayers resident in the other. This principle has been scrupulously observed by the United States since it was embodied in the first treaty with France, signed April 27, 1932, as well as in the twenty-one other general income tax conventions to which the United States is a Party and the recently ratified limited treaty with Trinidad and Tobago.

The provisions banning the extraterritorial application of the French tax on dividends distributed by American corporations to U.S. shareholders, which were adopted in 1932, were continued in the second convention signed July 25, 1939. This convention, as amended, is still in force but it will be superseded by the 1967 convention if it is ratified.

The objectionable provisions in the 1967 convention are articles 9 (4) (b) and 13 (1) (a) which provide for the acceptance by France of the U.S. definition of source to include dividends distributed by a French company to French residents and corporations, providing that the French company derives 80 percent of its gross income through a permanent establishment in the United States during a prescribed 3-year period. The scope of IRC 861 (a) (2) (B) is thus narrowed but the inherent extraterritorial exercise of jurisdiction is the same.

This may seem to be unimportant because the extraterritorial tax is the U.S. tax on dividends paid by a French corporation to residents of France. It is not known whether the French government has been aware of this incursion into its jurisdiction. The treaty narrows the scope of the liability that could have been asserted under Section 861 (a) (2) (B) itself. However, the primary reason for us to object is that this unilateral concession by France has been broadened into bilateral concessions to allow one country to collect taxes in the territory of the other in the treaty with Brazil of March 13, 1967. This means that Brazil is thus authorized by treaty, under certain conditions, to tax dividends distributed by a United States corporation to U.S. shareholders.

The treaty with Brazil was the subject of a hearing before this Committee on October 5, 1967, but has not yet been approved. It is reported that the Treasury expects to use it as a model for treaties with Argentina and other less developed countries. Recognition by treaty of the jurisdiction of foreign governments to levy a dividend tax on profits before or after distribution by a U.S. parent company with a subsidiary or branch in the taxing state would tend to discourage the promotion abroad of American exports or other types of business.

Hence, it is urged that the Senate delete by means of a reservation, these provisions for extraterritorial taxation, namely, Articles 9 (4) (b) and 13 (1) (a) of the pending treaty with France. For similar reasons it should delete Articles 5 (1) (b) and 12 (6) of the treaty with Brazil.

EXTRATERRITORIAL PROVISIONS IN FRENCH TREATY

More specifically, under the Internal Revenue Code, the United States reaches into the territory of France to tax dividends distributed in France to resident taxpayers, by a French corporation which derives 50 percent or more of its gross income over a prescribed 3-year period from U.S. sources (IRC Sec. 861(a) (2)(B). This provision in the Code is narrowed somewhat by the French treaty in Article 9(4) (b) which deems *dividends paid by a French company* to be *from U.S. sources* if such company had a permanent establishment in the United States to which more than 80 percent of its gross income was taxable during the prescribed 3-year period. Dividends "from U.S. sources" (though distributed by a French corporation) which are paid to a resident of France are sub-

*Counsel, Coudert Brothers, New York.

ject to withholding of tax by the corporation which distributes them. This tax is limited by the treaty to the rate of 15 percent in general, or of 5 percent if the recipient is a French corporation owning at least 10 percent of the voting stock of the paying corporation and if certain other requirements are met. The United States would levy this tax, in addition to the Federal corporation tax of up to 48 percent on the income of the foreign corporation taxable at the permanent establishment in the United States. It is doubtful that this liability to U.S. taxes under the treaty would preclude the collection by France of its taxes on the distributed income of a French company.

The liability of the recipient in France of dividends from a French company is confirmed in Article 13(1)(a) which says that dividends paid by a French corporation to a person *other than* a citizen, resident, or corporation of the United States—which obviously envisages a citizen, resident or corporation of France—shall be exempt from tax by the United States *unless* such French corporation had a permanent establishment in the United States to which more than 80 percent of its gross income was taxable for the prescribed 3-year period.

In other words, the U.S. collects tax extraterritorially on dividends distributed by a French company because they are deemed to be from U.S. sources.

EXTRATERRITORIAL TAXATION UNDER THE TREATY WITH BRAZIL

Before the 1967 treaty with France was completed, negotiations were begun with Brazil. The provisions authorizing the United States to tax dividends paid in France by a French company served as a model for a reciprocal provision in the treaty between Brazil and the United States, in Articles 5(1)(b) and 12(6). Consequently, dividends distributed by an American corporation to U.S. citizens and corporations may be treated as income from sources in Brazil (Art. 5(1)(b)). Apparently they may be taxed by Brazil if the U.S. corporation has a permanent establishment in Brazil and derives more than 85 percent of its gross income from sources within that country during the prescribed 3-year period. (Art. 12(6)). Liability also exists if the recipient of the dividend has a permanent establishment in Brazil with which the dividends are effectively connected. (Art. 12(6)). This concept was evidently added after the enactment of the Foreign Investors Tax Act on November 13, 1966.

The withholding tax of 28 percent collected by Brazil is limited by the treaty to 20 percent if certain conditions are met. (Art. 12(3)).

If this authorization is granted in a formal treaty, and if this treaty is to serve as a model for treaties with other less developed countries—it may be difficult, if not impossible, technically to object against the levy by a foreign country of its taxes in the United States on income distributed by a U.S. corporation because of deeming the income to be from sources in the taxing state.

Hence, it is urged that this Committee delete these provisions on extraterritorial taxation from the treaty with France and Brazil by means of a reservation or otherwise and denounce the incorporation of such provisions in future conventions.

EXTRATERRITORIAL TAXATION BANNED IN 17 U.S. TREATIES

In response to the objections of Canada in 1942, the United States has expressly renounced the taxation of dividends distributed by Canadian companies to residents of Canada.

It has likewise expressly renounced such taxation in 16 subsequent conventions with the United Kingdom, Netherlands, New Zealand, Belgium, Ireland, Norway, Greece, Switzerland, Finland, Australia, Germany, Italy, Austria, Pakistan, Luxembourg, and the latest with Trinidad and Tobago. The last mentioned was ratified last December while the treaties with France and Brazil were before the Committee. Such wide acceptance makes it a basic principle of international tax law.

Furthermore, extraterritorial taxation by foreign governments of U.S. citizens and corporations comes within the purview of Sec. 891 I.R.C., which authorizes the President, when he finds that such taxation exists, to retaliate by doubling the rate of tax on income from U.S. sources flowing to the taxpayers of the offending country, subject to a maximum rate of 80 percent.

To recapitulate, in 1932, the United States prevailed upon France to refrain from extending its fiscal arm into the United States and taxing dividends distributed by American corporations to its American shareholders. Instead, France agreed to subject to dividend tax only profits distributed or proved to

have been diverted by a French subsidiary to its American parent, and a proportion of profits realized by a branch that was deemed to have been distributed to the American corporation.

In 1942 the United States responded to the protest of Canada and formally renounced in its treaty with that country the taxation of dividends and interest paid by Canadian corporations to residents of Canada. This formal restriction on its power to tax has been repeated in 16 out of the 22 tax treaties to which the United States is a party.

In 1967, while requiring France to continue to levy its dividend tax territorially, i.e. only on actual or deemed distributions in France, the United States prevailed upon France to permit it to tax under certain conditions dividends distributed by French companies to residents of France. Also in 1967, while requiring Brazil to let it tax under certain conditions dividends distributed in Brazil, it agrees to let Brazil reach into the United States and tax dividends distributed by American corporations to American shareholders even though it taxes them itself.

As this treaty with Brazil is said to set the Treasury's pattern for treaties with less developed countries, does this Committee intend to share the jurisdiction of the United States over taxes on U.S. citizens and corporations deriving dividends from American corporations with an increasing number of foreign tax administrations?

DISCRIMINATORY TAXATION

A United States corporation with a branch in France is subject there to tax on its profits at the rate of 50 percent, and then to the dividend tax at the rate of 15 percent on ⅔ of what remains. On the contrary, the U.S. corporation would be subject to withholding of only 5 percent from dividends distributed by a French subsidiary, say to the extent of ⅔ of what remains after payment of the French company tax of 50% (Art. 13(2)(a)).

This discrimination in rate against branches of U.S. corporations has not been explained. The fact that it is discriminatory is acknowledged in Article 24, which first prohibits discrimination against U.S. residents in par. (1), and in par. (2) against a permanent establishment in France of a U.S. resident. It then says that this paragraph must not be construed to prevent France from taxing a branch of a U.S. resident as provided in Art. 13(2)(a), nor to prevent the United States from imposing a comparable burden on the income of a permanent establishment in the United States belonging to a resident of France.

In other words, France may continue to discriminate and the United States may discriminate in return! It is hard to believe that the United States would condone the violation of a treaty clause against discrimination by authorizing the United States to resort to comparable discrimination!

It is recommended that the discrimination be removed by making the reduced rate of 5 percent for dividends from a subsidiary applicable also to the net income of a branch which is deemed to be distributed to the U.S. parent (Art. 13(2)(a)) and (5). The fact that this can be done is shown in the convention with Trinidad and Tobago, signed December 22, 1966, which reduces the rate of 30 percent to 5 percent for both.

In any case, it is urged that a way be found to make these desirable changes so that the treaties will conform to the general principles embodied in the 21 income tax treaties concluded by the United States with other governments and in those between other pairs of states. Presumably, this could be done by the adoption of an appropriate reservation so as not to delay the approval of all the desirable articles in the convention, such as that reducing the rate of tax withheld from dividends paid by a French subsidiary to a U.S. parent corporation to 5 percent (Art. 9(2)(b)).

DISCRIMINATORY PROVISION IN FRENCH TREATY

The CHAIRMAN. Other than that you favor the French treaty?

Mr. CARROLL. Yes. I would just like to comment on one discriminatory provision which is rather strange, and that is this: When we negotiated the Treaty of 1932 with France we provided for equality in treatment as between a branch of an American company there and a French subsidiary. The branch was to be treated as an independent

entity, and subjected to the same taxes as the subsidiary would be subjected to, although the tax on dividends would be measured on an arbitrary basis of a presumed distribution of three-fourths of the profits.

In the present treaty the same pattern is evidently followed except that the presumed distribution of the branch is to be two-thirds instead of three-fourths. The discriminatory element is found in the rate to be applied to the profits of the branch, which is to be 15 percent instead of 5 percent, the rate applicable to dividends distributed to an American parent by a French subsidiary corporation.

Apparently this difference in rate has led to a very anomalous provision in article 24 of the treaty which, in the first place, prohibits discrimination, and then says that, nevertheless, despite the clause against discrimination that France can apply a discriminatory rate against branches in France of American companies, and the United States may, in turn, apply a comparable discriminatory tax against branches in the United States of French companies.

It seems to us that it is contrary to the history of treaty-making to provide for such a strange exception to the concept of nondiscrimination. While we would not want the treaty with France to be held up for that reason, we do feel that, nevertheless, such a distortion of the concept of discrimination should be avoided in future treaties.

The CHAIRMAN. But you do not think it is serious enough to hold up the treaty?

Mr. CARROLL. No, I would not hold the treaty up for that.

No, I think that the present treaty should certainly be ratified as soon as possible because a lot of corporations are exceedingly anxious to get the benefit of the reduced rate of 5 percent on upstream dividends from France.

The CHAIRMAN. Yes.

Mr. CARROLL. But I thought it important at this juncture to bring out these other aspects because we have a treaty pending with Brazil, and the treaty with Brazil was supposed to serve as a model for treaties with other less developed countries. We felt it important that the somewhat serious deviations from sound principles should not be repeated in future negotiations.

The CHAIRMAN. Yes.

CONCEPT OF PERMANENT ESTABLISHMENT—PHILIPPINE TREATY

Do you have anything to say about the Philippine treaty?

Mr. CARROLL. Yes, sir. Because of my general interest in sound principles of taxation, I would like to call your attention to many things that were said in the hearing on the treaty with Thailand regarding the concept of permanent establishment that relate as well to the treaty with the Philippines.

As you know, the United States has been participating first in the work of the League of Nations and then in the OECD in the development of sound principles of taxation. One of the most fundamental and important principles is the common concept of what constitutes a permanent establishment.

In other words, the two countries that are parties to treaties will not go chasing after the profit of every business relationship between

persons in their respective countries, but will try to reach the foreigner only when he has something permanent in the country that provides a sound basis for taxation.

I regret very much to note in this treaty with the Philippines that there are two provisions in there which we think are dangerous departures from this draft convention of the OECD that Mr. Surrey has alluded to with such respect. They are the provisions which would permit the Philippines to pursue the American corporation which is merely securing orders regularly through a commission agent in the Philippines or who has an agent of independent status who happens to act exclusively or almost exclusively for the American corporation.

We feel that such a relationship certainly is not enough substance in a country to constitute a permanent establishment. Pursuing profit from such activities would be contrary to the basic concept of a permanent establishment that is found in hundreds of treaties between other countries as well as in treaties hitherto adopted by the United States.

It would be very unwise to approve such a departure, and that was thoroughly brought out in the hearings on the treaty with Thailand that some kind of an understanding was reached and it would be well to reiterate that understanding in connection with the Philippine treaty that is now awaiting ratification.

DISTINCTION BETWEEN BRANCH AND COMMISSION AGENT

The CHAIRMAN. The distinction there between a branch and commission agent who acts exclusively or almost exclusively for an American corporation is rather difficult to delineate precisely, is it not? How would you propose to do it?

Mr. CARROLL. Goodness only knows, sir. Doubtless Mr. Surrey could explain that to you. But that is one of the reasons why we did not feel that any such vague concept should be regarded as a permanent establishment; we feel that in order to have such an establishment you should have some bricks and mortar, an office, a place of business where books are kept, and not just almost an exclusive agent who might get an occasional order which he passes on to the American firm.

I remember when that hearing took place before this committee in regard to the treaty with Thailand, a representative of one of our big corporations said if all the countries to which they had agents, who merely solicited orders and passed them on to the company, started trying to tax this large American corporation on the basis of the profit presumed to be derived on that meager activity, why, they would just have to quit doing business in those countries.

You will find all that in the record of the hearings of the Thailand treaty.

But in the interest of development of sound international tax laws, I think the exceptions that were expressed at that time should be reiterated at this time in the treaty with the Philippines.

The CHAIRMAN. Any questions, Senator Sparkman?

Senator SPARKMAN. Was there any modification or any reservation made in that treaty?

Mr. CARROLL. The Thailand treaty was not ratified.

Senator SPARKMAN. It was not ratified.

Mr. CARROLL. No.

Senator SPARKMAN. Was there a suggestion that there be a form of modification of the treaty or reservation or understanding to it?

Mr. CARROLL. I do not know. Mr. Surrey can tell you. I understand that the objections raised were influential because the definition on permanent establishment in the treaty with Brazil was more along the lines of the OECD definition. This attempt to broaden the concept of permanent establishment, which reaches almost anything, was abandoned.

The CHAIRMAN. When I asked Mr. Surrey a moment ago, I did not pursue it perhaps as long as I should have—how a distinction is made between a branch and an agent.

Mr. CARROLL. Yes.

The CHAIRMAN. What he did say led me to believe that by a permanent establishment he meant something with an inventory and a showroom, and so forth. I did not think of pursuing where the dividing line would be.

You say that a representative even without any place of business would be covered under the treaty. Correct?

Mr. CARROLL. Well, it says here, an agent of independent status, if he acts as an agent exclusively or almost exclusively for an American concern.

What it means is almost impossible to imagine. You cannot see it, you cannot feel it. It is too elusive a concept.

OECD DEFINITION OF PERMANENT ESTABLISHMENT

This question of where tax liabilities shall begin is one of the oldest and most studied points in international tax law. I can recall in the early days they used to go after traveling salesmen, and I know one country that even went after mail orders, tried to reach the profits of a foreign concern that was selling in the country through advertising in magazines and collecting orders in that way from persons in the country.

Well, obviously, that was utterly impractical.

So in treaties, on the basis of reciprocity, countries have given up trying to pursue these evanescent and elusive bases of taxation. They mutually and reciprocally agree to tax the enterprise of the other country only on something tangible like an office or shop or factory or something that is there and permanent and can be seen, and provides a basis for permanent operations and for keeping accounts so that you can determine a basis of taxation. The OECD, which is composed of the leading countries of the world, including the United States and Canada, have developed a very sound definition of what constitutes a permanent establishment. The Treasury has been, in general, following that definition in recent treaties, and why they departed from it in connection with Thailand and the Philippines I do not know.

But in the interest of a development of sound principles of international tax law, we respectfully urge that you return to the OECD definition.

The CHAIRMAN. Thank you very much, Mr. Carroll.

Mr. CARROLL. Thank you, sir.

The CHAIRMAN. I think we will ask the Treasury to comment on your testimony and see if we can work out something.

(Comments submitted by the Treasury Department follow:)

MEMORANDUM SUBMITTED BY TREASURY DEPARTMENT IN RESPONSE TO REQUEST BY CHAIRMAN FULBRIGHT CONCERNING THE PERMANENT ESTABLISHMENT AND BRANCH PROFITS PROVISIONS OF THE PROPOSED TAX CONVENTIONS WITH FRANCE AND THE PHILIPPINES

PERMANENT ESTABLISHMENT

As explained in the statement of Assistant Secretary Surrey, a question arose concerning the appropriate interpretation of the permanent establishment article of the tax convention with Thailand at the time that hearings were held on that convention. Mr. Hearne, a representative of the U.S. Steel Corporation, raised these questions, but in reality his interest was with respect to the Philippine treaty rather than the Thailand treaty. While other parties did express some concern, their concern was substantially identical to that of Mr. Hearne. A meeting was subsequently held between Mr. Hearne and representatives of the Treasury which resulted in a letter from Mr. Hearne to Senator Gore, Chairman of the Subcommittee that conducted the hearing and also a letter from Assistant Secretary Surrey to Mr. Hearne confirming Treasury's concurrence in the interpretation of the permanent establishment article as expressed in Mr. Hearne's letter. A copy of this correspondence is attached.

Mr. Hearne indicated at the meeting and in his letter that in light of the explanations and the principles intended to be followed in subsequent treaties, the objections which he had stated were eliminated.

The language which concerned Mr. Hearne is in paragraphs 4(b) and 5 of the convention. Paragraph 4(b) provided that a company shall be deemed to have a permanent establishment if it engages in trade or business in the other country through an agent who *regularly secures orders* in the latter state for a resident of the other country. Paragraph 4(b) has been eliminated from the proposed Brazilian convention and subsequent draft conventions under discussion with other countries.

Furthermore, neither the Brazilian convention nor subsequent drafts contain the language in paragraph 5 of the Philippine convention providing that an agent shall not be considered independent (and if not independent, possibly a permanent establishment) if it acts exclusively or almost exclusively for a related party. Mr. Hearne's letter reflects his satisfaction with our interpretation of the provisions relating to a subsidiary of a U.S. company in the context of the Philippine convention. However, elimination of the above-mentioned language in subsequent treaties would alleviate any remaining basis for Mr. Hearne's concern as to when a subsidiary of a U.S. company would be considered to be a permanent establishment of its parent.

While we have and will continue to use the OECD model convention as a guide in the negotiation of tax conventions, it was not prepared with a view toward its use in connection with conventions between developed and developing countries. The United Nations Economic and Social Council (ECOSOC) is presently studying the problem of tax conventions between such countries. We are cooperating with ECOSOC in this effort. In the meantime, we believe that many of the standard OECD provisions can be applied in substance to both developed and developing countries and our treaties to date have been negotiated on that basis.

BRANCH PROFITS

Many countries, including France and Brazil (but not the United States or the Philippines), have a branch profits tax, that is, a tax on foreign corporations engaged in business in the country, in addition to the regular corporate tax imposed on both foreign and domestic corporations. The usual purpose of this tax is to equalize the tax treatment of foreigners who do business in a country through a branch operation with those who do business through a domestic corporation of the taxing country. In the case of a domestic corporation a withholding tax is usually imposed on the payment of dividends to nonresident foreigners. In lieu of imposing such a withholding tax on the dividends paid by a foreign corporation, a tax is imposed on the profits of the branch as they are earned, in anticipation of their distribution as dividends by the foreign corporation operating the branch.

The United States does not impose a branch profits tax. However, under the Internal Revenue Code a tax is imposed by the United States on dividends paid by foreign corporations engaged in trade or business in the United States that earn 50 percent or more of their profits here. The tax is imposed at either the statutory 30% rate or the appropriate treaty rate, but only on a prorata share of the dividends paid.

Therefore, the tax imposed by the United States on dividends paid by foreign corporations with substantial United States business is to some extent the equivalent of the tax imposed by other countries, e.g., France, on the profits of such foreign corporations as they are earned. The proposed convention with France reduces the French branch profits tax to an effective rate of 10 percent on profits after corporate tax. The present convention with France provides for a rate of 18.75 percent. While the rate under the proposed convention is higher than the intercorporate dividend rate of 5 percent that applies under the treaty, it is lower than the treaty portfolio rate of 15 percent.

The treaty with France provides for a limitation on the French branch profits tax and also provides for the imposition of a United States tax on dividends paid by French corporations substantially all of whose business is done in the United States. Thus a form of reciprocity is achieved. This is also true under the existing treaty with France which permits the U.S. to tax all dividends having a source in the United States and France to levy a tax on branch profits. (The Brazilian treaty provides this reciprocity in a different form by permitting both countries to impose either a branch profits tax or a dividend tax. Brazil imposes a branch profits tax and not a dividend tax, and under our domestic law we impose a dividend tax but not a branch profits tax. If one country were to impose both forms of tax, it would result in discriminatory taxation which the treaty prohibits. Consequently under the present Brazilian tax system, which includes a branch profits tax, imposition of an additional tax in the form of a tax on dividends paid by a U.S. corporation would be in contravention of the convention.)

UNITED STATES STEEL CORP.,
New York, N.Y., April 4, 1966.

Senator ALBERT GORE,
Chairman of the Subcommittee on Tax Conventions,
Senate Committee on Foreign Relations,
Washington, D.C.

MY DEAR SENATOR: You may recall that I appeared before your Subcommittee on August 25, 1965 and testified, particularly concerning the definition of "permanent establishment" in the proposed Income Tax Convention with Thailand. At that time I stated that while we did not have any particular problem in Thailand itself, I was testifying with respect to the principle which Mr. Surrey had stated in his testimony was being established for extension to other undeveloped countries such as the Philippines and India. Mr. Surrey has recently written to me suggesting a discussion of the points raised in my testimony seeking to resolve these issues preparatory to conducting negotiations with Brazil where, in contrast to the situation in Thailand, we and many other United States corporations do have substantial interests. In a discussion with Mr. Surrey in his office on February 9th, Mr. Surrey said that his interpretation of three of the bothersome features of Article 3 of the proposed Thailand Treaty is as follows:

Paragraph (4)(b) provides that a resident or corporation of one of the Contracting States shall be deemed to have a permanent establishment in another State if such entity engages in trade or business in that State through an agent * * * who "regularly secures orders in the latter State for that resident or corporation." Mr. Surrey interprets this to mean that it must be the intent of the United States corporation that the agent shall regularly and consistently represent the United States entity and it must be the intent that he shall secure orders on a permanent basis and not on a temporary or sporadic basis. We remain in disagreement as to whether Paragraph (4)(b) should be included even though it does not now affect us in Thailand. However, Mr. Surrey stated that if Paragraph (4)(b) is included as a part of the Thailand Treaty it will not be considered as any sort of a precedent for inclusion in any other tax treaty. Mr. Surrey said he would have no objections to such a statement being included in the report of your Committee on the Thailand Treaty and I respectfully request that it be so spelled out in your report, if Paragraph (4)(b) is retained.

Considering Paragraph (4)(b) in connection with Paragraph (5), it is Mr. Surrey's interpretation that a subsidiary in a foreign country would not be considered an exclusive or almost exclusive agent for a United States corporation for which it solicits orders if it had substantial other activities within the treaty making country such as sales on its own behalf, or heat treatment of steel, for example.

Furthermore, with respect to Paragraph (5), particularly the parenthetical clause near the end thereof which indicates that an agent of independent status who operates exclusively or almost exclusively for the United States corporation would also be considered to create a permanent establishment for affiliated corporations, Mr. Surrey said that the scope of affiliation would not extend to any affiliated company which was not directly selling into the treaty country through the same agent. Put in another way, this attribution of "permanent establishment" would not exist for any affiliate who sold to a sudsidiary company which latter company was selling in the foreign treaty country. Thus, in our instance where United States Steel Corporation products are sold in foreign trade by a subsidiary engaged in foreign trade, none of the profits of steel making or ancillary processes would be subject to the jurisdiction of the foreign country or attributable to the sales made therein unless the manufacturing companies were also directly selling into the foreign country by means of the agent located in the foreign country.

Finally, with respect to Paragraph (8) of Article 3 which says, in effect, that if a resident or corporation of one of the Contracting States has a permanent establishment in the other at any time during the taxable year, it shall be considered to have a permanent establishment there for the entire year—Mr. Surrey interprets this to mean that we could not inadvertently have a permanent establishment through the activities of an independent agent who, without our knowledge and intent, became our sole representative, nor could we have a permanent establishment if one of our own employees might be in the country on other business and incidentally engaged in some sales efforts.

With respect to the Brazilian Treaty, Mr. Surrey said it was the intention of the Treasury to make every effort to secure a treaty with definitions of "permanent establishment" similar to those in the treaty with Israel. The definition of "permanent establishment" in the treaty with Israel are of the type suggested by the O.E.C.D. which I indicated was our preference in my testimony before your honorable Committee. However, if by unhappy circumstances, it should be necessary to have some features of the proposed treaty with Thailand respecting permanent establishment negotiated as part of the Brazil Treaty, Mr. Surrey indicated that not only for Thailand but for Brazil, or wherever used, the Treasury would incorporate the above interpretations in the Regulations and would be willing to have them incorporated in your Committee's Report.

Mr. Surrey has said that he will write me confirming his agreement to the matters of principle and interpretation concerning the Thailand Treaty and future treaties. Upon such agreement, we believe our objections to the Thailand Treaty would be substantially eliminated.

Respectfully submitted.

W. L. HEARNE, *Vice President-Taxes.*

APRIL 8, 1966.

Mr. W. L. HEARNE,
Vice President, Taxes, United States Steel Corp.,
New York, N.Y.

DEAR MR. HEARNE: This is to acknowledge receipt of a copy of your letter of April 4, 1966 to Senator Gore concerning several provisions in Article 3 of the pending income tax treaty between the United States and Thailand relating to the definition of a permanent establishment.

I am in agreement with the views that your letter attributes to me and I am glad to note that as a consequence this, in effect, eliminates your objections to the tax treaty with Thailand.

Sincerely yours,

STANLEY S. SURREY.

The CHAIRMAN. Mr. Robert T. Scott of the National Foreign Trade Council, Inc. is the next witness.

Mr. Scott, I understand you have two statements.

STATEMENT OF ROBERT T. SCOTT, VICE PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, INC.

Mr. SCOTT. Yes; I do, Mr. Chairman.

The CHAIRMAN. Could you put them in the record and then summarize them for us?

Mr. SCOTT. Surely; yes, sir.

For the record, my name is Robert T. Scott. I am vice president of the National Foreign Trade Council, and we will present testimony with respect to both the French and the Philippine treaties, and in both instances we recommend that the Senate give its advice and consent to the treaty as written.

The National Foreign Trade Council would like to urge this committee to give its advice and consent to the treaty with France.

ADVANTAGES IN FRENCH TREATY TO U.S. COMPANIES

In addition to the basic advantages contained in income tax treaties, the French treaty provides at least four specific advantages for companies operating in France:

1. One would be the adoption of the OECD permanent establishment definition contained in article 4.

2. Would be the abandonment of the "force of attraction" principle, which is also standard in the OECD model convention.

3. The treaty provides for reduced rate of withholding on interest from 15 to 10 percent. And, finally, the treaty provides for the establishment of a mutual agreement procedure whereby competent authorities of both countries can attempt to reach an agreement on such questions as the uniform location of income and the source of income.

Most significantly, the proposed United States-France treaty reduces the rate of withholding on intercorporate dividends from the existing 15 percent under the existing treaty to 5 percent.

In addition to eliminating double taxation that might otherwise result, the reduced 5 percent of withholding on intercorporate dividends will appreciably augment the Administration's action program to reduce the U.S. balance of payments deficit.

The Foreign Direct Investment Regulations, published by the Commerce Department on January 3 of this year, 33 Federal Register 49, are an integral part of this program, and these regulations require mandatory repatriation of current earnings of foreign subsidiaries of U.S. companies in varying amounts, depending upon the country wherein the subsidiary is located.

Thus, if a U.S. company were to satisfy its mandatory repatriation requirements under the Commerce Department regulations, such dividends would be subject to a French withholding tax under the existing treaty rate of 15 percent.

Including the French tax on which this dividend is paid, such dividend would be subject to an overall rate of French tax at the rate of 57.5 percent as compared with an overall effective rate of 52.5 percent after the ratification of the proposed treaty.

Thus, it reduces the rate of withholding tax on intercorporate dividends flowing to U.S. parent corporations from 15 to 5 percent, and will not only result in more dollars flowing into the United States but will also reduce excess foreign tax credits for many U.S. corporations.

Accordingly, the National Foreign Trade Council strongly urges that the Senate give its advice and consent to the ratification of the French treaty.

We recommend that this action be taken as soon as possible inasmuch as article 31(a) provides that the withholding provisions of the French treaty will become effective on or after the date that the treaty enters into force, and that is one month after the exchange of instruments of ratification.

That concludes my comments on the French treaty. If there are no questions I will go on to the Philippines treaty.

(The prepared statement of Mr. Scott follows:)

CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE FRENCH REPUBLIC WITH RESPECT TO TAXES ON INCOME

The National Foreign Trade Council, comprised of a broad cross section of U.S. companies engaged in all major fields of international trade and investment, has long endorsed the United States income tax treaty program and has recognized its constructive force in the promotion and expansion of foreign trade. The Council therefore favors early ratification of the proposed United States-France income tax treaty signed July 28, 1967, which, if ratified, will supersede the existing income tax convention of July 25, 1939 and will replace those portions of the double taxation convention of October 18, 1946, the supplementary protocol of May 17, 1948, and supplementary convention of June 22, 1956 relating to taxes on income, capital and stock exchange transactions.

The proposed U.S.-France treaty reflects changes in both French income tax law and in U.S. law as a result of the Foreign Investors Tax Act of 1966 as well as refinements resulting from the U.S. accommodation to the OECD Draft Double Taxation Convention on Income and Capital and is consistent with more recent U.S. income tax treaties with the developed countries.

GENERAL TREATY ADVANTAGES

In addition to the basic advantages contained in income tax treaties, such as making more certain the limits beyond which tax liabilities cannot be asserted by the two countries and the alleviation of double taxation, the proposed French treaty contains several advantageous provisions for U.S. taxpayers doing business in France. These advantages include:

1. Adoption of a permanent establishment definition similar to that contained in the OECD Draft Double Taxation Convention. Article 4.

2. Abandonment of the "force of attraction" principle. Treaty exemptions from, or reduced rates of, tax will be applicable to income derived from real property and natural resources, and dividends, interest, royalties, and capital gains where the recipient has a permanent establishment in the other treaty country unless the right or property giving rise to such income is effectively connected with such permanent establishment. Article 6(5). In addition, industrial and commercial profit earned by a resident of one treaty country will be taxable in the other country only if attributable to a permanent establishment maintained by such resident in the other country. Article 6(1).

3. Reduction of withholding rates on interest from 15 percent under the existing treaty to 10 percent. Article 10.

4. Establishment of a mutual agreement procedure whereby the competent authorities of both countries would seek to reach agreement on various tax problems. These include the uniform allocation of income between related companies as well as a uniform determination of the source of particular types of income. These provisions authorize both countries to make appropriate refunds when necessary. Article 25.

REDUCED DIVIDEND WITHHOLDING

Most significantly, the proposed U.S.-France treaty reduces the rate of withholding tax on intercorporate dividends from 15 percent under the existing treaty to 5 percent. In addition to eliminating double taxation that might otherwise result, the reduced 5 percent rate of withholding on intercorporate dividends will appreciably augment the Administration's action program to reduce the U.S. balance of payments deficit. The Foreign Direct Investment Regulations, 33 Fed. Reg. 49, (1968) are an integral part of this program, and require, inter alia, mandatory repatriations of the current earnings of foreign subsidiaries of U.S. corporations in varying amounts, depending upon the country wherein the subsidiary is located.

If a U.S. corporation were to satisfy its mandatory repatriation requirements under the Foreign Direct Investment Regulations by a dividend distribution from its French subsidiary, such dividend would be subject to a French withholding tax, under the existing U.S.-French treaty, at a rate of 15 percent. Including the French tax on profits from which paid, such dividend would be subject to an overall effective rate of French tax of 57.5 percent, as compared with an overall effective rate of 52.5 percent after ratification of the proposed treaty. Thus, reducing the rate of withholding tax on intercorporate dividends flowing to U.S. parent corporations from 15 percent to 5 percent will not only result in more dollars flowing into the U.S., but will also reduce excess foreign tax credits.

RATIFICATION RECOMMENDED

Accordingly, the National Foreign Trade Council strongly urges that the United States Senate give its advice and consent to ratification of the proposed U.S.-France income tax treaty. The Council recommends that this action be taken as soon as possible inasmuch as Article 31(a)(i) of the proposed treaty provides that the provisions dealing with French withholding taxes shall be effective on or after the date that the treaty enters into force, that is, one month after the exchange of the instruments of ratification.

The CHAIRMAN. Please proceed to the Philippine treaty.

PERMANENT ESTABLISHMENT CLAUSE IN PHILIPPINE TREATY

Mr. SCOTT. With regard to the Philippine Treaty, the Council again urges that the Senate give its advice and consent to ratification. We would like to point out the problems which Mr. Carroll, a previous witness, has just alluded to, that is, the section of the permanent establishment clause in article 8, which would provide that the securing of orders in the Philippines through an agent would constitute a permanent establishment as well as that portion of article 8, paragraph 5, which would hold that an otherwise independent agent who solicits orders exclusively or almost exclusively for a U.S. company would also constitute a permanent establishment.

The CHAIRMAN. Do you agree with Mr. Carroll on that?

Mr. SCOTT. We do not. We agree with Mr. Carroll insofar as we would raise it and state that this is objectionable.

We do not, however, suggest that this would be a sufficient objection to withhold ratification of the treaty.

The CHAIRMAN. If it is wrong something ought to be done about it. It sets a precedent, and the way these things operate, it may be picked up in a dozen or more treaties to come. Why shouldn't there be a reservation or some change put on it? This is a first treaty. There is no great urgency about it.

Mr. SCOTT. The only opposition is, as I have just stated.

However, I think it is important to note that the corresponding article of the Brazil treaty, which is purported to serve as a prototype

for less developed countries, does not contain this particular provision, so it would seem——

The CHAIRMAN. Why do you think they put it in here? What is your explanation?

Mr. SCOTT. I have no idea, sir.

The CHAIRMAN. Haven't you talked to anybody in Treasury about it?

Mr. SCOTT. No, we have not, sir. Some testimony, as you know, was elicited under the Thailand treaty, but that was before my association with the Council.

The CHAIRMAN. I must say I thought Mr. Carroll made a very persuasive case that this is a vague concept.

Mr. SCOTT. There is no question about it being vague.

For example, presumably if you hire one independent agent and he himself had a helper then, and he solicited orders, presumably that would not run afoul of the permanent establishment concept in article 8(5).

But if, for some reason, this chap, whom you never heard of in the United States, severs his association with your agent, and then the agent only worked for you, presumably then unbeknownst to the United States, you would then have a permanent establishment. This type of argument has been brought forth in the Thailand treaty hearings and there is no question about it but it is elusive, and no one knows what it means in practice.

We do not for a moment recommend it be put forward in other treaties. But my only point is that the Treasury, from what Mr. Surrey says, is aware of the problem and it is not a precedent.

The CHAIRMAN. It might be very helpful if you would give us a version of this definition of a permanent establishment which would be satisfactory. I expect it is rather difficult to draw, is it not?

Mr. SCOTT. I do not think so.

The CHAIRMAN. You do not? Well, have you got one?

Mr. SCOTT. I would merely suggest that we eliminate those provisions of article 8(4)(b), I think it is, which provide that soliciting orders would constitute a permanent establishment. Correspondingly, I would suggest that we could drop down to article 8(5) and eliminate that portion of the Philippine treaty which states that even though you used an independent agent, if he works exclusively for you, you will be considered a permanent establishment. These provisions are not contained in other treaties, and we could eliminate this problem merely by reverting to a normal permanent establishment definition.

LETTER ON THAILAND TREATY

The CHAIRMAN. In view of this, I think the letter from Mr. W. L. Hearne on this subject, which was received in connection with the hearing on the Thai treaty, should be put in the record so it will be available. It contains comments on the same subject.

Mr. SCOTT. Yes. I believe there are other organizations or interested citizens who have also submitted memoranda on the Thai treaty which dealt with this particular point.

The CHAIRMAN. Yes.

(The letter referred to follows:)

UNITED STATES STEEL CORP.,
New York, N.Y., August 29, 1965.

Re proposed treaty with Thailand.

Senator ALBERT GORE,
Senate Office Building,
Washington, D.C.

DEAR SENATOR GORE: You have stated that a public hearing is to be held on the proposed treaty with Thailand on Wednesday, August 25. Government witnesses on this treaty have appeared over the last few days.

Assistant Secretary of the Treasury Stanley S. Surrey testified before your subcommittee that the treaty with Thailand would "indicate the general procedure and standards being followed with respect to the negotiation of tax treaties with less developed countries."

We had been under the impression that the proposed treaty with the Philippines was to be the first of this type of treaty to come before your subcommittee and we sent you a protest dated August 5 against certain features of the proposed Philippine treaty dealing with "permanent establishments." The same objectionable features are contained in article 3 of the proposed treaty with Thailand. We object particularly to article 3, paragraph (4)(b), (c) and the last sentence of paragraph (5). Our reasons are explained in copy of our letter of August 5, attached, which as above indicated we sent to you with respect to the Philippine treaty.[1]

While the particular treaty with Thailand does not bother us substantially, we do object strenuously to the further proliferation of this principle with other undeveloped countries as proposed by Mr. Surrey.

We respectfully request that our protest be made a part of the record of the hearings.

Respectfully submitted.

W. L. HEARNE,
Vice President, Taxes.

UNITED STATES STEEL CORP.,
New York, N.Y., August 5, 1965.

Re proposed income tax treaty with Philippines.

Hon. J. W. FULBRIGHT,
Chairman and the Honorable Members of the Senate Foreign Relations Committee, Senate Office Building, Washington, D.C.

DEAR SIR: We wish to raise serious question as to the effect on American business of parts of article 8 of the proposed income tax treaty with the Philippines which has been negotiated by our Government and has come before your committee and the Senate for approval. The particular provisions that concern us are article 8, paragraph (4)(b) and (c), the last sentence of paragraph (5), and paragraph (8). These provisions say, in effect, that if a U.S. corporation has an agent in the Philippines who "exclusively or almost exclusively" secures orders in the Philippines for the U.S. corporation, the U.S. corporation and all affiliated corporations shall be deemed to have a permanent establishment in the Philippines. They shall be deemed to have permanent establishment for the entire year if there is such a permanent establishment at any time during the year. This provision would allow the Philippines to tax any U.S. corporation and its affiliates if any one of them employed such an independent agent or had a selling subsidiary in the Philippines.

Mr. Stanley Surrey, Assistant Secretary of the Treasury, in his speech of September 21, 1964, before a meeting of the Tax Executives Institute in Montreal, is quoted on page 24 of the Treasury release of this speech as saying respecting "permanent establishments:"

"* * * in a situation in which a less developed country feels that these issues are important, where otherwise appropriate we have explored adding to the definition of 'permanent establishment' such factors as an agent who regularly secures orders in the less developed country, or maintains a stock of goods from which he regularly makes deliveries. Also, the use of an agent of independent status could constitute a permanent establishment if the agent acted almost

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[1] Photocopy with enclosure sent to the Honorable J. W. Fulbright, chairman, and the honorable members of the Senate Foreign Relations Committee.

exclusively for the exporter and engaged in these activities. In addition, it may not always be appropriate to eliminate the force of attraction principle."

The writer has been in correspondence with and has talked to Mr. Surrey about this speech and about the Philippine treaty and if we interpret Mr. Surrey's last letter correctly, he claims that the "treaty * * * with the Philippines does not expand the taxing jurisdiction of either country * * *." This may be so because many countries have what might be called a global taxation orbit and they are limited in what they will tax only by what they can lay their hands upon, but it seems to the writer that two things can be said about the answer of the Treasury Department. In the first place, if it is not necessary to expand the taxing jurisdiction of the Philippines, then why do we put it in the treaty, and why does Mr. Surrey refer to it in his speech as "adding to the definition of permanent establishment"?

Secondly, and more importantly, the fact is that so far as we can determine none of the less developed countries at the present time exerts a power to tax an independent agent acting for a U.S. corporation based upon the profits of the U.S. corporation, nor do they seek to tax the U.S. corporation or its affiliates on account of the activities of such an independent agent.

Thus, if the objectionable provisions in this treaty are enacted it gives complete sanction to the Philippines to tax U.S. corporations in accordance with the terms of the treaty. Mr. Surrey's speech, above referred to, indicates that the United States will cooperate with other countries in enforcing their tax laws.

For corporations with substantial assets the proposal of the treaty with respect to permanent establishments is a most serious matter and would be a major deterrent to any effort to make sales in countries that have such a treaty with the United States.

It should be mentioned that the proposed definition of a "permanent establishment" is contrary to that proposed by the OECD. In their draft treaty in paragraphs 5 and 6 on page 44 of article 5 on permanent establishments the OECD specifically rejects any idea that a subsidiary or an agent can give rise to the claim that such subsidiary or agent is a permanent establishment of the parent or seller.

The Congress has provided in Public Law 86–272 that States may not impose an income tax upon a corporation which has employees or agents within a State if the only activity of the corporation is to solicit orders in such State. This is so even though the selling personnel live in the State. (*Smith, Kline and French Laboratories* v. *State Tax Commission*, Oregon Supreme Court, June 16, 1965, Commerce Clearing House Oregon Tax Service, pars. 201–591.) Nevertheless, the Philippine Treaty provides that the Philippines may tax a U.S. corporation and all affiliated corporations if one of them has an "exclusive or almost exclusive" agent who "regularly secures orders in the * * * State (the Philippines) for the (U.S.) corporation." (Par. (4)(b).) Thus, the Senate is by this treaty called upon to approve for foreign countries the taxation which the Congress has forbidden to each of our own United States. It is submitted that the same reasons which caused the enactment of Public Law 86–272 are present with respect to foreign nation taxation of U.S. business.

Several additional problems arise in connection with this new approach in the Philippine Treaty. Incidentally, we understand this same problem is in the proposed treaty with Thailand and is urgently desired by other countries. In the manner of foreign trade it is necessary for selling agents to assert great efforts to break into any new territory. For a long time the selling efforts do not return sufficient income to adequately compensate a selling agent. Either the selling agent must be subsidized irrespective of commissions, or a subsidiary of the parent must be established with sufficient funds to pay its salesmen over the early lean years. It seems clear from the proposed treaty, and Mr. Surrey agrees, that a subsidiary company would stand in the same light as an independent agent under article 8 of the proposed treaty and thus if the subsidiary acted "exclusively or almost exclusively" for the U.S. parent it would subject the U.S. parent and all affiliates to tax in the Philippines. Thus the provisions of article 8 of the treaty would limit any effort to sell U.S. goods merely to such efforts as could be put forth by an agent who had substantial other activities. We do not believe it is in the best interests of selling U.S. goods to limit the scope of the sales activities abroad.

Secondly, we do not believe this principle can be limited to selling agents or subsidiaries but would quickly be demanded by underdeveloped countries for application to all other subsidiaries such as raw material producers and any manufacturing subsidiaries that use goods produced by the parent.

Question can be raised as to what exactly constitutes "an agent acting exclusively or almost exclusively" for the U.S. corporation. For instance, if an independent agent had two employees, one of whom spent all of his time selling for the U.S. corporation, presumably the agent would not be operating exclusively or almost exclusively. But if one person alone was an independent agent and had no employees, and he spent all of his time selling for the same U.S. corporation, he would be deemed an exclusive agent under article 8, paragraph (4). Then it can be imagined that a U.S. corporation thought it had an agent that was not devoting substantially all of its time to selling for that corporation, but because business for that corporation increased or because the agent lost some other accounts he might become the exclusive agent for the U.S. corporation without any knowledge of the U.S. corporation and thus unwittingly subject the U.S. corporation to substantial taxes.

Such a proposal would subject a corporation such as ours to tremendous and perhaps overwhelming costs of administration in satisfying foreign government as to its taxable income. How is taxable income to be determined? Certainly it is to be determined under the laws of the underdeveloped country. These countries have different laws from those of the United States so that an entirely different tax return must be prepared and filed. What income and what percentage of that income shall be deemed earned in the less developed countries? Shall it be only on the products which are sold? No such breakdown of profits is now compiled or required under U.S. tax laws and can at best only be approximated. Is the income from other products and other business, and dividends and interest to be lumped together and subjected to a percentage allocation? What if such other income has already been taxed after having been earned by branches or affiliated corporations in other jurisdictions? If, for example, we sell pumps through an agent in the Philippines, is our steel business or our ore mining business to be also taxed there? How can these matters be audited reasonably? Our U.S. tax return is a large book of hundreds of pages. The laws of most foreign countries require that all books and records be produced in the foreign jurisdiction. Some underdeveloped countries, for example Venezuela, require the audit and verification of all invoices before any deduction for cost of goods sold, or expenses is allowed. Some foreign jurisdictions also impose severe penalties, up to 200 percent, for any disallowances which the taxpayer has not presented before audit.

The Treasury has cited the India Tax Treaty of 1959 as precedent for this concept of permanent establishment. However, the Treasury assured the Senate the treaty with India would not be used as a precedent. (Hearings of Senate Committee on Foreign Relations on India Tax Convention, 86th Cong. 2d sess., pp. 27–29, 43–45, June 28, 1960.)

The administrative problem and costs involved would be sufficient to shut off all our sales effort in the Philippines as soon as this treaty is approved and this would apply to every other country where a similar provision is negotiated. We suggest this would not be in the interest of the U.S. balance of payments nor U.S. employment and we respectfully suggest that the treaty be revised to eliminate paragraph (4), the last sentence of paragraph (5), and all of paragraph (8), of article 8.

Respectfully submitted.

W. L. HEARNE,
Vice President, Taxes.

DETERMINATION OF SOURCE OF INCOME

The CHAIRMAN. Is there anything else?

Mr. SCOTT. No. I would just point out that these two provisions which we are talking about raise this jurisdictional issue which has been spoken of before, and raise the question of the source of the income—the United States and the Philippines may have different concepts of the source of income in these particular sales.

So if I could just conclude then, we would suggest that this particular problem be handled by way of a protocol to the Philippine treaty, and if this protocol is not possible, if it cannot be obtained, we would then suggest that a protocol be negotiated which would clarify the

allocation of business profits. There should be some reliable assurance that this allocation will be given effect in the determination of the source of income for the purposes of the U.S. foreign taxpayer.

In conclusion then I would simply say that the National Foreign Trade Council urges that the Senate give its advice and consent to the ratification of both the Philippines and France.

(The prepared statement of Mr. Scott follows:)

CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE REPUBLIC OF THE PHILIPPINES FOR THE AVOIDANCE OF DOUBLE TAXATION WITH RESPECT TO TAXES ON INCOME

The National Foreign Trade Council, comprised of a broad cross section of U.S. companies engaged in all major fields of international trade and investment, has long endorsed the United States income tax treaty program and has recognized its constructive force in the promotion and expansion of foreign trade. The Council therefore favors early ratification of the proposed United States-Philippines income tax treaty.

However the National Foreign Trade Council does oppose those provisions of Article 8 of the Philippines treaty which expand the definition of a permanent establishment incorporated in other income tax treaties to which the United States is a party.

Under Article 8(4)(b) of the proposed Philippines treaty, a U.S. resident or corporation will be deemed to have a Philippines permanent establishment where business is carried on through an agent who regularly secures orders therein for such resident or corporation. Moreover, under Article 8(5) the securing of such orders through an independent agent who acts exclusively or almost exclusively for such U.S. resident or corporation will also constitute a Philippines permanent establishment.

Similar provisions are found in the proposed U.S. Thailand treaty, Senate Executive E, 89th Cong., 1st Sess., see also the proposed U.S.-India treaty, Senate Executive H, 86th Cong., 2d Sess., which treaties have not received the advice and consent of the Senate. Other treaties to which the United States is a party merely provide that the use of an independent agent shall not be deemed to constitute a permanent establishment. Nor do such treaties provide that the use of an agent to secure orders in a treaty country will constitute a permanent establishment in such country.

A United States resident or corporation having a permanent establishment in the Philippines due to an agent described in Article 8 (4)(b) and (5) is subject to tax on industrial or commercial profits from Philippines sources under Article 3(1) and Article 7(1). Since the treaty contains no specific source rules with respect to industrial or commercial profits, Article 5(2) requires that the source of such income be determined under local law.

American exporters, including those who manufacture the product exported, may thus be exposed to a double taxation situation. Philippines authorities might try to impose a tax computed upon the entire profits ascribed to the transaction. Under the same set of facts, the United States might determine that the transaction did not produce income from foreign sources, or that only a portion of such income was from foreign sources.

Article 8 (4) and (5) therefore present the jurisdictional issue of subjecting the U.S. exporter to Philippines tax and raise the question of whether a United States taxpayer may obtain relief from double taxation under the foreign tax credit provisions of the Internal Revenue Code. This constitutes a serious objection to Article 8 (4) and (5), producing an element of uncertainty which could have a deterrent effect upon United States exports to the Philippines.

Accordingly, the Council urges that paragraph 4(b) and that portion of paragraph (5) referred to above of Article 8 be deleted by protocol so that the definition of a permanent establishment contained in the Philippines treaty will conform with that contained in other treaties to which the United States is a party. If such a protocol cannot be negotiated, at a minimum, the situation should be clarified by a protocol dealing explicitly with the allocation of business profits. There should also be reliable assurance that the allocation will be given effect in the determination of source for purposes of the foreign tax credit to be allowed the United States taxpayer. Moreover, the above mentioned provisions of Article 8

should in no way be considered as precedent for the permanent establishment article in future U.S. income tax treaties.*

Despite the foregoing provisions of Article 8, the National Foreign Trade Council again urges that the Senate give its advice and consent to ratification of the income tax treaty between the United States and the Republic of the Philippines.

The CHAIRMAN. Thank you very much, Mr. Scott.

Mr. SCOTT. Thank you very much.

The CHAIRMAN. The committee is adjourned.

(Whereupon, at 12:05 p.m., the committee adjourned.)

*It is important to note that corresponding paragraphs of the permanent establishment definition set forth in Article 9 of the proposed U.S.-Brazil income tax treaty do not contain such provisions.

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