TAX CONVENTIONS WITH BELGIUM, FINLAND, TRINIDAD AND TOBAGO, AND THE NETHERLANDS

HEARINGS

BEFORE THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

NINETY-FIRST CONGRESS

SECOND SESSION

ON

Executive I, 91–2, Tax Convention with Belgium
Executive E, 91–2, Tax Convention with Finland
Executive D, 91–2, Tax Convention with Trinidad and Tobago
and
Executive G, 91–1, Estate Tax Convention with the Netherlands

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OCTOBER 6, AND NOVEMBER 19, 1970

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TAX CONVENTIONS WITH BELGIUM, FINLAND, TRINIDAD AND TOBAGO, AND THE NETHERLANDS

TUESDAY, OCTOBER 6, 1970

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

The committee met, pursuant to notice, at 10:45 a.m., in room 4221, New Senate Office Building, Senator Frank Church presiding.

Present: Senators Church, Case, Williams, and Javits.

OPENING STATEMENT

Senator CHURCH. The committee is meeting this morning to receive testimony on the income tax conventions between the United States and Belgium, Finland, Trinidad and Tobago, and the estate tax convention with the Netherlands.

Our first witness is Mr. Edwin S. Cohen, Assistant Secretary for Tax Policy, Treasury Department. He will be followed by Mr. L. N. Woodworth, Chief of Staff, Joint Committee on Internal Revenue Taxation.

Mr. Cohen, I believe you have a prepared statement. If you would like to summarize that statement, we would be glad to place the entire text in the record.

STATEMENT OF HON. EDWIN S. COHEN, ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY; ACCOMPANIED BY NATHAN N. GORDON, DIRECTOR, OFFICE OF INTERNATIONAL TAX AFFAIRS, OFFICE OF TAX ANALYSIS, AND ROBERT COLE, SPECIAL ASSISTANT FOR INTERNATIONAL TAX AFFAIRS

Mr. COHEN. Thank you, Senator Church.

It is a great pleasure for me to have this opportunity to testify before the committee for the first time since I assumed the office, and I am happy to review with you these four tax conventions which the President has transmitted to the Senate for its advice and consent.

The four conventions were transmitted by the President, and we have submitted for the record also a brief exchange of letters with the Prime Minister of Trinidad and Tobago. We have also submitted today for the record four extensive technical explanations of these conventions, and I would also submit a prepared statement which I have about the four conventions.

(The information referred to appears on pp. 55, 56–118, and 23.)

If I may, rather than read the statement at this time, I will summarize briefly some of the highlights of these conventions.

TAX TREATIES AT PRESENT

We have at the present time some 20 income tax treaties with foreign countries and about a dozen estate tax treaties, and we consider that these are quite important for the purpose of preventing double taxation by two or more countries of income and estates, and by eliminating this double taxation we remove fiscal barriers to international trade and investment.

We produce in the cases where we would otherwise have double taxation a fair division of the total revenue between the two countries concerned, and of considerable importance is the fact that when we have these treaties we have provisions for exchange of information between the tax authorities of the two countries in order to prevent international fiscal evasion.

THE NETHERLANDS TREATY

The Netherlands Treaty, which is an estate tax treaty, is the first such treaty that we have had with the Netherlands. It is somewhat new in form as contrasted with our some dozen previous estate tax treaties. It follows the model of the draft OECD treaty which was produced by the OECD in 1966.

Mr. Nathan Gordon, who is on my right, is the Director of the Office of International Tax Affairs of the Treasury's Office of Tax Analysis, is presently Chairman of the Fiscal Committee of the OECD and played a significant part in the drafting of their model convention.

Mr. Robert Cole, on my left, who is my special assistant for international tax affairs, has also participated extensively in the development of the conventions that we have before you today.

This is our first treaty modeled after the OECD draft of 1966, and we think it is a significant improvement from the standpoint of simplifying the problems of the estates of persons who are citizens or residents of one country and die in another country or die owning property there.

GEOGRAPHICAL LIMIT DIFFERENCES AMONG TREATIES

Senator JAVITS. Mr. Chairman, I must go to the floor. I have just one question about the geographical limit differences among the treaties and the chair will ask that question for me.

Thank you, Mr. Cohen.

Mr. COHEN. I know the general nature of the point in which he was interested, but I do not know the specific question. I think I can comment generally on the subject in which he was interested.

Senator CHURCH. Would you do that please, Mr. Cohen?

I may have some specific followup questions to what Senator Javits is asking.

Mr. COHEN. Would you like me to do so now, Senator?

Senator CHURCH. Yes, please.

Mr. COHEN. I think that Senator Javits' question related to the provisions in two of the treaties dealing with the territorial limits of the contracting States, and in particular in relation to the problem

of jurisdiction over the Continental Shelf of the United States and the country with which we have a convention.

I think one of his questions related to the point that we have a special provision in relation to the jurisdiction over the Continental Shelf for tax purposes in the treaties with Trinidad and Belgium, both of which deal with income tax matters, but we do not have such provisions in the treaty dealing with income taxes with Finland or in the treaty dealing with estate taxes with the Netherlands.

Senator CHURCH. Yes, that is the question.

Mr. COHEN. With respect to Finland, the Government of Finland in the negotiations was not prepared to deal with the problem and, hence, no provision was included in the convention in the case of Finland. It did not represent any policy decision to have this omitted in this treaty, but simply reflected the fact that the Government of Finland was not prepared to take a position with respect to it.

With respect to the estate tax treaty with the Netherlands, there is little reason to deal with the problem in an estate tax treaty because you will not find any person domiciled or resident on the Continental Shelf simply by reason of geography and, secondly, you will have little property that would be located on the Continental Shelf or above it which would be affected by the terms of the convention.

Most of the property there, I think, would belong to corporations and, therefore, the fact that it was located in the Continental Shelf or beyond the Continental Shelf would be immaterial to the question of taxation of the stocks or bonds of those companies.

There might theoretically be some problem with respect to unincorporated property located there, but we thought this would be a minimal problem and, therefore, the issue did not have any relevancy.

In the Belgium proposed treaty and the proposed convention with Trinidad and Tobago, these problems are dealt with and they are dealt with in a manner that is consistent with the provision that was added to the Internal Revenue Code in the Tax Reform Act of 1969 by an amendment introduced in the bill in the Senate.

I think these two conventions with Trinidad and Belgium in relation to the Continental Shelf are consistent with our own income tax law as it now stands.

STATE DEPARTMENT RESPONSE TO QUESTIONS CONCERNING TRINIDAD AND TOBAGO TREATY

I understand the committee has asked the State Department for answers to several questions in this connection, and a letter from the State Department has been sent to the committee, which assures the committee that nothing in these two conventions with Trinidad and Belgium is at all inconsistent with our own position, which we have advanced, in international treaty negotiations.

Senator CHURCH. It is appropriate that at this point the State Department's letter be included in the record.

(The information referred to follows:)

OCTOBER 5, 1970.

Mr. CARL MARCY,
Chief of Staff, Committee on Foreign Relations, U.S. Senate, Washington, D.C.

DEAR CARL: Thank you for your letter dated September 29, 1970, which enclosed a list of questions concerning the proposed Tax Convention between the United States and Trinidad and Tobago. Our responses to those questions follow in the order in which they were asked.

1. For the purposes of the proposed tax convention, the definition of the phrase "continental shelf" is expressed in terms of "international law." Both the United States and Trinidad and Tobago are parties to the 1958 Geneva Convention on the Continental Shelf, and the term "continental shelf" is defined in that Convention as the seabed and subsoil of the submarine areas adjacent to the coast but outside the area of the territorial sea, to a depth of 200 meters or, beyond that limit, to where the depth of the superadjacent waters admits of the exploitation of the natural resources of that area.

As you are aware, there are differences of interpretation among nations as to the precise application of the Geneva Convention definition, particularly differences as to whether the definition may apply to the "continental slope" or "continental rise." We hope that these differences will be resolved by a seabed treaty similar to the Draft United Nations Convention on the International Seabed Area presented to the U.N. Seabeds Committee in Geneva on August 3, 1970.

When such a seabed treaty enters into force, the extent of any Party's jurisdiction over the seabed will be governed by the provisions of that treaty. The United States will, after the entry into force of such a treaty, refuse to recognize any claim of jurisdiction inconsistent with that treaty.

2. Because of the difficulty in applying the Geneva Convention definition referred to above, it would be practically impossible to indicate on a map the precise outer limit of the area described by the definition.

3. The United States and Trinidad and Tobago agree that the applicable international legal principles covering the exploration and exploitation of the continental shelf are reflected at present in the 1958 Geneva Convention on the Continental Shelf. There have been no discussions between the United States and Trinidad and Tobago concerning the interpretation of those principles or the location of the outer boundary of the continental shelf.

4. No, Trinidad and Tobago's continental shelf legislation does not establish a precise seaward boundary. That legislation defines the continental shelf in the same language as is contained in the 1958 Geneva Convention on the Continental Shelf. A copy of the legislation, dated December 22, 1969, is attached.

5. We have no information on the views of the Government of Trinidad and Tobago with respect to changes of an outer boundary according to advances in technology. Copies of Trinidad and Tobago's statements at the United Nations on the seabed item are attached. Trinidad and Tobago did not attend the May 1970 Montevideo Conference. Trinidad and Tobago did attend the August 1970 Lima Conference, but abstained in the voting at that Conference. We have no information as to whether Trinidad and Tobago has formally protested claims by other nations to territorial sea limits of 200 miles, but we are asking our Embassy to obtain this information.

6. We have asked other governments for their views on the Draft Convention on the International Seabed Area presented by the United States. We have given a copy of the draft to the Government of Trinidad and Tobago, but have not yet received their comments. The statement made by H.E. Mr. Karl Hudson-Phillip, Trinidad and Tobago's Representative to the August 1970 meeting of the Seabeds Committee in Geneva makes reference to the Draft Convention. A copy of that statement is attached.

Since the proposed tax convention between the United States and Trinidad and Tobago was negotiated before either the May 23, 1970, Statement of U.S. Oceans Policy issued by President Nixon or the Draft Convention, the concepts contained in those two documents were not discussed during negotiation of the proposed tax convention.

7. The proposed tax convention between the United States and Trinidad and Tobago does not prejudice the Draft U.N. Convention on the International Seabed Area. The proposed tax convention defines the continental shelf in terms of "international law" which would, of course, include a seabed treaty

like the Draft Convention on the International Seabed Area upon its entry into force. A seabed convention, once it enters into force, will supersede any other inconsistent international agreements of a Party.

It may be noted that the proposed tax convention defines differently the tax jurisdiction over the seabed area off the coasts of the United States and Trinidad and Tobago. This is due to the fact that United States tax legislation, i.e., section 638 of the Internal Revenue Code, requires with respect to foreign countries that they exercise taxing jurisdiction not only in accordance with international law but also in accordance with their domestic tax legislation. The United States interprets the proposed tax convention's reference to "Trinidad and Tobago legislation and international law" as conjunctive in nature. The United States will recognize legislation on the subject only if it is consistent with international law.

Article 2 of the U.S. proposed Draft Convention on the International Seabed Area provides that a contracting party shall not recognize any claim or exercise of sovereignty or sovereign rights by any State over any part of the International Seabed Area or its resources. Assuming that the final text of a seabed convention would contain a similar provision, the United States would be bound not to recognize any claim by any State to tax jurisdiction which is inconsistent with the seabed convention.

As far as the interim policy is concerned, the Department of State believes that a tax convention is not the appropriate means of dealing with a statement of such policy. The interim policy called for by President Nixon in his May 23rd Statement is being implemented as of that date.

Since the date of the President's Statement, no leases for exploration and exploitation of seabed mineral resources beyond the 200-meter isobath have been issued, as there has been no demand for such leases. One permit for the exploration of minerals, however, has been issued by the Department of the Interior after May 23, 1970. That permit was a 30-day permit issued to Deepsea Ventures Inc. for exploration of an area of the Blake Plateau, and was issued subject to the provisions of the international regime to be agreed upon.

I hope that the above information will be of assistance to the Committee, and that you will not hesitate to write again if I can be of further assistance.

Sincerely yours,

DAVID M. ABSHIRE,
Assistant Secretary for Congressional Relations.

Attachments: As stated.

(The attachments referred to are on file with the Committee.)

Senator CHURCH. Do you have any further comment, Mr. Cohen, that you would like to make in regard to the treaties?

Mr. COHEN. I was going to point out, Senator, a few highlights of these four treaties.

NEW PROCEDURE UNDER NETHERLANDS TREATY

As I mentioned, with respect to the Netherlands, this treaty attempts to simplify the procedures and avoid double taxation of estates of persons who may be otherwise subject to estate taxes in both countries. This can occur, for example, where an American citizen is working in the Netherlands, and the Netherlands may regard him as a resident of the Netherlands and subject to tax on his worldwide assets at the time of his death, even though as an American citizen he is also subject to U.S. estate tax on his worldwide assets.

The previous treaties that we have had with other countries have dealt with this by trying to allocate the jurisdiction to tax specific properties according to the types of property, and to allow a credit in one country for the tax paid in the other. But this leaves the estate with the necessity of complying with both estate tax laws, going through two evaluation procedures and crediting one against the other.

The new procedure that we have worked out with the Netherlands

Government will provide that if an American citizen is working in the Netherlands he will not be deemed to be a resident of the Netherlands unless he has been physically in that country for at least 7 out of the 10 years preceding his death, so long as he had no intention to remain in the Netherlands indefinitely, and we apply the same rule to the Netherlands citizens who would be temporarily in the United States. This will eliminate double taxation in that case because in that event the Netherlands would agree not to tax the intangible property, the tangible personal property and the securities and stocks that the man might own. They would limit their jurisdiction to the taxing of his real estate holdings in the Netherlands, if any, and to unincorporated business property located in the Netherlands. The same rules would apply in the United States on a reciprocal basis.

To the extent that there would be a Netherlands tax, we would allow credit for it, and in a contrary case the Netherlands would allow credit for the tax in the United States. But for the main, this provision would relieve Americans who are temporarily in the Netherlands of the necessity for paying a Netherlands tax and then crediting it in the United States.

$30,000 Exemption

Moreover, the Netherlands has agreed to allow a $30,000 exemption. With respect to estates of $30,000 or less that would be subject to tax in the Netherlands, there would be no tax. With only one minor exception, this allowance would not be available for the larger estates.

Senator Church. That compares to an exemption under our estate tax law of $60,000?

Mr. Cohen. Yes, but we allow $30,000 under our law with respect to nonresident aliens who have property in the United States.

Senator Church. So the exemption corresponds?

Mr. Cohen. In general, the exemption corresponds. It will correspond as to relief from tax of estates of $30,000 or less.

Allowances and Limitations

Moreover, we enacted the Foreign Investors Tax Act of 1966, which provides a lower schedule of estate taxes with respect to nonresident aliens which is equivalent to the marital deduction which we allow under our law to U.S. citizens and residents for property passing to a widow. The Netherlands in this treaty agreed to make a similar allowance for American citizens resident in the Netherlands who leave property to a surviving spouse.

With respect to nonresidents, each country has agreed to limit tax to real estate and unincorporated business property within the jurisdiction. This means that the Netherlands could not, when the treaty comes into effect, impose a tax on U.S. residents who own stocks or bonds of Netherlands companies, and we would relieve similarly from tax the stocks and bonds of American companies that are owned by residents of the Netherlands.

We would not, however, eliminate——

Senator Church. Does this not result in preferred treatment for nonresidents as compared to our own citizens?

Mr. COHEN. Well, it does so only with respect to persons who are subject to the Netherlands estate tax, which is a very significant and substantial tax. They are not relieved of tax liability. They pay the tax in either one country or another.

Senator CHURCH. But they are relieved of double taxing.

Mr. COHEN. They are relieved of double taxation in that fashion.

Now, I think that this procedure for letting one government or the other in general tax, rather than have both of them tax, is a substantial simplification of the procedures and the work of both governments with respect to these estates. We think that this simplification, together with provisions which follow the OECD model and which bring into play some of the directions that we introduced in our law in the Foreign Investors Tax Act of 1966, represents a significant step forward, and we would hope to use this as a model for our subsequent estate tax treaties.

NEW DEPARTURE IN NETHERLANDS TREATY

Senator CHURCH. This treaty, then, represents an entirely new departure in the approach taken to the estate tax question?

Mr. COHEN. It represents a new departure in the types of solutions to the problems. It deals with substantially the same questions.

Senator CHURCH. Yes.

Mr. COHEN. But we think in a simplified and improved fashion.

Senator CHURCH. Yes. But the technique that is used in dealing with these questions is completely different from previous techniques incorporated in previous treaties with other foreign governments; is that correct?

Mr. COHEN. Yes. And this is consistent with the recommendations of the Organization for Economic Cooperation and Development, which has for the last decade been working to improve the network of income tax and estate tax treaties among the member countries of the organization.

Senator CHURCH. Do you believe this treaty will serve as a model for future treaties in this field?

Mr. COHEN. I think so, Senator. We have at least one under negotiation which, in general, follows this model.

DEPARTURES FROM PAST PRACTICE IN OTHER TREATIES

Senator CHURCH. Are there any other departures from past practice incorporated in any of the other treaties that you are testifying on?

Mr. COHEN. Well, there are some, Senator.

With respect to the treaty with Trinidad and Tobago, we originally had a treaty with Trinidad and Tobago. Our treaty with the United Kingdom was, in accordance with its provisions, permitted extension to overseas possessions. It extended to Trinidad and Tobago while it was a colony of the United Kingdom. Subsequently, I believe in 1962, Trinidad and Tobago became independent, and by supplementary protocols and temporary extensions, this treaty has been continued in operation with some modifications through until this year. But it will expire this year, and it is important, we believe, that this new treaty be approved and come into effect before December 31, 1970.

The principal provision in this treaty that is somewhat different from our previous treaties deals with transfers from persons in one country to corporations organized in another country of patents, technical information, so-called know-how, and ancillary services. It is of importance to the less-developed countries to have made available to them without income tax impediments such know-how and patents and technical information that are important in the development of their businesses and their economy. There have been a number of problems which the Internal Revenue Service has had to deal with which have resulted in the possibility of an income tax to an American citizen or corporation who, on the organization of a corporation abroad, transfers so-called know-how and technical information and patents.

The present tax deferral provisions of the code apply only to transfers of property, and there is some doubt as to the extent to which some of these items such as know-how constitute property rather than services. To clarify this matter in the case of the treaty with Trinidad and Tobago, there is a general provision that provides for deferral of tax on the transfer of these items in exchange for stock of a corporation in the other country, with a provision that the stock received without tax in exchange for these items will bear the same basis as the property transferred to the other company, and a further provision that on the sale or other disposition of the stock at a later time, income tax would then be paid on the same amount of income on which tax would have been due had this transfer been treated as a taxable exchange.

Senator CHURCH. Thank you.

Perhaps only Senator Williams on this committee fully understands what you have just said. It is rather esoteric; he is the fiscal expert.

Mr. COHEN. Yes, sir.

WHY HAVEN'T OTHER COUNTRIES RATIFIED TREATIES?

Senator CHURCH. I want to ask you about the Trinidad Treaty, as well as the other three. It is my understanding that none of the countries to these conventions have ratified them as of now; is that correct?

Mr. COHEN. That is correct; yes, sir.

Senator CHURCH. Can you explain why? Are they waiting for us to ratify first?

Mr. COHEN. The normal procedure, Senator, as I understand it, is for the negotiations to occur and when the negotiators are in agreements, a draft of the treaty is initialed. It is then translated into the several languages that may be involved. It is approved by the necessary agencies in the Administration and then signed, but does not come into effect until there is an exchange of ratifications, and I believe that is the case with respect to each of these treaties. While they have been signed and the President has submitted them to the Senate for its advice and consent, we await the advice and consent of the Senate before exchanging instruments of ratification.

Senator CHURCH. Yes, I understand that. I was wondering why the ratification process, which must take place on their side as well as ours, has not gone forward on their side.

Mr. COHEN. Mr. Gordon tells me that the agreement with the Netherlands has been approved under their system and they are awaiting action by us. I will ask Mr. Gordon to respond.

Mr. GORDON. Frequently in these countries, once the agreement is signed, it amounts to consent to ratification because, under the foreign parliamentary system, ratification is a very simple process. Consequently, there is generally a tendency to wait to see whether the United States will be in position to ratify.

Senator CHURCH. I see.

Mr. COHEN. Mr. Cole would like to comment, particularly with respect to Belgium.

Mr. COLE. Two weeks ago I discussed the parliamentary situation in Finland and Belgium with their representatives. Finland has to submit the treaty to two committees of their one-house legislature. They have submitted it to one committee which has approved it, and I believe this week they are submitting it to the other committee.

With respect to Belgium, they have the papers virtually prepared to submit to their Parliament, and it is just the press of other business which has prevented their Parliament from considering it before this time.

Both countries, Finland and Belgium, are in the process of going forward with their legislative process.

URGENCY CONCERNING TREATIES WITH TRINIDAD AND BELGIUM

Mr. COHEN. Senator, I would like to call attention to the fact, as I mentioned earlier in the case of Trinidad and Belgium, there is considerable importance in exchanging ratifications, if possible, before the end of this year.

In the case of Trinidad, this is especially important.

I think in Belgium it would be possible to work it out retroactively, but it would lead to complications in withholding after January 1. There is not that urgency with respect to the estate tax convention with the Netherlands, but it will go into operation, as I recall it, only with respect to persons dying after the exchange of ratifications and since there is no such treaty at the moment, it would be desirable to bring it into operation as soon as we could.

GOVERNMENTS PREPARED TO EXCHANGE RATIFICATIONS

Senator CHURCH. Just so the record will be clear on this point, I understood the answer to my previous questions to be that none of the other parties to these conventions have yet deposited an instrument of ratification; is that correct?

Mr. COHEN. That is correct, sir.

The Senator asked whether they had deposited the instrument of ratification.

Mr. GORDON. There is really no way of depositing it. There is an exchange.

Senator CHURCH. Exchange.

Mr. GORDON. And you cannot have an exchange unless both parties are prepared to do so.

Senator CHURCH. Is any government now prepared to——

Mr. GORDON. Yes, the Netherlands Government.

Senator CHURCH. The Netherlands Government is prepared at this time to exchange ratifications as soon as we are able to?

Mr. GORDON. That is right, and the Trinidad and Tobago Government would be prepared to do so too.

TAX INCENTIVE PROTOCOL WITH TRINIDAD AND TOBAGO

Senator CHURCH. The exchange of letters which you submitted to the committee indicates that you expect to negotiate a protocol with Trinidad and Tobago which would provide for a tax incentive for U.S. investors in that country. Would you explain in detail what you had in mind?

Mr. COHEN. Yes, Senator.

There has been a significant prior history with respect to treaties with less developed countries or developing countries. Many of them have programs for offering tax incentives to nationals of other countries who would start businesses or invest in the developing countries. The U.S. income tax law, as it exists in the Internal Revenue Code, imposes a tax on the worldwide income, generally speaking, of U.S. citizens and domestic corporations, but allows a credit for taxes paid abroad under certain limitations.

As a result, if a developing country allows a reduction in tax as an incentive to bring foreign business into the country, and the United States imposes a tax on all of the income, the tax is payable by the investor or the businessman in any event to the United States, if it is not paid to the developing country.

These countries then asked us to make in the income tax treaty which we would negotiate with them some provisions so we do not automatically nullify the incentive which they are offering to attract business.

There have been at least two forms of treaty provisions to deal with this subject submitted to the Senate over the last dozen years, and neither of them has been approved by this committee and none of those treaties have been ratified.

One proposal advanced in a treaty and actually signed in a treaty some 12 years ago and in several subsequent treaties would have given a credit for the tax which would have been payable in the foreign country but for the fact that it relieved the company from the tax as an incentive. Objection was raised to that provision in this committee. Only one such treaty was approved and in that case that provision was not ratified.

Subsequently, when we had an investment credit of 7 percent for investments in plant and equipment in the United States, but not for investments in plant and equipment to be used abroad, or located abroad, a treaty was submitted involving a developing country and in which we agreed to allow an American corporation or an American citizen an investment credit for investments in plant and equipment in that developing country. This was not approved by the committee, and I think would no longer be a possible consideration because we have now repealed the investment credit on investments in the United States and we, therefore, would not allow an investment credit in any event with respect to investments abroad.

Now, in the treaty with Trinidad and Tobago, that Government strongly urged us to insert in the treaty some provision that would prevent a nullification, in effect, of the income tax incentives that they

would offer. We said in the light of the history of this provision, and changing considerations in the United States, that we would have to defer the discussion of that provision. We decided to go ahead with the treaty without any special provision in it relating to tax incentives, and to take up that matter further.

I have discussed this with the chairman, Senator Fulbright, and said to him that the Treasury Department has for some months been trying to develop some alternative approaches for dealing with this problem, and that we would like to discuss these with your committee to see if we could develop a policy that we could apply in dealing with this matter in the future.

Senator CHURCH. All right.

POSSIBILITY OF PROTOCOL WITHOUT COMMITTEE APPROVAL

If this treaty were approved by the Senate, would it then be possible for you to attach subsequently a protocol to the treaty which would not have to come back to this committee for approval?

Mr. COHEN. No, sir; we have assured the committee in my statement that any such protocol would be submitted to the Senate and to this committee before it would come into effect, and I suggested to the chairman that it would be desirable for us to review this as a matter of policy before we enter into the further negotiations.

Senator WILLIAMS. Will the Senator yield?

Senator CHURCH. Yes, Senator Williams has a question.

POTENTIAL LOOPHOLES IN TAX INCENTIVE

Senator WILLIAMS. Do I gather that you are seriously negotiating a treaty where companies can get credit for tax deferrals that are granted to them in the other country on the same basis as though they were paying those taxes?

Mr. COHEN. Senator, we are seriously reviewing the matter at this time, and not considering at this point the negotiation of treaties in this regard before we have a review of this as a policy matter within the Administration and also with the committee.

We think it would be better to try to deal with this as a policy matter and decide whether we want some version of that or no version of it, and reach that decision before we have a negotiation with a foreign country.

Senator WILLIAMS. If I may pursue that point, this was brought up once before to the committee and we rejected it on the basis that country A could have a projected tax of 40 percent and then defer that tax. If we allowed them to get the credit, what would there be to prohibit this country A from raising their tax rate to 60 percent and deferring 60 percent? In other words, why not defer all taxes, and you could have a situation where companies would not care how high their tax rates were. In fact, they could encourage foreign countries to make them high and then defer them. They could just manipulate this tax credit.

I think before you explore that too far, you had better watch the potential loopholes in it.

My question would be this: If you would consider that for international taxation, would you consider the same rule applicable here in this country among States, so that the State of Delaware could impose a tax of 30 percent and then forgive the tax and get the credit for that? Would you consider a similar rule here in this country?

I only ask that to point up the Pandora's box that you are opening when you move into that area.

INTERMEDIATE GROUNDS FOR CONSIDERATION

Mr. COHEN. I think we are aware of this, but there are some intermediate grounds that might be worthy of consideration.

For example, Senator, the State of Delaware gave an incentive to the location of a plant there by reducing its income tax or by the use of industrial development bonds which are permitted on plants up to a million dollars. This results in benefits to the industrial company.

The Federal Government does not immediately nullify that by a tax on it. The man retains the benefits. His income is higher, and we get a 48-percent corporate tax on the higher income, but we do not nullify it completely. I just suggest that as one point to be considered.

There is a middle ground possibly between a full tax sparing, as it is called, and a complete nullification, which is the situation at the moment.

Senator WILLIAMS. That is correct.

Mr. COHEN. But we have no position with respect to it at the moment, but we do feel that the matter has been left unresolved and uncertain for so many years that it warrants a further review at this time and no commitment as to what the Administration would propose, but with our seeking the informal advice of the committee before we would proceed.

Senator WILLIAMS. Well, under this present set-up in our State, we do have an income tax on corporations and if the State wishes to exempt some company from the income tax it does not get a credit for tax that has not been paid under existing law and it should not.

Mr. COHEN. That is correct. There is no credit.

Senator WILLIAMS. Sure there is not.

Mr. COHEN. But we in one sense nullify that State tax exemption because, when that taxpayer does not pay a State tax, his taxable income is greater on account of it, and then when we apply our tax to his income we pick up a tax on that increased income. It is not a tax credit, but it is a deduction.

Senator WILLIAMS. That is correct.

Mr. COHEN. So it has some effect, but not a complete effect.

Senator WILLIAMS. That is correct and that is what you are doing internationally now?

Mr. COHEN. Yes, but only in a case where a taxpayer elects to deduct, rather than credit, foreign taxes. If the taxpayer elects to credit foreign taxes, he loses the entire benefit of the foreign incentive at the time of distribution.

Senator WILLIAMS. And my point is that before you change that policy, you had better watch just how far you are opening a Pandora's box.

REJECTION OF PREVIOUS INVESTMENT TAX CREDIT PROPOSAL

You mentioned the investment tax credit, the proposal that was before this committee 3 or 4 years ago in a treaty. Looking back, do you not agree that our committee was wise in rejecting those treaties that would have written into treaty form the so-called investment tax credit, particularly in view of the fact that we have now repealed it in this country? If it had been adopted in a treaty, it would have been the law now so far as international tax is concerned.

Looking back, do you not think our rejection of that was wise?

Mr. COHEN. I think it certainly would have been an undesirable result to have the investment credit applicable to investments in foreign countries and not to investments in the United States. I am not sure whether the treaties that were then proposed would have extended the investment credit abroad if the law were repealed in the United States.

Senator WILLIAMS. As first presented to the committee, it would have. As later presented to the committee—I think it was changed—it would not have and would have followed the existing law.

Mr. COHEN. Well, we would not have considered this proposal as a part of our current review of the matter.

STATE DEPARTMENT ROLE IN NEGOTIATING TAX TREATIES

Senator CASE. Mr. Chairman, may I ask the Senator from Delaware to yield?

The document submitting these treaties to the committee states that the Department of State and the Department of Treasury have cooperated in the negotiations. I believe this is true in the case of each treaty. Has the State Department taken an active role in negotiating the treaties or has it just given pro forma agreement?

In other words, to what extent is this a matter of foreign policy in the political sense as opposed to the economic sense?

Mr. COHEN. Well, I was not in the Treasury at the time that some of these early negotiations started. Some of them go back as far as 1966. I know in general that we cooperate with the State Department both here and in the embassies abroad when we are abroad on the negotiations, but the detailed responsibility for them is in the Treasury Department. They are always reviewed with the State Department and on particular questions that would come up, such as the question earlier about the Continental Shelf, we coordinate with the State Department.

Senator Case, before we enter into negotiations with a foreign country for a tax treaty, we do have discussions with the State Department on broad policy issues and we have their approval to the opening of the negotiations.

As a matter of fact, at times the suggestion and recommendation for the negotiations of a particular treaty will come to us informally from the State Department, and when we are overseas in negotiations, the economic counselor or some representative of the State Department at our Embassy will frequently sit in on the discussions.

I know this has occurred in some recent discussions. But when we get to the technical parts of the tax law, in which we have the problem

of meshing the income tax law in our country with that in one of the foreign countries, they generally defer to our judgment.

Senator CASE. Thank you.

TAX IMPETUS TO UNITED STATES DIRECT INVESTMENT IN TRINIDAD AND TOBAGO

Senator WILLIAMS. Further in line with the questions about giving credit for these tax deferrals, an exchange of correspondence between the Prime Minister of Trinidad and our own State Department has been called to my attention. I quote one paragraph of this exchange:

> My Government recognizes the value to Trinidad and Tobago of increased United States investment in your country and the importance which your Government places on promoting such investment through the tax treaty mechanism. I want, therefore, to assure that my Government is prepared, at an early date, to resume discussions with representatives of Trinidad and Tobago with a view toward reaching agreement on a supplementary protocol that would provide a tax impetus to United States direct investment in Trinidad and Tobago.

What type do you have in mind and how far have you gone toward entering into an agreement? How firm is it?

Mr. COHEN. We have an agreement only to discuss it. We have no agreement with them as to any resolution of the problem and, as I said, Senator, I would very much prefer at this time to try to have a resolution of the policy with respect to this rather than to move ahead with a specific treaty and then bring it before this committee for its approval.

I think that the matter has been discussed and debated so long and conditions have changed so much since it was last discussed that we ought to have a review and reappraisal of the policy that the United States should follow before we would resolve this.

So while we have a commitment to discuss it with the Government of Trinidad, we have no commitment with respect to the resolution of the issue.

Senator WILLIAMS. And you would confer with the committee before you arrived at any major change or decision?

Mr. COHEN. Yes, sir, I would do so.

CHANGES CONCERNING MOTION PICTURE INDUSTRY'S TAX OBLIGATION IN FINLAND

Senator WILLIAMS. What is there in this tax convention with Finland that would change the existing law relating to the motion picture industry and their tax obligation?

Mr. COHEN. A problem with respect to each of these treaties is whether motion picture rentals are deemed to be industrial or commercial profits in which event they are taxed only if the American motion picture company would have a permanent establishment in Finland or the other treaty country.

It is provided in the proposed treaty with Finland that the term "industrial or commercial profits" includes rents or royalties derived from motion picture films, films or tapes of radio or television broadcasting and, hence, under this provision, there will be no tax in Finland as long as the American motion picture company has no permanent

establishment in Finland. I would understand that, generally speaking, they would not have.

The letter of transmittal from the State Department to the President, dated April 15, 1970, which is in the printed pamphlet, says that motion picture royalities are not covered in the existing convention and are, therefore, subject to tax in Finland under the statutory provisions there.

Under the new convention, motion picture royalties are included within the definition of industrial or commercial profits and consequently will be subject to tax only if effectively connected with a permanent establishment in Finland.

Senator WILLIAMS. How will this affect their tax as compared with the existing law? Give us a hypothetical case.

Mr. COHEN. Well, I understand, Senator Williams, that if an American motion picture firm produces a film in the United States and leases it for showing in Finland, and it does not have a sufficient activity in Finland, at least an office and representatives, to be considered to have a permanent establishment in Finland, then after this convention comes into effect there would be no Finnish income tax on the royalties or rentals derived by the American company.

There would, however, be an American tax on the worldwide income. So by relieving the American motion picture firm from Finnish tax in that case, our revenues would be increased because we would not have to allow a credit for a Finnish tax, which we would have to do under existing circumstances. At the present time the Finnish tax authorities assume a net income of 7 percent of gross royalties which it subjects to tax at the ordinary corporate or individual rates.

The nub of it is that in that type of a case where an American company has no permanent establishment in Finland, it would be paying Finnish tax on the rents and royalties now, but they would not pay the tax after the convention would come into effect.

Senator WILLIAMS. To the extent that they did not pay the Finnish tax after the adoption of this convention, their American tax liability would increase proportionately; is that correct?

Mr. COHEN. Their net American tax would increase because they will not be allowed a credit for a Finnish tax since the Finnish tax is not being paid.

Senator WILLIAMS. Yes.

TAX DEFERRAL FOR TECHNICAL ASSISTANCE

I did not get the full import of something you mentioned earlier. We will call them the rollover transactions, where you could trade for and defer the tax, capital gains tax or income tax, until the subsequent sale of the security or whatever may be involved in the transaction. To what treaty were you referring at the time and how would that work?

Mr. COHEN. This is only with respect to the convention with Trinidad and Tobago. Article 7 of this treaty provides, as the title says: "Tax deferral for technical assistance."

Under our present Internal Revenue Code, in section 351, if an individual or corporation transfers property to a newly organized cor-

poration solely in exchange for stock and securities, the taxpayer has no gain or loss recognized on that transfer, and there is, in effect, a deferral of the tax that would be due had the property transferred been sold to a third party. That tax is not collected at that time, but there is a carryover of the basis of the investment in the property, and the cost or other basis which the taxpayer making the transfer has in the property before the transaction would carry over to the stock that he gets in the transaction, and if he later sold the stock he would pay the tax at that time, and not at the time of the transfer.

This involves two problems in this connection.

One is, if there is a transfer to a foreign corporation, it is provided in the law that the prior approval of the Commissioner of Internal Revenue is required. The Commissioner gives his approval if he is satisfied that the transfer is not for the principal purpose of avoiding Federal income tax. If we did not have such a provision, there might be a possibility of people avoiding American tax by transferring property to foreign corporations and having the foreign corporation then make the sale.

Senator WILLIAMS. You are speaking of the existing law?

Mr. COHEN. That is the existing law.

A problem has arisen, however. Over the last 8 or 10 years, there has been a difficult question, as to what is property, because that section 351 is applicable by its terms only to a transfer of property. And you get difficult questions involving transfers of so-called know-how, as to whether know-how is property or whether it really represents, when one transfers know-how or makes know-how available, a transfer of services for which compensation is derived. It has been difficult to resolve these questions in advance.

At times it depends upon the law in the country to which the property is transferred. It is particularly important that the possibility of a tax-free transfer exist in the case of the developing countries that are anxious to obtain the know-how, technical information and the right to use patents. Yet it is in the developing countries where it is most difficult to discover what the law provides.

Thus, we have provided in this treaty in article 7 for a broader rule for the deferral of tax on transfers of patents, inventions, models, designs, secret formulae or processes or similar property rights and information concerning industrial, commercial or scientific knowledge, experience or skill. We have provided that those transfers to a Trinidad corporation in exchange for stock will not give rise to income tax regardless of the present technicalities that might exist under our section 351, but with a reservation that the stock received would continue to have the cost or basis which the taxpayer had for this knowledge and know-how that he transferred, and upon a sale or other disposition of the stock he would pay the tax at that time.

The purpose of this is to get over some of the technical problems that have proved difficult to resolve under our present section 351 while adhering in general to the same principle as existed before.

Senator WILLIAMS. Technical problems will arise because section 351 is not broad enough to cover it; is that not correct?

Mr. COHEN. That is correct.

Senator WILLIAMS. So it is an expansion of existing law?

Mr. COHEN. Yes.

SECTION 351 DEFINITION FOR TAX FREE TRANSFERS

Senator WILLIAMS. So it is not really technical problems. Under existing laws applicable here in this country, how do you treat those same items? Are the same items that will be covered under this treaty allowed to be considered on a tax-free exchange under section 351?

Mr. COHEN. Well, it is difficult to say in some cases, Senator. The distinction is that under our present law in section 351 we would give this deferral if the items transferred constituted "property."

Senator WILLIAMS. I know. But I am asking you, do you define what is property? Do you define these same items under existing law for transfers in this country? Are they defined in the same manner in which they would be defined under this treaty?

I think the answer is no; is it not?

Mr. COHEN. The answer is clearly no in the sense that this provision would be broader and cover items which may not be property, although most items would be considered property.

For example, a patent, I would think, is clearly property under our concept. An invention is probably property. But whether a formula or process or similar property right is property or not has been a very grievous problem.

Senator WILLIAMS. I know it has, but under the existing law, section 351 as it is applied domestically, do any one of those three items qualify for a tax-free stock transfer?

Mr. COHEN. I do not want to evade your question, Senator, but I must answer it that I do not know because it depends in large part, I believe, upon the applicable State law. One of the problems in this area is that when we are dealing domestically we have a pretty good idea of the applicable State law. It may vary from State to State, but we do have in general the common law applicable in the United States. But when we go into the developing countries, a particularly difficult problem is to know what the law is in that country with respect to these items in determining whether it is property or not property.

Senator WILLIAMS. I do not think that the section 351 definition can be determined necessarily by the legislatures of various States.

For example, many patents are for some new product, a secret process, on which the company may have spent $30, $40 or $50 million in developing. Now it may be a failure; it may be a loss or it may be a success, but it does have a tangible value. I do not think under section 351 that it is treated as a tax-free transfer in this country, and I am wondering if you are not broadening the definition of section 351 under this treaty in a manner in which it is not being applied in this country.

APPLICATION OF TREATY LANGUAGE TO SECTION 351

My next question is this: If the Senate approves the treaty as you have it here for Trindad and with the definitions of section 351 transfers broadened would you endorse the application of the same language to section 351 here in this country?

Would you endorse that? That is, that section 351 be broadened nationally to cover all of the same items which are covered under the treaty, and how much would be involved in revenue?

Mr. COHEN. I think—I speak necessarily without knowledge of all of the facts——

Senator WILLIAMS. If you would rather furnish that for the record, I will not press it this morning because I would like to have the Department's position on this broad language which you are recommending. I would like to know approximately how much may be involved and whether or not you would embrace the same extension domestically. If you did, then how much would be involved in that?

Mr. COHEN. Well, Senator, my difficulty is going to be that we cannot really estimate the cost in the United States. In general, I would say that in substantial business transactions, the transaction will not be done if this would produce taxable income upon the receipt of the stock. It is not so much a matter of whether we would get revenue or not. I think the answer is that the transaction would not occur if the receipt of the stock would produce income.

The second problem that we would have is to try to determine the extent to which the resolution of these doubts would be different from what it would be under existing law. I have no difficulty in saying that the policy directions ultimately worked out here should be applicable domestically. But we are dealing here with a Trinidad situation which involves a relatively limited dollar amount in view of the small size of the country. We have a provision in article 7 which provides that "With respect to the United States tax, the provisions of this article shall be subject to such regulations as are prescribed by the Secretary of the Treasury or his delegate to effectuate the provisions of this article and to further define and determine the terms, conditions, and amounts referred to herein." This gives us very broad authority to make sure that this provision is not used for any tax avoidance operations.

But I would be most reluctant to suggest this to the Senate Finance Committee as a provision for domestic operation without considerable additional study.

Senator WILLIAMS. I gathered that you would, and I would have been surprised if you had taken a different position. But I still get back to my basic question.

I want the position of the Department. I would like for you to furnish it at this point in the record, if you would, later, as to your endorsement or rejection of this same policy applicable to domestic industries, and your reasons and the amount involved.

I realize you cannot put your finger on the amount of money now because the tax consequences prohibit it.

Mr. COHEN. Yes.

Senator WILLIAMS. But if you extend this tax-free exchange, it is almost unlimited as to what could be done, and at least I would like to have your estimate, if you care to make an estimate.

What disturbs me is the thought of extending a tax benefit abroad which we are not willing to give to domestic industries and if it is the mere fact that it is a small country and it may be small in amount, it does not make any difference. It is the principle of it. It is right or it is wrong, and I would still like you to furnish this recommendation for the record because I personally have questions in my mind as to the advisability of this step.

Senator CASE. Would the senator yield?

Please go ahead and comment.

Mr. COHEN. I would like to say that for a good many years I practiced law in the tax field and worked particularly in the area of corporate transactions. I found that this problem does not really occur in the domestic area because, except in a most unusual situation, there is no particular advantage in transferring know-how and technical assistance from persons to domestic corporations in a section 351 transaction.

It theoretically is a problem that we have worried about often, but aside from the possibility of thereby converting what would be ordinary income into a capital gain, it has not been a very serious problem. There are some problems in the technicalities of section 351 where it arises, but it has not been a very difficult problem.

The problem has existed in the international area, and it has been difficult for the Internal Revenue Service to deal with this problem in advance rulings in each case. This article would give a broader authority to the Treasury and the Internal Revenue Service by regulations.

I would not like to see the broad authority with respect to domestic transactions, but I think I can answer for the record that I would not object in principle to extending in the domestic area the same provisions that would be here, but I think I would like to work it out in greater detail in the statute. I would not ask the Congress to delegate this much authority to the Treasury in the domestic area.

But in the case of the types of problems that would come up in Trinidad, which would be limited in number, I see no reason not to ask for that authority so that we can gain experience with the provision.

Senator WILLIAMS. I shall look forward to seeing your comments in answer to my question. When you furnish it for the record, I would like you to send a copy of it to my office.

Mr. COHEN. I would be delighted, Senator.

I would like to think a little bit further on it, but I do believe that, in general, I would support this as a general policy with respect to the United States, but I would want to see it in more specific statutory language, and with less delegation of authority to the Treasury.

Senator WILLIAMS. I was not suggesting that it should or should not be approved, but asking for the comments which have been suggested in your answer.

(The information referred to follows:)

THE DEPARTMENT OF THE TREASURY,
Washington, D.C., November 4, 1970.

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

DEAR MR. CHAIRMAN: At the public hearing of the Committee on October 6, 1970, at which the proposed Tax Convention with Trinidad and Tobago was considered, Senator Williams inquired with respect to Article 7, which is entitled "Tax Deferral for Technical Assistance". He asked for information on the revenue loss which might result from Article 7, whether the Treasury would support the extension of a similar provision to domestic transactions and the revenue loss which such an extension might entail.

Article 7 of the proposed convention is closely related to section 351 of the U.S. Internal Revenue Code. Section 351 provides that no gain or loss shall be recognized if property is transfererd to a corporation by one or more persons

solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons owns stock possessing at least 80% of the voting power and at least 80% of the total number of shares. Section 351 further provides that stock or securities issued for services shall not be considered as issued in return for property, although this limitation does not apply if the services are ancillary to a transfer of property.

Where property is transferred to a foreign corporation, section 367 of the Internal Revenue Code provides, however, that section 351 can apply only in those cases where the Internal Revenue Service rules prior to the exchange that such an exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax.

As I indicated at the hearing, in most cases the application of Article 7 of the proposed treaty will produce the same result as sections 351 and 367 of the Internal Revenue Code. However, there are a number of differences which can be listed as follows:

(1) There is no requirement in the proposed convention that the Internal Revenue Service give advance approval of the transaction as provided under section 367.

(2) There is no requirement in the proposed convention that the recipient corporation be at least 80% controlled by the transferor, or the transferor and other transferors, as provided under section 351.

(3) While section 351 applies to the transfer of any type of "property," Article 7 applies to transfers of any:

(*a*) Patent, invention, model, design, secret formula or process, or similar property right;

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

(*c*) Technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which are ancillary and subsidiary to the transfer of the property rights referred to in (*a*) or the information referred to in (*b*).

At the outset, it should be noted that since taxpayers who are well advised normally will not transfer patents, similar rights and information to a corporation in exchange for stock unless the exchange is tax free, we obtain no significant revenue from the limitations resulting from the use of the "property" concept and the other restrictions in section 351. Rather, the effect of these restrictions is to prevent transactions from taking place or to alter the form in which transactions take place. The same is true in connection with transfers to Trinidad and Tobago. Therefore, it is our view that if the treaty were approved with Article 7, the provisions of this article which have the effect of broadening the possibilities for a tax-free exchange would not result in any significant revenue loss, but rather could result in transfers to Trinidad that would not otherwise be made or which would have been made in a different form. Similarly, if the Trinidad treaty rules were made generally applicable there would be no significant revenue loss.

With respect to the advance ruling requirement, section 2(a) of Article 7 gives the Secretary of the Treasury or his delegate the authority to promulgate regulations under Article 7 to "further define and determine the terms, conditions, and amounts referred to herein." The Treasury Department therefore could and would provide that, at least so long as section 367 requires an advance ruling generally on transfers to foreign corporations, such a prerequisite would be applicable under Article 7 of the treaty with Trinidad and Tobago.

With respect to the 80% stock ownership requirement which is contained in present section 351 but which would not be applicable under the proposed treaty, we believe that it is appropriate for the treaty to permit a reduction in this requirement. A treaty for avoidance of double taxation and the prevention of tax avoidance must necessarily result in modification of some of the domestic tax rules in each country in order that those rules may be appropriately meshed in connection with international transactions between their citizens or corporations. Both countries would ordinarily have jurisdiction to tax and the application of section 351 affects not only the transferor stockholder but also the transferee corporation. Thus, when the transferor and the transferee are in two different countries which are negotiating a treaty, it is appropriate to reach some common rule that will govern the tax treatment flowing from the transaction in both countries in order to avoid double taxation or prevent escape from taxes in both countries.

Some foreign countries, particularly developing countries, wish to have a substantial local ownership of stock in the corporation. We thought, therefore, in connection with these negotiations with Trinidad and Tobago, that on a reciprocal basis we could permit reduction in the 80% control requirement, particularly since, by the regulations that would be authorized and by the requirement for a ruling by the Commissioner of Internal Revenue, this reduction in the necessary percentage could not be used for tax avoidance purposes.

We would not be prepared, at least at the present moment, to recommend that the 80% requirement in section 351 be reduced in entirely domestic transactions. In the first place, there is no problem of meshing our own tax laws with those of another country in international transactions or taking account of its desires in a treaty negotiation. In the second place, in the domestic area there would be no requirement for a ruling by the Commissioner, and hence no opportunity to review the tax avoidance potential that might be involved in the transaction. In the third place, while there are reasons to review a number of the present statutory provisions in Subchapter C, we would not be inclined to recommend a change in section 351 without some corresponding changes in other provisions in Subchapter C where no requirement for a Commissioner's ruling exists.

With respect to the differences in the scope of section 351 and Article 7 resulting from the use of the "property" concept in section 351 and the reference to specific items in Article 7, it should be noted that, in a sense, Article 7 is clearly narrower than section 351. For example, Article 7 applies only to the limited types of property rights listed above and does not include, for example, the transfer of machinery, equipment, stock and securities which are all covered by section 351. On the other hand, Article 7 is broader than section 351 to the extent that some of the items listed thereon may not qualify as "property" for purposes of section 351. Considerable difficulty has been experienced in determining the meaning of the term "property" in relation to items such as "know-how" and other types of intangible property. This is particularly true with respect to transfers to developing countries, where concepts of "property" ownership may not be well defined in legislative or judicial law. We believe that, in view of the provision for regulations under this article of the treaty and the requirement of a ruling by the Commissioner, no opportunity for tax avoidance would exist by this expansion of the term "property" in the context of transfers to Trinidad and Tobago corporations. We would not propose to have the Internal Revenue Service approve any transfer of an item under this Article 7 of the treaty to a Trinidad and Tobago corporation in any case in which we would not be prepared to endorse a statutory amendment of section 351 to permit an identical transaction between United States domestic taxpayers. While we would not be prepared to abandon the "property" requirement in section 351 for domestic purposes at this time because there would be no prerequisite of a ruling, as experience is gained with the type of provision which is set forth in Article 7, consideration will be given to developing an amendment to section 351 along such lines.

We have concluded in these circumstances that this Article 7 of the treaty is desirable, particularly because on a bilateral basis it dealt with a special problem of a developing country, tax avoidance could be prevented by the provisions of the regulations and the necessity for the transferor to obtain a ruling of approval by the Commissioner of Internal Revenue, and by the fact that we would anticipate that the requests for rulings under this treaty provision would be few in number.

If the Committee should view the difference in the scope of section 351 and Article 7 as significant and should conclude that it does not at this time want to approve this provision, the Treasury would be willing to accept approval of the proposed convention with a reservation concerning Article 7. We have been in contact with the Trinidad and Tobago authorities on this matter, and they would not object to a reservation with respect to Article 7 if necessary to obtain approval of the proposed treaty. We do believe, however, that it would be preferable to approve Article 7 and observe carefully the experience thereunder.

Finally, notwithstanding our willingness to accept a reservation with respect to Article 7 under the circumstances set forth above, the Treasury believes that provisions similar to Article 7 of the proposed treaty are desirable in the case of tax treaties between the United States and less developed countries. Therefore if the Senate enters a reservation to Article 7, I would hope to have the opportunity at an early date to discuss this matter further with the Committee in the

context of an examination of U.S. treatment of less developed country tax incentives.

Sincerely yours,

EDWIN S. COHEN,
Assistant Secretary.

Senator WILLIAMS. Go ahead, Senator Case.

Senator CASE. Do you have any further comment to make?

FULL TAX PAYMENT UPON SALE OF STOCK SUGGESTED

Mr. COHEN. Well, Mr. Gordon suggested to me, and I thought I made this comment but perhaps I did not, that in the international area, particularly with respect to the developing countries, the developing countries are anxious to obtain the know-how and the technical assistance from the U.S. firms. But the U.S. firms, while willing to render that assistance and make the know-how available, would not do so if there would be prohibitive taxation on the value of a stock which has an uncertain value.

It has seemed to us that in that situation a fair resolution of it is to say no tax will be collected at that time, but upon a sale of the stock that the full tax would be paid then.

Senator CASE. Thank you, Mr. Cohen and Senator Williams.

TRANSFER OF PATENT TO FOREIGN COMPANY

From an expert you are going to a complete neophyte now. What is the transfer of a patent? A patent is an exclusive right in a certain area; is it not? How does an American company transfer a patent to a company in a foreign country?

Mr. COHEN. Well, Senator, we are neophytes together in the patent area certainly. I have had some experience in this. You could have a property right in an invention and then patent it, but I suppose that this would come up, not on transfer of a U.S. patent to a Trinidad corporation, but frequently an invention is patented not only in the United States but in foreign countries. An American might have a U.S. patent and he could have a Trinidad patent or he could have a patent in some other country, and he could transfer all his right, title, and interest under the patent to a Trinidad corporation in exchange for stock of the Trinidad corporation.

Senator CASE. Do you mean he could transfer his U.S. patent?

Mr. COHEN. He could transfer the U.S. patent, but I do not think that that is what is involved here, because that would not seem to be sensible from an income tax standpoint.

More likely the transfer of a patent involves the patent issued by the foreign country. It may cover the same invention that is covered in the United States by a U.S. patent. So I think what is involved here, generally speaking, are patents of foreign countries.

Senator CASE. Well, again, this is difficult to understand.

You mean a U.S. company would transfer to a Trinidad corporation patent rights in a process under the law of the United Kingdom?

Mr. COHEN. But, suppose I, for example, patent a new widget. I patent it in the United States, and I also get a patent in Trinidad.

Senator CASE. But this does not say just Trinidad patents.

Mr. COHEN. No.

Senator CASE. In fact, I do not think it means that; does it?

Mr. COHEN. But it is not limited to that. But then this is an illustration and you asked for an illustration.

Senator CASE. Please continue. I did not mean to interrupt.

Mr. COHEN. Suppose, for example, that you have a patent in Trinidad to make, use and sell, and you want to manufacture in Trinidad. I think the normal practice would be to transfer that Trinidad patent to a Trinidad corporation upon the organization of the company and that would entitle that corporation to manufacture and use and sell.

There is a limitation in Article 7. While it is not limited to a transfer to a corporation of the country that gives the patent, it does make this provision applicable only where there is a transfer for use in connection with a trade or business actively conducted by such corporation in Trinidad.

Senator CASE. In other words, you could not trade in patents?

Mr. COHEN. No.

Senator CASE. A company could not acquire a patent and sell it?

Mr. COHEN. It is only for use in a trade or business actively conducted by this Trinidad corporation transferee in Trinidad.

Senator CASE. But if a company wanted to set up its world operation in Trinidad, it could do so through this mechanism. It could make all the widgits in the world in Trinidad and sell them anywhere they want to.

Mr. COHEN. Yes.

(Mr. Cohen's full statement follows:)

STATEMENT OF HON. EDWIN S. COHEN, ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY

Mr. Chairman and Members of the Committee: this is my first appearance before this Committee since taking office and I welcome the opportunity to discuss with you an estate tax treaty which has been signed with the Government of the Netherlands and three income tax treaties which have been signed with the Governments of Trinidad and Tobago, Finland and Belgium.

I believe that income and estate tax treaties are a very important aspect of our tax program. Tax treaties are important in preventing unjustified double taxation of income or estates and thus removing fiscal barriers to international trade and investment. They are also important in providing for an equitable division between countries of revenues from international transactions and for the prevention of tax evasion and avoidance. We are devoting increasing attention to these problems and are seeking solutions through treaties, legislation and administrative action.

The three income tax conventions pending before this Committee bring up to date and would replace existing income tax conventions with Belgium, Finland and Trinidad and Tobago. The fourth pending convention is an estate tax treaty with the Netherlands which is new both in the sense that we do not now have an estate tax treaty with the Netherlands and in the sense that it represents a new approach to dealing with international estate tax problems.

ESTATE TAX TREATY WITH THE NETHERLANDS

The purposes of the proposed estate tax convention with the Netherlands are the same as those of the twelve other estate tax conventions now in force between the United States and other countries;[1] namely, to minimize the burdens of double taxation at death, to assure an equitable division of revenue between the two Contracting States and to prevent fiscal evasion with respect to taxes on estates and inheritances.

[1] Australia, Canada, Finland, France, Greece, Ireland, Italy, Japan, Norway, the Republic of South Africa, Switzerland, and the United Kingdom.

In accomplishing these purposes, the convention departs from the pattern of our existing estate tax conventions in order—

(a) to take into account problems which employees of international businesses assigned to foreign countries have encountered under previous conventions;

(b) to follow the direction indicated by the U.S. Foreign Investors Tax Act of 1966 (FITA) in assisting our balance of payments by minimizing deterrents to foreign portfolio investment in the United States; and

(c) to conform to the extent practicable with the provisions of the Draft Double Taxation Convention on Estates and Inheritances published in 1966 by the Organization for Economic Cooperation and Development (OECD).

As background, it would be useful if I briefly outlined the United States and Dutch tax systems to indicate the problems which the treaty attempts to solve.

The United States imposes an estate tax which is applied to the estates of decedents who are citizens or residents of the United States and to the estates of other decedents who left property located in the United States. In the case of citizens and residents of the United States, the gross estate which is subject to the estate tax includes worldwide assets. In our Internal Revenue Code double taxation is avoided (assuming the estate of the decedent is not subject to taxation by another country on a worldwide basis) by our allowing a credit for foreign estate or inheritance taxes against that part of the U.S. estate tax which is attributable to property located in a foreign country.

In the case of decedents who were neither U.S. citizens nor residents, only the property with a U.S. situs is included in the gross estate and there is a $30,000 specific exemption which makes our estate tax applicable only to U.S. property in excess of that amount.

An alien in the United States acquires residence for purposes of the estate tax if he is physically present in the United States and has an intention to remain indefinitely. This is really a "domicile" test, but the term "resident" is used in our Internal Revenue Code. The term "domicile" is used in the proposed convention and hereafter in this statement.

The Netherlands imposes a Succession Duty on all property in the estates of domiciliaries, regardless of where the property is located. The Netherlands also levies a transfer tax at death which is, in general, applicable to transfers by non-residents of real property and unincorporated business assets located in the Netherlands.

It should be noted that it is easier for an alien in the Netherlands to acquire domicile [2] for purposes of its Succession Duty than for an alien in the United States to acquire domicile for purposes of the estate tax. While the United States requires both physical presence and an intention to remain here indefinitely, Dutch domicile is equated only with the location of one's principal abode. A rented house or apartment in which an individual lived in the Netherlands with his wife and children would generally be considered to be his principal abode.

The Netherlands law only partially eliminates double taxation in cases where a resident of the Netherlands had property in foreign countries subject to estate or inheritance tax there, since with respect to some types of property, including investments in marketable securities, the Netherlands normally allows the foreign tax only as a deduction in computing the net amount subject to Dutch tax rather than allowing a credit for the foreign tax against the amount of Dutch tax.[3]

Thus, under Dutch law, a U.S. citizen who dies in the Netherlands and who rented or purchased a house or apartment is likely to be treated as a domiciliary for Dutch estate tax purposes. All of his assets would therefore be subject to the Dutch Succession Duty. Since he is a U.S. citizen all of his assets would also be subject to the Federal Estate tax. The U.S. would give a credit (subject to the statutory limitations) for the Dutch taxes on assets our law considers to be located in the Netherlands, but this may be of limited benefit because under our law

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[2] This is a translation of the Dutch word "woomplats" which apparently can be translated either as "domicile" or "residence".

[3] The difference between a deduction and credit can be illustrated by assuming that States A and B both impose a 50 percent tax on the same assets with a value of $100,000. If State B allows a credit for the tax of State A the net effect is that the tax of $50,000 is paid to State A; no tax is paid to State B. On the other hand, if State B allows a deduction for the tax, State B imposes a tax of $25,000 by applying its 50 percent rate to the assets net of the tax imposed by State A. The result is a total tax liability of 75 percent rather than of 50 percent as individually imposed by both States A and B.

most of his assets may be regarded as being located in the U.S. or third countries. Moreover, the Netherlands would, for most types of property, only permit a deduction for the U.S. tax. If, for example, such a decedent left an estate of $250,000, consisting primarily of stocks and obligations issued by a U.S. corporations, and bequeathed all of it to his wife, the U.S. tax would be $10,900 and the Dutch tax would be $23,930. The combined tax liability of $34,830 exceeds the tax either country would impose by itself—$10,900 in the case of the United States and $25,612 in the case of the Netherlands.

A similar situation arises where a Dutch citizen and resident invests in U.S. securities the value of which exceeds $30,000 at his death. Again, the U.S. tax would only be partially offset by the deduction allowed under Dutch law.

Our older treaties contained comprehensive situs rules and typically eliminated double taxation by giving the primary right to tax a given type of property to the country of situs. The country of citizenship or domicile had the residual right to tax and then, if a tax was levied, a credit was given for the situs country's tax on property situated within its borders. In certain cases, as where property is situated in a third country, each treaty country gives a partial credit for the tax imposed by the other.

While existing treaties have more or less eliminated double taxation, they have not eliminated the compliance problems of a decedent's survivors, since the basic estate tax laws of both countries have continued to apply. As a consequence of the differing domicile laws a decedent may be considered to have been domiciled in both signatory countries and the problems associated with filing estate tax returns in two countries, such as complying with the valuation procedures of both countries, continue unabated. This has been a source of difficulty and concern to the families of businessmen who die abroad.

The proposed Dutch treaty deals with these problems of double taxation and compliance in the following ways:

1. *Elimination of dual domicile—Seven-out-of-ten-year rule.*—The treaty eliminates all cases of dual domicile by providing a series of tests under which the decedent is treated as being domiciled in only one of the treaty countries. The most important of these tests, which unlike the others is not based on the OECD model, is the seven-out-of-ten year domiciliary rule. This rule is one of the principal innovations of this convention. Under this rule a decedent who is considered by each country as having been domiciled therein at death will generally be deemed to have been domiciled only in the country of which he was a citizen if he had been resident in the other country for less than seven years in the ten-year period ending at his death and did not have the intent to remain there indefinitely.

This provision is largely designed to deal with the problem of estates of employees of multinational corporations who are sent abroad for a limited tour of duty. Under the proposed convention, an employee of a U.S. corporation or its Dutch subsidiary stationed in the Netherlands for less than seven years, without indicating an intent to remain in the Netherlands indefinitely, would not be treated as a domiciliary of the Netherlands for purposes of its inheritance tax. Dutch tax would not apply except to real estate or unincorporated business property located in the Netherlands. Thus, there would be no Dutch tax unless the value of such Dutch property exceeded the exemption provided elsewhere in the treaty. On a reciprocal basis, the same rules would be applicable to a Dutch citizen temporarily in the United States. The seven-year domiciliary rule applies to persons in the other country for professional, educational, training, tourism, or a similar purpose (or in his capacity as the spouse or a dependent member of the family of a person who is in the other country for such a purpose).

2. *Credit where both countries tax on a worldwide basis.*—The provisions determining a single domicile will generally result in only one State taxing on a worldwide basis. However, both will still tax on a worldwide basis when a U.S. citizen either (a) stays in the Netherlands for more than seven years or (b) goes there with the intention to remain indefinitely. In the first case the treaty provides that the U.S. will give a credit for the Dutch tax regardless of the situs of the property of the estate, except that in the case of real estate or unincorporated business property in the U.S., the Netherlands would give a credit. In the second case a credit formula limits the total tax to the greater of the two taxes and provides for a division thereof between the two countries.

3. *Limiting taxation of residents of the other country to local real estate and unincorporated business assets.*—To deal with the case of the Dutch resident who invests in U.S. securities, the U.S. agrees to forego its tax on the securities even

if the value of the U.S. assets exceeds the $30,000 U.S. exemption. To accomplish this the treaty provides that each State will only tax the local real estate and unincorporated business property in the estate of domiciliaries of the other State. The U.S. however still reserves the right to tax its citizens on a world-wide basis even if they are Dutch domiciliaries.

In this connection, it should be noted that this treaty provision will involve little revenue loss. The treaty seeks to assure that a Dutch tax will be paid on U.S. securities by retaining the requirements for filing a return in the U.S. This will enable the U.S. to obtain the information on U.S. securities held by Dutch decedents so that such information might be forwarded to the Dutch.

4. *Matching allowances granted by the Netherlands.*—Because the special U.S. tax rate schedule applicable to nonresident aliens that was enacted as part of the FITA is essentially equivalent to our giving Dutch estates the marital deduction, the Dutch have agreed to reciprocate. In Article 10 of the convention, they have agreed to give a 50 percent marital deduction with respect to real property and unincorporated business property going to the spouse of a decedent. This exemption provided under the convention by the Netherlands will apply only as long as the favorable treatment provided for nonresident aliens under FITA continues to apply.

The Dutch have also agreed to give, a "disappearing" $30,000 exemption to the estates of decedents who were U.S. domiciliaries or citizens not domiciled in the Netherlands at death. This corresponds to the $30,000 exemption the United States granted to nonresident alien estates under FITA. The convention exemption will completely relieve from tax an estate of $30,000 or less of a decedent who was not a domiciliary of the Netherlands. It applies to a lesser extent to estates of up to $34,090 and not at all to larger estates, and thus may be said to "disappear" with respect to larger estates.

As in the case of our income tax conventions, the proposed Dutch estate tax convention includes an article on the exchange of information. This provision is primarily designed to assist in the prevention of tax evasion.

The convention would apply to estates of persons dying on or after the date on which instruments of ratification are exchanged and will continue in force unless terminated, subsequent to five years after ratification, by the United States or the Netherlands.

I should like to note the pioneering nature of this convention. It is our first estate tax convention along the lines of the OECD model. It ties together two countries with differing views regarding the primary basis for tax jurisdiction, the United States emphasizing citizenship and domicile and the Netherlands emphasizing residence. It deals with a serious problem of double taxation which has been of great concern, especially to those Americans temporarily living in the Netherlands. We feel that this approach will not only avoid double taxation but make it easier for taxpayers to fulfill their obligations.

This convention will serve as a prototype for our future estate tax negotiations.

We have submitted a technical explanation which discusses the proposed convention article by article.

REVISED INCOME TAX CONVENTIONS WITH TRINIDAD AND TOBAGO, FINLAND, AND BELGIUM

I now turn to the proposed income tax conventions with Trinidad and Tobago, Finland, and Belgium. I would like to emphasize that all three conventions closely follow our recent treaty with France which was approved by the Senate in 1968. These conventions are also along the lines of the OECD income tax model and recent treaties entered into by other countries.

Each of these conventions is a revision of an existing convention. For the most part the changes made are the result of the rethinking of tax treaty concepts and language which has taken place during the years since the original conventions were signed. A major influence on this rethinking process has been the work of the Fiscal Committee on the OECD which published its Draft Double Taxation Convention on Income and Capital in 1963 and which has held continuing discussions since then on the various provisions. Also an important influence is the policy development reflected in the Foreign Investors Tax Act of 1966.

An important example of the modernization of treaty concepts that these conventions embody is the elimination of what has come to be called the "force of attraction" rule which is incorporated in the existing treaties with Finland

and Belgium. Under that rule, if a resident of one State engages in trade or business through a fixed place of business (permanent establishment) in the other State, all of his income from the other States is taxed as profit of the permanent establishment. The limitations on the rate of tax which can be imposed on dividends, interest and royalties or the exemption for interest or royalties and the exemption for capital gains would not be applicable.

Recent treaties, including the three under consideration, provide instead that only income which is "effectively connected" with a permanent establishment will be taxed as business profits without regard to the limitations which the treaty provides for the tax which may be imposed on certain types of income; therefore, dividends, interest and royalty income not attributable to a permanent establishment will be accorded any reduced rate provided for in the treaty and the exemption for capital gains not so attributable could apply.

The basic functions of an income tax treaty are to avoid double taxation, to provide for a fair division of tax revenues between the two States, and to prevent fiscal evasion. To accomplish these purposes, a number of basic rules are set forth in the proposed treaties with Trinidad and Tobago, Finland and Belgium. The rules, which are described in greater detail in the technical explanations that have been submitted for the record, are as follows:

1. *Taxation of business profits.*—In order to give business flexibility to undertake foreign operations in a preliminary or limited fashion without being subject to foreign income taxes, the treaties provide that a resident of one State (including a corporation) is not subject to tax in the other State on industrial or commercial profits unless it has a permanent establishment in that other State. The definition of industrial and commercial profits in the proposed conventions with Finland and Belgium and in our existing convention with France includes motion picture rents and royalties and results in the taxation of motion picture royalties by the State of source only if the income is attributable to a permanent establishment in that State.

In general a permanent establishment is a fixed place of business, but following the OECD model, certain types of fixed places of business (such as purchasing offices) do not constitute permanent establishments and certain activities carried on without a fixed place of business (such as a local dependent agent who concludes contracts) do constitute a permanent establishment.

2. *Air and sea carriers.*—The treaties provide reciprocal exemption for international air and sea carriers.

3. *Double taxation arising from inconsistent treatment.*—The treaties provide a mechanism for avoiding double taxation resulting from different allocations of income and deductions between head office and branch or between related companies in the two countries. This is to be accomplished by consultation between the "competent authorities" of the two States for the purpose of seeking to agree on an allocation. If an agreement is reached, the treaties provide that taxes will be imposed or adjusted to reflect the allocations agreed upon. In addition to problems of allocation, the treaties provide for mutual agreement to resolve differences in source rules and to deal with difficulties or doubts arising in the application of the provisions of the convention.

4. *Credit or exemption to avoid double taxation.*—While the United States and some other countries have provisions in their domestic law to avoid double taxation on income from foreign sources which is subject to foreign tax, it is traditional to agree in income tax conventions to allow a tax credit or exempt such income. Thus, in each of these conventions the U.S. agrees to grant a foreign tax credit for the tax paid to the other country. This obligation is met by the provisions of our domestic law. Trinidad and Tobago similarly agrees to grant a credit. Finland agrees to a credit in certain cases and an exemption in other cases. Belgium agrees to a partial or full exemption in certain cases and a credit in other cases. In the case of both Finland and Belgium, exempt income can be taken into account for purposes of determining the applicable rate of tax.

5. *Taxation of dividends, interest and royalties and exemption of capital gains.*—The treaties contain provisions establishing the maximum rates of tax on direct investment and portfolio dividends, interest and royalties which may be imposed by the State of source. These provisions are for the purpose of both avoiding double taxation and dividing the revenue between the payor's and recipient's country. The treaties (other than the one with Trinidad and Tobago) provide exemption for capital gains for a resident of the other country. The conditions for the exemption differ somewhat in the Finnish and Belgian treaties,

but will generally be met by the ordinary investor. In the case of Trinidad and Tobago, both it and the United States have domestic rules which provide a large measure of exemption for foreigners deriving capital gains and it was thought unnecessary to have a treaty provision.

6. *Exemption for individuals.*—In order to give flexibility to employees and independent persons (such as doctors and lawyers) of the type given to businesses, the treaty similarly provides in general that activities of a temporary or limited nature by a resident of one State in the other State will not result in the resident being subject to income tax in that other State. In the OECD model artists and entertainers do not qualify for these benefits; they are taxable wherever they perform services. Finland agreed not to treat such persons differently, but the Belgian and Trinidad treaties compromise by providing special dollar limits (and in the Belgian case a shorter time period) for such persons if they are not to become subject to tax in the State visited.

7. *Retirement and alimony.*—The treaties deal with the taxation of retirement income and include provisions for the taxation of pensions, annuities and, except in Trinidad, social security payments. Each also contains a provision on alimony.

8. *Students and teachers.*—In order to encourage cultural exchanges of students, trainees and teachers, temporary exemption from host State taxes are provided.

9. *Nondiscrimination.*—The treaties contain a nondiscrimination provision.

10. *Measures against evasion.*—The treaties provide for exchanges of information. While the provisions are standard, the U.S. has in recent months given increased attention to the most effective use of these provisions to prevent tax evasion and avoidance.

Before turning to separate discussion of each of these treaties, I should note that the proposed conventions with Trinidad and Tobago and Belgium specifically include continental shelf areas as part of the respective countries. While a similar provision was proposed to Finland, and while the concept was agreeable to Finland as well as to the United States, we could not agree on a provision in the absence of certain Finnish policy decisions.

I will now review briefly the special features of each of the proposal income tax conventions.

Treaty with Trinidad and Tobago

The proposed treaty with Trinidad and Tobago would replace an abbreviated, interim treaty, which was signed in 1966 and expired on December 31, 1969.

The interim treaty was limited in scope and covered only the withholding tax on dividends and the allowance of a foreign tax credit. The proposed treaty is comprehensive, covering the full range of commercial and financial transactions between the United States and Trinidad and Tobago.

1. Tax Deferral for Technical Assistance

To facilitate the flow of technical assistance and know-how to Trinidad and Tobago, we have included, as Article 7 of the proposed treaty, a provision for the deferral of the tax in both countries where stock is received in exchange for patents, technical assistance, know-how and ancillary services. When the stock is disposed of, tax is imposed.

While a similar result can be achieved under section 367 and other provisions of the U.S. Internal Revenue Code, the treaty provision is somewhat broader and applies to taxes of both countries. Absent this provision, the taxes which would be imposed would often act as a barrier to such technical assistance since the transaction does not give rise to the liquid assets necessary to pay the tax.

We consider this type of provision appropriate to treaties with developing countries.

2. Taxation of Investment Income

Under the interim treaty, the withholding tax rate on dividends was limited, on a reciprocal basis, to 25 percent, except that in the case of direct investment dividends where the recipient corporation owned 10 percent or more of the voting stock of the paying corporation, the rate was limited to 5 percent.

Under the proposed treaty Trinidad will reduce its rates of withholding tax on dividends from the statutory level of 30 percent to 25 percent, except that direct investment dividends will be taxed at 10 percent. There is to be no reduction in the U.S. statutory withholding rate of 30 percent.

The proposed convention provides for the reciprocal exemption of interest paid to the government of a Contracting State or its wholly owned instrumentalities. Interest derived from sources in Trinidad and Tobago by a resident of the United States which is a bank or other financial institution not having a permanent establishment in Trinidad and Tobago will be subject to Trinidad withholding at a reduced rate of 15 percent. United States tax in the reciprocal case will be levied at the full 30 percent rate.

Withholding rates on royalties, under the proposed treaty, are to be reduced from the statutory level of 30 percent in both countries to 15 percent.

While artistic royalties are generally exempt under this provision, at the insistence of Trinidad and Tobago royalties are defined to exclude motion picture royalties. Neither are such royalties included in the definition of industrial and commercial profits as in the case of Finland and Belgium. As a result, payments from motion pictures will continue to be taxed under the respective laws of the two countries. In the case of Trinidad, tax will presumably continue to be imposed on the basis of a 1956 agreement with the motion picture distributors, under which the distributors are taxed on the portion of their worldwide net income allocable to Trinidad and Tobago.

3. Effective Date

In Article 28, Trinidad and Tobago has agreed to put into effect the reduced rate of tax on dividends as of January 1, 1970. This unilateral reduction of the withholding rate will terminate on December 31, 1970, unless instruments of ratification are exchanged by that date. Therefore, Senate action in time to permit an exchange of instruments or ratification this year is most important. If this is done there will be no hiatus in treaty coverage as it will have effect for taxable years beginning on or after January 1, 1970.

4. Investment Incentive

The Government of Trinidad and Tobago was most eager, throughout the negotiations, to have included in the proposed treaty a provision that would preserve for U.S. investment in Trinidad and Tobago the effect of a tax incentive program provided under their law. In a view shared by most developing countries, they feel that such tax incentive can be an important factor in the economic development of the developing country, and that its preservation in a tax treaty is an appropriate quid pro quo for the revenue loss which a standard type treaty imposes on the developing country. In order to expedite ratification of the new treaty, Trinidad and Tobago nevertheless agreed to a treaty without such an incentive. It was agreed, however, through an exchange of notes which I have submitted to the Committee for publication in the record of these hearings, that further discussions would be held between the two governments in an effort to agree on some form of supplementary protocol that would provide a tax impetus to U.S. direct investment in Trinidad and Tobago. Such a protocol would, of course, be submitted to the Senate for its advice and consent.

Treaty with Finland

The convention with Finland was signed on March 6, 1970, and replaces our earlier treaty signed in 1952.

1. Taxes Covered

The existing treaty limits the coverage of Finnish taxes to the national income tax. The proposed treaty expands this coverage to include the communal tax, the sailors tax and the capital tax.

As the United States does not have a separate net wealth tax, the new article reciprocally exempting nonbusiness property, other than real property, of a resident of one State from the capital tax of the other State, represents a unilateral concession by Finland.

2. Investment Income

The proposed convention eases the requirements necessary to obtain the reduced treaty rates on direct investment dividends. The existing treaty provides for a maximum rate of 5 percent of intercorporate dividends if the parent corporation owns at least 95 percent of the stock of the paying corporation. The proposed convention maintains the 5 percent rate and lowers the stock ownership requirements from 95 percent to 10 percent.

The proposed convention limits the rate of tax on other dividends to 15 percent which is the Finnish statutory withholding rate.

The exemption of interest in the country of source is carried over to the new treaty from the present treaty.

The proposed convention carries over the provision in the existing treaty exempting royalties in the State of source. However, it also extends the exemption by broadening the definition of royalties significantly beyond the copyright royalties covered by the existing convention to include such royalties as patent, secret-process and trademark royalties.

3. Income of Finnish Trainees

There is a new provision in Article 23, not included in any previous U.S. convention, which provides that an individual who is a resident of one Contracting State and is present as a teacher, student, or trainee in the other State and qualifies for exemption under the teacher or student and trainee article of the treaty shall be allowed by his State of residence to deduct foreign travel and living expenses. Such expenses are deemed to be at least 30 percent of the income exempted in the State visited.

Although the provision is written reciprocally it has an impact only on Finnish tax. There are joint U.S.-Finnish programs, privately administered, to encourage young Finnish trainees to come to the United States for periods of six months to a year to work in U.S. industry. Under Finnish law the income they earn here continues to be subject to the steeply progressive Finnish income tax but no deduction is given for their travel and living expenses. Their expenses are higher as participants in these programs than they would be if they remained in Finland, but their Finnish tax is not reduced to reflect this. This result has discouraged Finns from participating in these programs and is corrected by the treaty provisions.

Treaty with Belgium

The convention with Belgium was originally signed in 1948. It has been subsequently amended, most recently in 1965 in connection with major amendments in Belgian law in a Protocol which expires as of December 31 of this year. The Protocol was deliberately limited in duration to assure that the convention would receive a prompt and thorough review which both sides recognized to be desirable.

1. Branch Profits: Statutory Discrimination Eliminated

Belgian tax law treats branches of foreign corporations less favorably than Belgian corporations. Foreign branches are taxed at the highest statutory rate which applies to undistributed profits of domestic corporations, presently 40.6 percent. Recognizing that this treatment is inconsistent with the treaty principle of nondiscrimination, Belgium has since 1968 been applying its lower rate (37.7 percent) for distributed profits to the profits of Belgian branches of U.S. corporations which can be assumed to have been distributed. In the new treaty this practice is confirmed. Thus, if a U.S. corporation with a Belgian branch distributes one-half of its total profits, the Belgian branch will be assumed to have also distributed one-half of its profits on which it will pay the lower rate.

2. Taxation of Investment Income

The statutory Belgian withholding rate on dividends paid to nonresidents is 20 percent. The new United States-Belgian treaty retains the existing treaty maximum of 15 percent by either State on dividends paid to residents of the other State. Because the Belgian corporate tax is relatively low (37.7 percent on distributed profits) Belgium is not willing to give up additional revenue by reducing its withholding rate on direct investment dividends below 15 percent. No Belgian treaty authorizes a lower rate for direct investment of dividends.

The new convention maintains for the general case the 15 percent limit on interest paid to a resident of the other State found in the existing convention, but introduces exemption in selected cases. Under the new treaty, generally, there will be no tax at source on interest: (a) paid to governments and their instrumentalities, (b) arising from commercial credit, (c) paid between banks and (d) paid on bank deposits.

With respect to royalties, it was agreed to retain exemption at source as provided for in the existing convention.

3. Effective Date

The convention will enter into force one month after the exchange of instruments of ratification and will have effect with respect to income of calendar or taxable years beginning on or after January 1, 1971.

In conclusion, Mr. Chairman, I would strongly urge, on behalf of the Administration, that the Senate, as promptly as possible, give its advice and consent to the ratification of these four conventions.

Senator CASE. We have a rollcall vote, gentlemen.

FURTHER HEARINGS

I would like to return if the Senator would like to. Mr. Woodworth has not yet commented on these treaties and I think it would be helpful to have his views. Should we do it today or some other time?

Well, it seems that the consensus, among Senator Williams and the staff, is that it would be best to ask you to come back another time, at a time convenient to us. Perhaps we could have an informal discussion with Mr. Cohen and Mr. Woodworth in executive session, and then a decision could be made as to whether we would want to proceed further in public hearings.

Mr. COHEN. Very good, Senator.

Senator CASE. Thank you.

We are adjourned.

(Whereupon, at 12 noon, the committee adjourned, subject to the call of the Chair.)

TAX CONVENTIONS WITH BELGIUM, FINLAND, TRINIDAD AND TOBAGO, AND THE NETHERLANDS

THURSDAY, NOVEMBER 19, 1970

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

The committee met, pursuant to notice, at 10:05 a.m., in room S-116, the Capitol Building, Senator J. W. Fulbright (chairman) presiding.

Present: Senators Fulbright, Sparkman, Church, Symington, McGee, Aiken, and Javits.

Also present: Edwin S. Cohen, Assistant Secretary (tax policy), Department of the Treasury.

The CHAIRMAN. The committee will come to order.

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The CHAIRMAN. We will now hear Mr. Woodworth, who is the chief of staff of the Joint Committee on Internal Revenue Taxation, on several conventions.

With which do you wish to start, the Tax Convention with Belgium?

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

Mr. WOODWORTH. I thought, if it would meet with your approval, that generally I would discuss them jointly.

The CHAIRMAN. Do you have a prepared statement?

Mr. WOODWORTH. I have a statement, but I thought that I would not read all of it.

The CHAIRMAN. All right. We will put it all in the record and you give us the essence of it.

(The full statement of Mr. Woodworth follows:)

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

As requested by the Foreign Relations Committee, the staff of the Joint Committee on Internal Revenue Taxation has prepared an analysis of the four tax treaties being considered by the committee which I will submit for the record. This morning I would like to limit my comments to what I believe to be the highlights of these treaties.

The three income tax treaties before the committee, with the exceptions which I will point out in just a few moments, follow the general format of tax treaties in the past.

The existing tax convention with Belgium was signed in 1948 and modified by supplementary conventions in 1952 and 1957 and by a protocol in 1965. The proposed convention replaces these conventions and protocol.

The present income tax convention with Finland was signed in 1952 and would be replaced by the proposed convention.

The existing tax convention with Trinidad and Tobago was signed in 1966 but ceased to be effective at the end of 1969. It was a treaty of limited scope and had been entered into pending development of a more comprehensive income tax convention.

The treaties with Belgium and Finland are both in large part an effort toward modernization and standardization of international tax treaties. They also reflect the changes which have been made in the U.S. tax laws in recent years, particularly by the Foreign Investors Tax Act of 1966. Probably the principal change made in this respect is the adoption of the "effectively connected" concept in place of the so-called "force of attraction" doctrine. Under the effectively connected concept, a resident of one country who has an investment in the other country will be entitled to the reduced rates of or exemptions from tax provided by the treaty for investment income even though he has a permanent establishment in the source country, so long as the income is not effectively connected with the permanent establishment. This concept may be found in all three of these treaties.

In the case of the Belgian and Trinidad and Tobago treaties, the terms United States and Belgium or Trinidad and Tobago are defined as including their continental shelves insofar as income arising from exploration and exploitation of natural resources on the continental shelf is concerned. This is consistent with a similar provision added to the tax laws by the Tax Reform Act of 1969.

The Trinidad and Tobago treaty differs from the usual conventions in two significant respects. These arise from the fact that most of our treaties are with developed countries, while Trinidad and Tobago falls into the category of a developing country. First, the Trinidad and Tobago treaty provides for the deferral of both countries' taxes which would otherwise be imposed on the transfer of technical assistance (such as patents, designs, know-how, and related services) by a U.S. corporation to a Trinidad and Tobago corporation in return for stock of the latter. This is designed to induce the flow of know-how and related services to Trinidad and Tobago.

There was a similar provision in the proposed treaties with Thailand and Israel, treaties on which this committee has not acted. The treatment provided under this provision differs in three respects from the treatment otherwise applicable under present law. First, it provides for the tax-free transfer of this technical assistance whether or not it is classified as property under existing law. Second, under present law, property may not be contributed on a tax-free basis under section 351 to a corporation except where the transferor has at least 80 percent control of the transferee. Under this treaty, transfers by U.S. corporations to Trinidad and Tobago corporations would not have to meet this 80 percent test in order to be tax free. Third, advance rulings under section 367 would not have to be obtained on transfers from U.S. corporations to Trinidad and Tobago corporations in order to assure the tax-free status of the transfer (although some sort of ruling or notification procedure might be required under the treaty).

In the absence of this treaty provision, the transfer of technical assistance which was not considered property would be taxable, regardless of the transferor's percentage of ownership of the transferee, and would result in ordinary income. If the technical assistance transferred were classified as property and the transfer was taxable because the transferor had less than 80 percent control of the transferee, the transaction generally would result in the realization of a capital gain except where the property transferred was a patent, invention, model, design, secret formula or process, or similar property and the transferor had more than 50 percent control of the transferee. In this case, the transaction would result in ordinary income. Since the treaty provision in question is a tax deferral provision, it does not affect the character of income arising on a transfer of technical assistance, but rather defers taxation of the income until the stock received in the transfer is disposed of.

The second principal difference in the Trinidad and Tobago treaty lies in the fact that while Trinidad and Tobago makes a reduction in its withholding taxes on dividends and interest which flow from that country to the United States, the United States withholding taxes on this type of income are not reduced. The intent of this is to encourage the outflow of capital to Trinidad and Tobago but not from that country to the United States. The Trinidad and Tobago withholding tax on intercorporate dividends (where the recipient has a 10 percent ownership interest) is reduced from 25 percent to 10 percent and the Trinidad and Tobago withholding tax on interest is reduced from 30 per-

cent to 15 percent where the recipient is a financial institution not having a permanent establishment in Trinidad and Tobago.

Still one more point of difference between these three income tax treaties and prior treaties is that all three of the treaties provide that the countries involved may, under a mutual agreement procedure, establish common meanings for undefined terms used in the proposed conventions. This should enable the countries involved to work out their differences arising from variations in the way terms are used.

Let me turn now to the treatment of dividends, interest and royalties under the three treaties. Under the Belgian treaty, the rate of source country tax on dividends will continue as in the past to be limited to 15 percent. In addition, dividends paid by a U.S. corporation to a U.S. citizen or resident are to be exempt from Belgian tax even though received in Belgium. Presently they are subject to a 20 percent tax.

In the treaty with Finland, the withholding tax on intercorporate dividends has been limited to 5 percent in the past where there was a 95 percent ownership interest. Under the proposed convention, this is to be applicable where there is a 10 percent or larger interest (in the absence of a treaty, dividends would be taxed by the United States at a 30 percent rate and by Finland at a 15 percent rate). As I have already indicated, in the case of Trinidad and Tobago, the Trinidad and Tobago withholding tax on dividends is to be reduced from 25 percent to 10 percent where there is a 10 percent ownership interest. The same is also true for the branch profits tax imposed by Trinidad and Tobago.

Let me turn now to interest. Under the Belgian treaty, the present generally applicable 15 percent withholding rate on interest is continued, but an exemption is to be available under the proposed convention where the interest is received by the government of one of the countries, is interest on commercial credit arising from sales between residents of the two countries or is interest on bank deposits or interbank loans.

In the case of the Finnish treaty, the present exemption for interest is continued.

Under the treaty with Trinidad and Tobago, the withholding tax on interest is reduced from 30 percent to 15 percent where the recipient is a financial institution not having a permanent establishment in Trinidad and Tobago.

In the case of royalties, the Belgian treaty continues the present exemption from source country withholding tax in the case of nonmineral royalties and in addition provides that these royalties are to be considered as derived from sources within the country of residence of the payor. The normal rule under our tax laws is that this type of income has its source in the country in which the property right is used.

The present exemption from source country tax for artistic royalties under the Finnish treaty is extended to cover industrial and commercial royalties. In the absence of the convention these royalties would be taxed at 30 percent by the United States and at the regular rates by Finland.

Under the treaty with Trinidad and Tobago, artistic royalties will be exempt from source country taxation and industrial and scientific royalties will be subject to a 15 percent rate of tax. In the absence of a treaty, these royalties would be taxed by both the United States and Trinidad and Tobago at a 30 percent rate.

Let me turn now to the tax treatment of capital gains. In the Belgian treaty, the reciprocal exemption already applying to income from shipping and air transportation is extended to gains arising from the sale of the ships or aircraft. In addition, an exemption from source country tax is also provided for capital gains (other than on real property) which are not effectively connected with a source country permanent establishment (or fixed base). Nonbusiness capital gains of an individual are not taxed unless the individual is present in the source country for 183 days or more during the year.

Substantially the same rules apply under the Finnish treaty.

Finally, I should probably also call your attention to some of the rules relating to foreign tax credits under the proposed income tax treaties. First, in the case of the Belgian treaty, the foreign tax credit limitation is not formulated in terms of a specific type of limitation. Our other income tax treaties normally have imposed a per country limitation on the foreign tax credit. The limitation under the convention will be whatever limitation is generally applicable under the Internal Revenue Code. Also under the Belgian treaty, business profits and other income which Belgium may tax under the convention are treated as from sources within Belgium even though the United States tax laws may treat them

as from sources outside Belgium. This, of course, is significant in determining the amount of foreign taxes eligible for the credit. A similar rule may also be found in the treaties with Finland and Trinidad and Tobago.

The estate tax treaty with the Netherlands differs in significance from the income tax treaties in that it establishes an entirely new pattern for estate tax conventions. The United States has 12 estate tax treaties, the most recent of which is the 1962 Canadian treaty.

The proposed convention has as its objective the same goal as the other estate tax treaties—lessening double taxation at death and the prevention of tax evasion.

This treaty, however, sets a new pattern in effecting these results. This is primarily because it is felt that the past treaties have not successfully dealt with the situations where employees of private businesses die while on a foreign assignment that is basically of a temporary nature.

Our existing estate tax conventions give primary jurisdiction to the country where the property involved has a situs. This is accomplished by both the country of domicile and the country of situs imposing an estate tax with respect to the same property, but by the country of domicile allowing a tax credit for the tax paid with respect to this property in the country of situs. The principal difficulty with this approach has been that where an employee of a corporation is abroad for a period of time both the country of citizenship and the country where he is employed considers they are the country of domicile, and thus both would tax his property on a worldwide basis. Tax conventions the United States has entered into in the past have dealt with this problem by a rule which in these cases splits the tax between the two countries. However, under this approach, the total tax could turn out to be more than the tax that would have been imposed by the United States alone.

The Dutch Treaty, which may very well be a precedent for other treaties, generally approaches this problem in an entirely different manner. First, it gives primary jurisdiction to the country where the property is located, only in the case of real property and business assets which are effectively connnected with a permanent establishment.

Second, where both countries would tax on a worldwide basis, it distinguishes between the country of citizenship and the country of domicile by providing generally that where a citizen was in the other country for not more than 7 out of the 10 years before death and did not have a clear intent to remain there indefinitely, the country in which he was located will not impose an estate tax in his case except to the extent of the real property and business property I have already mentioned, and even that generally will be imposed at the lower rates applicable to nonresident aliens and in the case of U.S. citizens in the Netherlands, subject to a 50 percent marital deduction and an exemption from tax of small estates ($30,000 or less). In this case, only the country of citizenship would impose tax on the worldwide estate of the individual involved and allow a credit only for the taxes imposed on this real or business property.

Third, on the other hand, where the individual involved is domiciled in the other country for more than 7 years, then both the country of citizenship and country of domicile would impose their taxes on a worldwide basis. However, in this case, the country of citizenship would relinquish its primary jurisdiction by allowing a foreign tax credit for the tax imposed by the country of domicile.

It is contemplated that the basic pattern of taxation I have described above will cover the large majority of cases. The proposed treaty, however, also contains a series of rules to deal with other situations, such as where a citizen of one country is domiciled in the other country for less than 7 years, but intends to remain there permanently.

Mr. WOODWORTH. We also have prepared a detailed analysis of the four pending treaties, as requested by the Foreign Relations Committee, which we have submitted for the record.

The CHAIRMAN. Yes.

(The information referred to appears on pp. 119–177.)

INCOME TAX TREATIES

Mr. WOODWORTH. The three income tax treaties, with the exceptions that I will point out to you, follow the usual format of past income tax treaties.

The one with Belgium replaces the existing treaty which was signed in 1948, and modified by supplementary conventions in 1952 and 1957, and a protocol in 1965.

The existing treaty with Finland—the one that is being replaced—was signed in 1952.

The existing treaty with Trinidad and Tobago applied during the period 1966 through 1969, and expired at the end of that time, but it was of very limited scope.

The Belgian and Finnish treaties, for the most part, are simply modernizations of the existing treaties. The principal change is that they take into account the changes made in the U.S. tax laws by the Foreign Investors Tax Act of 1966.

The concept that was included in that legislation, which is of most general application, is the so-called "effectively connected" doctrine which replaced the so-called "force of attraction" doctrine. By this we mean that investment income of a nonresident alien who is carrying on a business in the United States won't be subject to the regular tax rates in the United States unless the income is effectively connected to a permanent establishment here. The fact that they have a permanent establishment here, if the income is not effectively connected, won't bring that result about. In that case, it would still be treated as nonbusiness investment income of the nonresident alien which is eligible for the treaty's reduced rates of, or exemptions from, tax for investment income.

Now, let me go, if I may, to the significant differences in the three treaties.

OBJECTIVE OF INCOME TAX TREATIES

The CHAIRMAN. May I ask, as a general proposition, are these treaties designed to encourage American investment abroad? Is that their objective?

Mr. WOODWORTH. I think that has been a factor in the past. I think, however, that these treaties also are designed simply to aid the two countries, at least in part, in better working out the taxation of their residents and businesses and to increasing equity so as to prevent double taxation. But I would certainly have to agree with you, in the past encouragement of investment has been a factor. I do not think that in these three treaties this is a very important factor, however, except in one respect which I will get to in just a moment.

The CHAIRMAN. I know there was a time when the so-called dollar gap existed, when it was our declared policy to encourage private investment abroad.

Mr. WOODWORTH. Yes.

The CHAIRMAN. I wondered if this persists. I am not sure that our condition now would warrant it, whereas it might well have warranted it in 1952 or 1953 or 1954, and it may have been a sensible policy. I am not at all sure it still is in view of our difficulties here. I was referring to that.

RECIPROCAL INVESTMENT IN UNITED STATES

Senator AIKEN. I would like to ask a question. Mr. Manfull told us that last year something over a billion dollars of American investment took place in Belgium. What was the Belgian investment in the United States during the same period?

Mr. WOODWORTH. I could not tell you, I am sorry. I could probably get you that information. I would assume it was a very small fraction of that amount.

Senator AIKEN. Very little probably, possibly the international corporations.

Mr. WOODWORTH. Yes, I would think that would be the main area. I am sure this information is available, but I do not have it at hand.

Senator AIKEN. I believe Belgium is very anxious to become a producer of enriched uranium for the world's nuclear powerplants. They would like all our processes given to them, not only to Belgium alone, but to other countries in Western Europe.

I was wondering if there was any reciprocal investment from that area. I am not thinking only of Belgium but of other countries, too.

Mr. WOODWORTH. I do not believe that any of these countries have really significant investments in the United States.

Senator AIKEN. Yes.

Mr. WOODWORTH. Belgium probably more than any of the others, except, of course, the Netherlands—they have some significant investments here by international corporations.

Senator AIKEN. There is hardly any country more prosperous than Belgium at this point; is there?

Mr. WOODWORTH. I know they are doing very well.

Senator AIKEN. They are doing all right.

The CHAIRMAN. Ever since they rid themselves of the Congo, they have done much better; have they not?

Mr. WOODWORTH. I imagine they have retained their investments but not——

The CHAIRMAN. They do not pay the bills.

Mr. WOODWORTH. That is right, and that makes the difference.

PURPOSES OF INCOME TAX TREATIES

Trying to be responsive to your question, Senator Fulbright, it seems to me that one of the purposes of the treaties, and this could encourage investment abroad, is to lessen the overall tax burdens on dividend, interest, and royalty payments from investments located in these countries.

I do not believe, however, that that serves only the purpose of encouraging investments there. It also serves the purpose of encouraging the payment of dividends, interest, and royalties back to the United States because it lessens the double taxation of that income, so that I have a little trouble in saying which is the principal purpose. I think that the emphasis of the tax treaties in recent years has been on this latter aspect.

Insofar as the significant points in these three treaties are concerned, one of the differences is that the Belgium treaty and the Trinidad and the Tobago treaty recognize the Continental Shelf as being a part of the United States, on the one hand, and part of Belgium or Trinidad and Tobago, on the other hand, for the purpose of taxing income from natural resource exploration on the Continental Shelf.

A similar provision was in the Tax Reform Act of 1969, so in that sense these treaties conform to the action that Congress took.

The CHAIRMAN. Out to what depth?

Mr. WOODWORTH. I do not—I think it is what they call the——

The CHAIRMAN. Does it go beyond a certain depth?

Mr. WOODWORTH. Mr. Bedell points out to me that under the treaty it is the seabed and subsoil of the adjacent submarine areas beyond the territorial sea, over which Belgium exercises sovereign rights in accordance with international law. That is the language actually used in the treaty.

The CHAIRMAN. There is not any international law that is very clear about that; is there? I thought maybe they were attempting to define what the shelf is. The shelf itself is still a rather indefinite concept.

Mr. WOODWORTH. That is true and to whatever extent it is indefinite it remains indefinite under the treaties.

The CHAIRMAN. It remains indefinite. I see.

Mr. WOODWORTH. Insofar as the treaty is concerned.

The CHAIRMAN. I thought it was unusual to undertake to do this in a tax treaty.

Mr. WOODWORTH. That is why I mentioned it. This is the first time, to the best of my knowledge, that this has been done in a treaty.

The CHAIRMAN. All right.

Mr. WOODWORTH. I think it is based on the fact that the United States took similar action in the Tax Reform Act of 1969, and it does more or less simply correspond with that.

Senator AIKEN. In the case of Trinidad and Tobago we leave it to them to determine unilaterally the extent of the Continental Shelf; don't we?

Mr. WOODWORTH. The treaty language in that respect is that it has to be consistent with Trinidad and Tobago legislation and international law, so that it is not entirely left to the question of local determination.

Senator AIKEN. What international law? How does it fit in with Venezuela's shelf? I suppose Venezuela has a shelf that far north. You can look from Trinidad and see Venezuela over the other side.

Mr. WOODWORTH. I cannot pretend that I am an authority on what constitutes a Continental Shelf. I have general ideas about it, but I am sure they are not as extensive as your knowledge of it.

Senator AIKEN. I am sure you did not write any of these conventions.

Mr. WOODWORTH. You are right about that. But I think the general policy here is not to try to define the Continental Shelf at all, but simply to recognize the Continental Shelf for purposes of the taxation of natural resources income with respect to the two countries.

In the past it was unclear as to whether income from offshore exploration was income from sources inside the United States or not, and

vice versa, and this provision simply attempts to lay that kind of an issue to rest.

The CHAIRMAN. It is not a very radical departure.

Mr. WOODWORTH. No, and it is not a very important aspect of the treaties.

TAX DEFERRAL ON TRANSFERS OF TECHNICAL ASSISTANCE

The second principal difference is in the Trinidad and Tobago treaty, and this is due to the fact that Trinidad and Tobago is still classified, as you know, as a developing country rather than a developed country. There is a feature in this treaty which provides tax deferral on transfers of technical assistance. What this has reference to is when a U.S. company has a corporation down there, often a subsidiary, and it transfers patents, copyrights, secret processes, know-how, and things like that. The question in this case is whether that transfer to the corporation represents a taxable transaction or not.

The CHAIRMAN. Transfer from the parent here?

Mr. WOODWORTH. Yes, to the subsidiary.

The CHAIRMAN. How would it be taxable? Give us a simple illustration.

Mr. WOODWORTH. All right.

If you have a patent which you are contributing to the corporation in exchange for its stock, ordinarily that would be considered a taxable transaction. The result is that gain would be recognized to the parent generally to the extent of the excess of the value of the patent over the cost of the patent to the parent. I am referring only to the patent rights that are being transferred.

I would like to go into this particular feature with you a bit, if I could. There are some fairly detailed rules which presently apply.

First of all, under present law generally what would happen here is if this were held not to be property—that could be true of technical know-how, for example, which might not be considered property—the transfer in exchange for stock, or even without the stock being received if it were a hundred percent owned subsidiary, would result in ordinary income being recognized with respect to that property.

Now, under this treaty that will not occur. It would be a tax-free transaction and no tax would be imposed until such time as the stock was disposed of. That is one difference from the present law.

The CHAIRMAN. Give a concrete example. Some of our oil companies are big operators down there; are they not?

If one of these companies has a subsidiary down there and transfers to it all the know-how and the patents for a plant, would this be the sort of case of which you are thinking?

Mr. WOODWORTH. Yes, it could be if the subsidiary is a Trinidad and Tobago corporation.

The CHAIRMAN. And the effect again is to encourage them to transfer their patents down there.

Mr. WOODWORTH. That is correct.

The CHAIRMAN. It is an encouragement to investment abroad.

Mr. WOODWORTH. This is part of the general concept the Administration has asked for in the past insofar as encouraging investment in developing countries is concerned.

It is not a very big item, but, knowing the interest of the Foreign Relations Committee in this area, I wanted to be sure that you were aware of this particular provision.

The CHAIRMAN. We used to be very strong for it. I think some of us have reservations about whether we can afford to continue to encourage investments abroad. This is a rather minor part of it, I would think.

Mr. WOODWORTH. Yes, it is a minor part, but it is a part.

PRECEDENT SET BY TAX DEFERRAL ON TRANSFER OF TECHNICAL ASSISTANCE

The CHAIRMAN. It is a precedent, at least; is it not?

Mr. WOODWORTH. Yes, it is.

The CHAIRMAN. Is it the first time you know of that this concept has been included in a treaty?

Mr. WOODWORTH. Similar provisions were included in the Israeli treaty, and also in the Thai treaty, neither of which you have approved, but which were presented to you.

The CHAIRMAN. This then is setting a precedent so that we will be in a position of having to approve the others later on.

Mr. WOODWORTH. Of course, those two treaties went further. I assume that you had reservations on them primarily because of the investment credit features.

The CHAIRMAN. That is not involved in any of these.

Mr. WOODWORTH. That is not involved in any of these. It is just a question of this transfer of technical assistance.

I have explained the one difference, that where the technical assistance was not property, it would ordinarily result in ordinary income instead of being tax free.

TRANSFER TO CONTROLLED CORPORATION

Also under section 351 of the tax law, which deals with contributions to controlled corporations, the transfer would, even if it involved property, be tax free only if the transferor had 80-percent control of the transferee, the subsidiary.

The CHAIRMAN. Eighty percent?

Mr. WOODWORTH. That is correct.

The CHAIRMAN. In many cases local people have as much as 51 or 49 percent. In Mexico, I think, they now require Mexicans to own at least 51 percent.

Mr. WOODWORTH. I think that is the reason why the Administration would like to move that requirement down—this interest in local control. What is involved here is the taxable treatment—generally capital gains treatment—which would otherwise occur where they had less than 80-percent control. Under this provision it would be tax free so there is that——

The CHAIRMAN. This makes it tax-free where it is less than 80 percent?

Mr. WOODWORTH. That is correct. It is already tax free if it is property and if there is at least 80-percent control.

SENATOR WILLIAMS' VIEW OF TREATIES

The CHAIRMAN. Incidentally, have you talked to Senator Williams about these treaties?

Mr. WOODWORTH. I have to some degree; yes.

The CHAIRMAN. Does he approve them?

Mr. WOODWORTH. He does not approve of this feature, to the best of my knowledge. In fact, I am sure he does not approve of this feature.

The CHAIRMAN. You did not negotiate it.

Mr. WOODWORTH. I did not negotiate it.

The CHAIRMAN. Who negotiated it?

Mr. WOODWORTH. The Treasury and the State Departments.

The CHAIRMAN. Go ahead.

SECTION 367 RULING

Mr. WOODWORTH. The third difference from present law is that you do not have to get what is called a section 367 ruling; that is, an advance ruling before you make the transfer. This probably is not as important as the other two differences, although it does ease up in that respect. So there are those three differences between the present treatment of transfers of technical assistance and the treatment provided under this treaty.

The CHAIRMAN. Have you made any calculations about the impact of this principle applied across the board to all foreign investments?

Mr. WOODWORTH. I have not.

The CHAIRMAN. In other words, it is very small in Trinidad and Tobago.

Mr. WOODWORTH. Yes.

The CHAIRMAN. But if this applied to Belgium, France, England, Canada, and everywhere else, would you have any idea of the magnitude of the amount?

Mr. WOODWORTH. I can only give you a general impression in that regard.

The CHAIRMAN. Give me a general impression.

Mr. WOODWORTH. I would think if it were limited to developing countries it probably would not be very large. But if it were applied across the board to developed countries as well, it could amount to several hundred million dollars. That is the order of magnitude I think is probably involved here.

DANGER OF ESTABLISHING PRECEDENT

The CHAIRMAN. The danger of these matters is that you establish a precedent and then they come along a little later and say, "You did it for X, why can't you do it for Y?"

This is what happens so often, and it creates a condition that makes you somewhat apprehensive about doing it.

Mr. WOODWORTH. It seems to me, if the committee wished, that it could study the general matter to see what type of tax benefits you do or you do not believe should be made available in the case of treaties with developing countries. If you did so, you could reserve on this provision without prejudice to its future consideration once you had

established a policy in that regard. That is one way you could handle this if you wished.

Senator AIKEN. Mr. Chairman, this is a little out of the field of the members of this committee. These are very important matters that they are asking us to pass on and we ought to get the best advice that we can get.

The CHAIRMAN. Mr. Woodworth is the best man I know of in the tax field.

Senator AIKEN. I know he is.

CHAGUARAMAS BASE

Who owns Chaguaramas Base now? Is it Trinidad?

Mr. WOODWORTH. I do not know.

The CHAIRMAN. That is the naval base in Trinidad that we built.

Senator AIKEN. It was our naval base. We gave it away and I wondered what Trinidad did with it. Who has that now?

The CHAIRMAN. You see, we acquired this, I believe, at the time of the destroyer deal in World War II.

Mr. WOODWORTH. Yes.

The CHAIRMAN. And we built some buildings out there, and I think we turned it back to Trinidad.

Senator AIKEN. We gave them back a lot of land.

The CHAIRMAN. Is there anyone from the State Department who knows about it?

Senator AIKEN. We gave them back the base and nothing appeared about it and, I believe, there was a tracking station put in nearby, et cetera, et cetera. But I was wondering what Trinidad did with that. Who eventually got it?

The CHAIRMAN. I think the Government still owns it.

Senator AIKEN. I do not know.

The CHAIRMAN. Their Government, not ours.

Senator AIKEN. Maybe they do.

The CHAIRMAN. I think we gave it back to them.

RESERVATION ON ARTICLE 7

Mr. WOODWORTH. I might say insofar as this idea of a reservation is concerned, you have a letter, of which I was given a copy, which indicates that the Treasury Department would accept a reservation on this point if that were necessary. Obviously, they would prefer not to, but they have indicated——

The CHAIRMAN. I know they say that they do not like it, but they would be willing to accept a reservation on article 7.

Senator AIKEN. Which one is that?

The CHAIRMAN. That is on this question we were discussing about the transfer of know-how and patents without, in effect, recognizing them for tax purposes. Here is the language.

What is your own view? Do you have any advice to give about this or do you feel that is not your responsibility?

Mr. WOODWORTH. I will volunteer my view if you would like, Senator.

The CHAIRMAN. We heard Mr. Cohen.

Mr. Cohen, did you not testify on this?

Mr. COHEN. I did, Mr. Chairman, but I think you were not present that day.

The CHAIRMAN. I think Senator Sparkman was.

Mr. COHEN. Yes, I believe so. I talked to you about it previously in your office.

The CHAIRMAN. That is right.

Go ahead, Mr. Woodworth; volunteer your individual view.

Mr. WOODWORTH. I think it would be appropriate for you to take a reservation on this provision pending an opportunity for the Foreign Relations Committee, or any subgroup that may be set up, to consider with Treasury what you think the appropriate policy is with respect to less developed countries.

I think what is needed is a full discussion of what is the real purpose of tax treaties with less developed countries, why you need them, and an explanation of these considerations from the Treasury. It has continued, as you know, through several administrations, to be of the belief that tax benefits are necessary in these treaties.

I think, in part, this is based on a feeling that we cannot get tax treaties with the less-developed countries unless there is a tax benefit provision in them.

Now, whether that is a good idea or not seems to me to depend in part on the extent to which you do or you do not want to encourage investment in those countries.

CHANGES CONCERNING PRIVATE U.S. INVESTMENT IN FOREIGN COUNTRIES

The CHAIRMAN. As I said already, and I will repeat it, there was a time when I thought it was a good idea to have private American investments in these countries, but there have been several different reasons why I have changed my mind. One is that our balance of payments is so bad and the other is the growing tendency of the foreign countries to expropriate our property, as is proceeding now in Chile. It is almost inevitable in Chile and there is nothing feasible we can do about it as a matter of policy.

We put in the Hickenlooper amendment and the Administration does not enforce it. I am not criticizing them. I do not think they can enforce it very reasonably, but all of this has led to a new approach.

The way we now intend to help them is through international financial institutions such as the International Bank and the Inter-American Bank.

So you achieve at least part of the purpose of helping them develop industrially by doing it without getting involved in these very difficult and nasty situations in which they expropriate your property. You break relations and the whole situation deteriorates. We are faced with it now, because some of our industrial concerns are so outraged about the expropriation of their property that they tend to do all sorts of things that embarrass our relations. So there has been a rethinking about what is the right way to go about these things.

In addition, the local people in smaller countries resent having big American companies come in and dominate their economy. Even in Canada, a very sophisticated country, when Diefenbaker was Prime

Minister, he discouraged American investments and every now and then a great protest breaks out against our domination of not only their industrial economy but their communications, as well.

They also resent the great influence of our news media. This is not good for international relations, and eventually it is not good for business because we lose our investments.

ANDEAN PACT

Senator CHURCH. Mr. Chairman, apropos of that, have you seen the news coverage of the agreement referred to as the Andean pact?

The CHAIRMAN. No, it has not been called to my attention.

Senator CHURCH. It has just been called to mine. I think it represents a whole new departure and it has great ramifications for the future. These countries that differ greatly in their governments have apparently reached an agreement establishing standards to restrict American investments, that is foreign investments, in the future in their own countries, and to do it in ways that go far beyond anything that has been contemplated before, and certainly far beyond anything that the countries have agreed in concert.

This is an indication of the deep feelings that have been aroused by the extent and the character of American investments in Latin countries, and I agree with the suggestion that we have to reexamine all of this in the future.

INCONSISTENCY OF SPECIAL PRIVILEGES AND TAX DEFERRALS

The CHAIRMAN. As I recall, a year or two ago there were discussions about what took place in Chile under a previous Administration. I think they took over half of Anaconda and Phelps-Dodge. They paid for it, I believe, but they took over half of those investments and now they expect to take all of them, I guess. If there is this movement, I don't understand why we go about giving special privileges and tax deferrals to American investors.

This is what seems a little inconsistent, if that is the way things are moving.

Mr. WOODWORTH. I think the problem is that there are advantages to the United States in having tax treaties wholly apart from the question of investments. These involve tax equity on an international scale, the lessening of double taxation on international business, aiding us in the administration of our tax laws by being sure that we get full reporting of income abroad, and purposes of that type which are desirable wholly apart from the question of investment.

The CHAIRMAN. I see.

EXPLORATION OF BENEFICIAL DEVICES OUTSIDE TAX SYSTEM SUGGESTED

Mr. WOODWORTH. The developing countries, however, apparently are receiving tax concessions from other countries, and they are reluctant to enter into tax treaties with the United States without receiving comparable benefits. It seems to me that possibly an exploration of other devices outside of the tax system, perhaps loan guarantees

or something of that type, to be tied in with tax treaties might be desirable in considering this problem.

The CHAIRMAN. We have that already in the AID program, as you know.

Mr. WOODWORTH. Yes.

The CHAIRMAN. Extensive guarantee programs.

Mr. WOODWORTH. I am just suggesting a possible way of approaching the problem—that is, considering whether an expansion of something in the nontax area might not be a better method of dealing with the developing country tax treaty problem than a special tax deferral or incentive provision.

The CHAIRMAN. So you recommend a reservation on the tax deferral provision?

Mr. WOODWORTH. Yes.

TAX REDUCTIONS IN TRINIDAD AND TOBAGO TREATY

I think I should also mention that in the Trinidad and Tobago Treaty, the withholding tax which they would impose on dividends and interest is reduced, but the United States withholding tax on these items is not reduced.

From their standpoint, it does encourage U.S. investments there, but from our standpoint it also is desirable because it would encourage the repatriation of earnings from that country.

Their tax rate on intercorporate dividends is reduced from 25 to 10 percent and the tax they impose on interest would be reduced from 30 to 15 percent if the recipient is a financial institution which does not have a permanent establishment there.

I cannot see any problem with respect to this, although it is somewhat of a departure from the usual pattern.

SPECIFIC PROCEDURE FOR DEFINING UNDEFINED TERMS

The third principal point on which these three income tax treaties differ from the normal format is that they attempt to establish a specific procedure for the defining of undefined terms in the treaty. I think this is a wholly desirable procedure.

In the past, problems have arisen because the United States and the foreign country sometimes defined a term of the treaty differently. To deal with this, these three treaties establish a specific procedure for the countries to get together and establish a common understanding of the undefined terms.

With that, I would say that I have discussed all the significant differences insofar as the income tax treaties are concerned.

NEW PATTERN SET BY NETHERLANDS TREATY

Turning now to the estate tax treaty with the Netherlands, this does set a new pattern for estate tax treaties. We have at present some 12 estate tax treaties, the most recent of which is the 1962 treaty with Canada.

I should note that there is no policy I know of in this estate tax treaty of encouraging investment abroad. The objectives here are less-

ening double taxation at death and preventing tax evasion, which I think are well established objectives.

The principal problem which has arisen under the approach of our existing treaties concerns employees of U.S. businesses abroad who die when they are abroad. In this case both the United States and the foreign country where he is employed often impose their estate taxes with respect to the worldwide estate of the individual.

Let me explain how that works. In the past the primary tax jurisdiction was given to the country where the property is located. The country of domicile imposes a tax on the worldwide estate of the individual, but then allows a credit for the tax imposed——

The CHAIRMAN. Is this the way it already is or the way the treaty provides?

Mr. WOODWORTH. This is the way it already is. The country of domicile provides a credit for the tax imposed by the country where the property is located.

The principal difficulty with this approach in the past occurred where both the country of citizenship and the country of employment contended they were the country of domicile.

The CHAIRMAN. In the case of an employee as opposed to an investor?

Mr. WOODWORTH. That is right. This is primarily concerned with employees of American companies who are located abroad and who die while abroad.

In the past, our estate tax conventions have tried to deal with this problem by splitting the tax in these cases, but that could result in the total tax being greater than the tax the United States alone would have imposed.

It really is that problem which the Dutch estate tax treaty tries to deal with by setting up a new pattern of rules in this area. First, the new Dutch treaty, insofar as a country's jurisdiction to tax on the basis that property is located there is concerned, would give primary jurisdiction to the situs country only in the case of real property located there and business assets effectively connected to a permanent establishment located there.

The CHAIRMAN. Tangible assets?

Mr. WOODWORTH. Yes, and intangibles, but only if they are associated with a permanent establishment there. It does not extend to assets which are not effectively connected with a business and permanent establishment there.

Second, the Dutch treaty attempts to deal with this double domicile question of citizenship country versus employment country by approaching it in this general way: Where an individual has not been domiciled in the foreign country for 7 or more out of the 10 years before death unless there is a clear indication that he intended to stay there indefinitely, then the primary emphasis is given to the tax system of the country of citizenship. By this I mean that the employment country would only tax the real property that was located there and the business assets effectively connected with a permanent establishment there. And even in this case, the Netherlands would give a 50-percent marital deduction and would exempt estates of $30,000 or less.

This pattern is more or less consistent with the way we presently treat nonresident aliens.

Third, the reverse of what I have just described would occur where the employee is abroad for more than 7 out of the 10 years before his death. In that case, both the country of employment and the country of citizenship would impose their tax on a worldwide basis, but the country of citizenship would give a credit for the taxes paid to the country of employment.

It seems to me that this new pattern which has been worked out will prevent double taxation in the majority of cases and is a rational, reasonable way of dealing with the problems which have arisen in the past.

EFFECT OF NETHERLANDS TREATY ON INVESTMENT OF U.S. DOMICILIARY

The CHAIRMAN. How does it work in the case of an investment? Suppose a person is a resident and domiciled in the United States. He owns a tremendous piece of real estate and he dies. What happens in such a situation?

Mr. WOODWORTH. Well, there really is not——

The CHAIRMAN. Does this treaty affect it?

Mr. WOODWORTH. It does not basically change existing law in that case.

The CHAIRMAN. I see.

Mr. WOODWORTH. No, because the country of situs, insofar as the real property is concerned, may still tax it.

I should say the treaty does affect a country's situs jurisdiction to the extent that it cuts it back to real property plus business assets which are effectively connected with a permanent establishment there. If the U.S. domiciliary had other assets over there, the Netherlands would not impose a tax in that case—only the United States would. Or vice versa, if it was a Dutch domiciliary and the property was located over here.

The CHAIRMAN. On balance, you think this is a good treaty?

Mr. WOODWORTH. Yes. It is a new pattern, but it looks to me like it is a desirable one.

The CHAIRMAN. It would probably be used as a precedent for other countries. Can you see any dangers if the same principles would apply to a big country where we would have many more investments than in the other?

Mr. WOODWORTH. No, and I agree with you that it will probably be used as a pattern.

The CHAIRMAN. Very likely.

Mr. WOODWORTH. But I cannot see that there is any difficulty in that respect. It seems to me like it is a rational way of proceeding to deal with the problem of double taxation at death.

The CHAIRMAN. If it seems that way to you, how do you think it is going to seem to those of us who do not understand our own taxes? We have to trust your judgment, so you have to be very careful.

Mr. WOODWORTH. I will try.

The CHAIRMAN. I am sure you will. It is a precedent that you would not object to having applied to any country under any circumstances. What often bothers us a little is that they come in with something

for a very small country and it is so insignificant. But then they come in with a treaty with a big country.

Mr. WOODWORTH. I am aware of that.

The CHAIRMAN. So you think it is plausible even if it may be applied to other countries?

Mr. WOODWORTH. Yes.

RESERVATION ON TRINIDAD AND TOBAGO TREATY

The CHAIRMAN. With respect to the Trinidad and Tobago Treaty, however, you think we ought to have a reservation?

Mr. WOODWORTH. You might want to say on the reservation on the Trinidad and Tobago Treaty that you are not passing on it until you review the whole situation.

The CHAIRMAN. Save that for the report?

Mr. WOODWORTH. Yes.

The CHAIRMAN. As you know, our own tax laws are so complicated that it is impossible for ordinary people to understand them, so it is doubly difficult to understand them as they apply to international situations.

Mr. WOODWORTH. That is right.

One of the problems we need to work on more is to try to get rid of some of those complexities, but it seems very difficult to do.

CONCERN ABOUT OVERALL POLICY

The CHAIRMAN. I am very worried about this overall policy that we have already mentioned.

This committee recently reported out a bill authorizing large contributions to certain international financial institutions. I think the overall amount is something like three and a half billion dollars. Generally, I believe the committee feels that this is a more effective and less risky way to help developing countries than direct intervention such as our old aid program or private investments in many places, because of this rising tendency for expropriation.

That obviously creates very bad relationships. We went through that with Mexico, as you well know, where they expropriated the oil. It took us about 25 or 30 years to get over that, but now our relations are good. At the present time, there is great apprehension about what is going to happen in Chile, and I am very much concerned that some of our industrial people may do things they should not do to try to save the situation, which would embarrass our country and disturb our political relationships.

So there is a serious question of whether we ought to continue to encourage American investment abroad. I do not want to discourage it, if people want to take their chances, but to give special privileges would be, it seems to me, a little improvident, especially to a subsidiary and then have it taken over. That only deprives this country of whatever benefits it might have had in the field of taxation as well as losing the corpus of the estate, so to speak. So I think it is a serious question.

I believe this Administration has stated publicly that they thought we ought to move toward multilateral assistance programs, such as those I mentioned, rather than bilateral programs. I do not know that

they have expressed themselves directly on the encouragement of private investment abroad other than saying "We are willing to subsidize them by tax deferrals or tax preferences." I am not too sure on that point, but they have been very clear about using multilateral organizations for assistance, and I agree with them.

I think if we are going to do anything, we ought to do it that way. Of course, our own domestic situation is getting so bad we really cannot afford to do any of this if we were to be very sensible about it. It is sort of silly for us to be giving away large sums when we are going to have a deficit of $15 billion in our own Government accounts. At least it looks that way to me. Maybe that is old fashioned.

Mr. WOODWORTH. We have a very real deficit problem; there is no question about it.

The CHAIRMAN. It is not only the deficit in our own domestic accounts, but there is a big deficit in our balance of payments, and on either account it does not look very provident or very prudent to be going around as Lady Bountiful under these circumstances. These policies started when it was not that way.

Mr. WOODWORTH. That is right.

The CHAIRMAN. For many years we had a favorable balance of payments, up until 1957, I think; did we not?

Mr. WOODWORTH. I think it was a little further back than that.

The CHAIRMAN. Between World War II and the fifties there was a very substantial cumulative favorable balance of payments—something in the neighborhood of $100 billion—was there not?

Mr. WOODWORTH. It was very large, and then my recollection is that in the early fifties it shifted over.

The CHAIRMAN. I thought it was the middle or late fifties, but maybe that is wrong. Perhaps that was when the domestic deficit developed. That is an important policy.

APPROPRIATENESS OF RESERVATION

Mr. WOODWORTH. That is really why I suggested the reservation. Until the committee works out what it wants to do in this area, it seems to me that it would be appropriate to reserve on this point.

The CHAIRMAN. You are correct. That is what I think we ought to do.

It is very difficult for the committee to work it out when we are in this transitional period. I hope we do not continue with a deficit in our balance of payments as we now are.

I do not know what is going to happen in the trade bill. I think they are voting on it today in the House. My own feeling is that if it passes the House and the Senate, we will probably start another repetition of the Smoot-Hawley era and foreign countries will refuse to import our soybeans. That is what worries me, at least, because Arkansas produces soybeans, poultry, and cotton, and the next thing you know our whole international trading area will deteriorate.

It is what happened in the past whenever that has taken place. So we are in a very difficult period to know what is going to happen. I think we ought to have a reservation and hold our breath to see where we go.

George, have you any questions?
Senator AIKEN. No.

PROSPERITY OF COUNTRIES OTHER THAN UNITED STATES

I think you have raised a good subject here. The Common Market seems to be something which upsets a good share of the world, like New Zealand, Australia, Canada. What is going to happen there, I do not know, but certainly most of the Common Market countries are pretty prosperous now; are they not?

Mr. WOODWORTH. That is my understanding.

Senator AIKEN. And Japan.

The CHAIRMAN. Most of these are. The United States is the only one I know of that is suffering. We have been milked so hard for the last 15 years that there is not much left.

Senator AIKEN. We are getting down to being kind of thin.

The CHAIRMAN. We sure are.

Thank you very much, Mr. Woodworth.

The committee will have an executive session to consider the nomination and conventions and other business.

Mr. Cohen, did you want to say a word?

REQUEST FOR MEETING TO DISCUSS POLICY

Mr. COHEN. Mr. Chairman, if I may, I would like to repeat my request to you before the previous hearing, at which I testified, that the Treasury Department and the State Department be given the opportunity of meeting with your committee, either in public hearings or in executive session, to discuss the policy which we should follow in the negotiation of tax conventions.

We have some 30 tax conventions now, but for some 10 years we have been unable to negotiate tax conventions with the developing countries. We think it is very important in connection with the administration of the tax laws involving international transactions that we have income tax treaties with other countries in order to avoid persons being subjected to double taxation in both countries——

The CHAIRMAN. That is not the real issue. What about this question of encouraging investments abroad? That is the issue.

Mr. COHEN. Well, Mr. Chairman, the two are inextricably linked and that is why I make my plea at this moment. We in the Treasury Department want tax treaties in connection with the administration of the tax laws, which is in our charge.

The CHAIRMAN. Yes, I understand that.

Mr. COHEN. We need provisions for elimination of double taxation of the same income in two or more countries.

The CHAIRMAN. Yes.

Mr. COHEN. Second, we do not like income escaping tax in both countries because the laws do not mesh. Third, we would like to have a treaty because it entitles the Treasury Department and the Internal Revenue Service to negotiate and deal directly with the tax authorities of the other country without going through diplomatic channels, and we get exchange of information for the purpose of preventing tax evasion.

Now, we have been able to have this network of conventions with the developed countries, the industrialized countries of the world, but we have been unable for a dozen years to produce tax conventions with the developing countries because each of them wants some provision dealing with the tax treatment of investments made by U.S. investors in their countries.

Now, we would like to move this off of dead center if we could. We have some suggestions that we would like to review with the committee, and to get at least the informal reaction of the committee. Until now every suggestion that has been advanced in a treaty that has been negotiated has been turned down by the committee when the treaty has been laid before you.

Now, if we could, we would like to review this policy with the committee before we attempt to negotiate a treaty.

The CHAIRMAN. Okay. We will do that.

Mr. COHEN. We would be very appreciative of an opportunity to do that.

U.S. INTEREST IN ENCOURAGING INVESTMENT ABROAD QUESTIONED

The CHAIRMAN. We will do that, but, as you can see this morning, the real crux of the matter is whether it is still in our interest to encourage investment abroad as long as we are so improvident in our domestic affairs and spending all our money so unwisely. This is just one of the things that is disrupted by a distorted and disrupted economy. You can see the relationship.

Mr. COHEN. I understand your concern and we share the concern.

The CHAIRMAN. We will be glad to talk to you about it.

Mr. COHEN. We would appreciate it.

The CHAIRMAN. This is the question. The President has made statements indicating that in the field of aid he wants to move in the direction of multilateral organizations. This is not necessarily against private investment, but when U.S. investments are being expropriated, that certainly dampens the enthusiasm of a lot of us to encourage it. You know the problem. We will be glad to have you here.

Mr. COHEN. I would appreciate very much if we could have that opportunity early in the next Congress.

The CHAIRMAN. I cannot guarantee we will agree with you that we will want to continue encouraging investments abroad.

Mr. COHEN. I would like to see if we cannot get the question resolved. It is not a question of whether you encourage or do not encourage. It is also a question of whether you can maintain a neutrality, and we have some suggestions along those lines that we think might be acceptable.

The CHAIRMAN. I would be very pleased to do that.

Mr. COHEN. We have no objection, as we said, to a reservation on this one article of the convention. We do not think it is that important and, as we said in our letter to you, we think that we could control any opportunity——

The CHAIRMAN. Do I understand that you would like us to act on these treaties, with the reservation relating to the Trinidad and Tobago convention, and then have this conversation or further meeting relating to other treaties you are negotiating? Is that right?

Mr. COHEN. Yes, with respect to other treaties or a further negotiation with Trinidad and Tobago.

Senator AIKEN. I think that is a great idea, almost an innovation, being willing to discuss with the committee before they act.

The CHAIRMAN. Sure.

Senator AIKEN. I would like to submit a list of three or four other agencies of Government to which we could try to sell the same idea.

The CHAIRMAN. If we could settle the matter, it would be very good.

Mr. COHEN. If we might, we would like to ask your advice before we ask your consent.

(Laughter.)

Senator CHURCH. Revolutionary.

The CHAIRMAN. That is a radical idea, but we will accept it.

Mr. COHEN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

The committee is adjourned and we will go into executive session.

(Whereupon, at 11:20 a.m., the committee proceeded to executive session.)

APPENDIX

PORT OF SPAIN, TRINIDAD,
January 9, 1970.

The Honourable J. FIFE SYMINGTON, JR.
Ambassador Extraordinary and Plenipotentiary, Embassy of the United States of America, Port-of-Spain.

SIR: I have the honour to refer to your letter of the 9 January which reads as follows:

"I have the honor to refer to the income tax treaty between the Governments of Trinidad and Tobago and the United States, which has been signed today. This treaty makes no provision for special recognition, in the calculation of United States tax on income derived from United States direct investment in Trinidad and Tobago, of tax incentives offered by Trinidad and Tobago to attract such investment.

My Government recognizes the value to Trinidad and Tobago of increased United States investment in your country and the importance which your Government places on promoting such investment through the tax treaty mechanism. I want, therefore, to assure that my Government is prepared, at an early date, to resume discussions with representatives of Trinidad and Tobago with a view toward reaching agreement on a supplementary protocol that would provide a tax impetus to United States direct investment in Trinidad and Tobago."

I have the honour to inform you that my Government accepts the above mentioned assurances and looks forward to the early resumption of discussions on this subject.

Accept, Sir, the renewed assurances of my highest consideration.

ERIC WILLIAMS,
Prime Minister.

CERTIFICATION

TRINIDAD AND TOBAGO CITY OF PORT OF SPAIN EMBASSY OF THE UNITED STATES OF AMERICA: SS

I, Robert J. MacQuaid, Consul of the United States of America at Port of Spain, Trinidad, West Indies, duly commissioned and qualified do hereby certify that the attached copy of Embassy Note No. 1 of January 9, 1970 to Dr. the Right Honourable Eric Williams, Prime Minister of Trinidad and Tobago, signed by J. Fife Symington, Jr., American Ambassador, is a true and faithful copy of the original.

In Witness Whereof I have hereunto set my hand and affixed the seal of the Embassy at Port of Spain, Trinidad, West Indies, this 9th day of January, 1970.

ROBERT J. MACQUAID,
Consul of the United States of America.

PORT OF SPAIN, *January 9, 1970.*

No. 1

Dr. the Right Honourable ERIC WILLIAMS,
Prime Minister,
Trinidad House.

SIR: I have the honor to refer to the income tax treaty between the Governments of Trinidad and Tobago and the United States, which has been signed today. This treaty makes no provision for special recognition, in the calculation of United States tax on income derived from United States direct investment in Trinidad and Tobago, of tax incentives offered by Trinidad and Tobago to attract such investment.

My Government recognizes the value to Trinidad and Tobago of increased United States investment in your country and the importance which your Government places on promoting such investment through the tax treaty mechanism. I want, therefore, to assure you that my Government is prepared, at an early date, to resume discussions with representatives of Trinidad and Tobago with a view toward reaching agreement on a supplementary protocol that would provide a tax impetus to United States direct investment in Trinidad and Tobago.

Accept, Sir, the renewed assurances of my highest consideration.

J. FIFE SYMINGTON, JR.

OCTOBER 6, 1970.

TECHNICAL EXPLANATION OF U.S.-BELGIUM INCOME TAX CONVENTION, SIGNED JULY 9, 1970

(Department of the Treasury)

ARTICLE 1. PERSONAL SCOPE

This Article, which is not found in other United States tax treaties, is similar to Article 1 of the Draft Double Taxation Convention on Income and Capital developed by the Fiscal Committee of the Organization for Economic Cooperation and Development and published in 1963 (hereinafter referred to as the OECD Model Convention). The Article does not have substantive importance. Its purpose is to generally delineate the persons who come within the scope of the Convention. The Article is not complete in its delineation of persons covered in that persons who are residents of one or both of the Contracting States are sometimes not covered in the Convention and that other persons who are not residents of either of the Contracting States are covered by this Convention. For example, Article 19 (Governmental Functions) applies to citizens of a third State who come to one of the Contracting States expressly for the purpose of being employed by the other Contracting State. While the title of Article 1 is "Personal Scope," the Convention, of course, is applicable to corporations and other entities as well as to individuals.

ARTICLE 2. TAXES COVERED

This Article designates the taxes of the respective States which are the subject of the proposed Convention. With respect to the United States, the taxes included are the United States Federal income taxes imposed by the Internal Revenue Code. This includes, for example, the surtax and would also include such taxes as the temporary surcharge which was in force from 1968 to 1970. However, the Convention is not intended to apply to taxes which are in the nature of a penalty such as the taxes imposed under section 531 (accumulated earnings tax) and section 541 (personal holding company tax) of the Internal Revenue Code.

With respect to Belgium, the taxes included are (1) the individual income tax; (2) the corporate income tax; (3) the income tax on legal entities; (4) the income tax on nonresidents; (5) the prepayments and additional prepayments; and (6) surcharges on any of the taxes referred to in (1) through (5), including the communal supplement to the individual income tax.

The Belgian individual income tax is payable by resident individuals on income from all sources but with reduced rates for foreign source income.

The Belgian corporate income tax is payable by resident Belgian companies on income from all sources but with reduced rates for foreign source income.

The Belgian income tax on legal entities is a tax payable in lieu of the corporate income tax and is imposed upon the political subdivisions of Belgium and those resident legal entities which are not engaged in business activity. This tax is levied solely on income from movable capital (generally dividend and interest income) and real property.

The Belgian income tax on nonresidents is payable by nonresident individuals, corporations, and other legal entities on income earned or received in Belgium.

In addition to the above-enumerated taxes, prepayment of tax in the form of withholding by the payor is required by Belgian law in the case of income from movable capital (generally dividend and interest income) and income from real property. There is also a standard professional prepayment (withholding) which applies to wages and salaries, remuneration paid by a corporation to managers, directors and persons with similar functions, and to pensions, certain prizes and subsidies, and in the case of a nonresident recipient, alimony. These taxes are

known as "les précomptes." While Articles 2 also lists "additional prepayments" (compléments de précomptes), that tax, which was an additional 15 percent prepayment on income from movable capital, has not been in force since January 1, 1967. It was included at the request of Belgium in the case such tax is re-established, although even in the absence of an express reference, a new or re-established tax would be covered by paragraph (2) of this Article. In the case of income from real property, Belgian law provides for an additional advance payment in the case of taxpayers subject to the income tax on nonresidents whose fiscal domicile is in a country with whom Belgium has concluded a double taxation agreement giving Belgium exclusive right to tax real property situated in her territory. Since, under the proposed Convention, Belgium does not have an exclusive right to tax United States residents on income from real property, there is no additional advance payment on such income paid to United States residents.

Pursuant to paragraph (2) of this Article the proposed Convention would also apply to taxes substantially similar to those enumerated which are imposed, in addition to or in place of the existing income taxes, after the date of signature of this Convention (July 9, 1970).

This Article also provides that the competent authorities of the Contracting States are to notify each other of any amendments of the laws imposing the enumerated taxes and of the adoption of any taxes which are subsequently imposed by transmitting the text of any amendments or new statutes at least once a year. Further, the competent authorities are to notify each other of the publication by their respective States of any material concerning the application of this Convention, whether in the form of regulations, rulings, or judicial decisions, by transmitting the text of any such material at least once a year.

ARTICLE 3. GENERAL DEFINITIONS

This Article sets out definitions of certain of the basic terms used in the proposed Convention. A number of important terms, however, are defined elsewhere in the Convention.

Any term used in this Convention which is not defined therein shall, unless the context otherwise requires, have the meaning which it has under the laws of the State which is imposing the tax. However, in a case where a term has a different meaning under the laws of Belgium and the United States or where the meaning under the laws of one or both of the States is not clear, the competent authorities may agree on a uniform definition. See Article 25 (Mutual Agreement Procedure). While treaties in the past did not specify the power of the competent authorities to resolve such differences in definitions, this power is nevertheless inherent in the authority set forth in the mutual agreement article of these treaties to resolve "difficulties or doubts."

This Article defines geographical Belgium and geographical United States to include their respective continental shelves. The addition of a definition of the continental shelf is intended to clarify what the Contracting States consider to be included within their respective jurisdictions to tax. The United States continental shelf is defined as the seabed and subsoil of the adjacent submarine areas beyond the territorial sea over which the United States exercises exclusive rights in accordance with international law for the purpose of exploration and exploitation of the natural resources of such area, but only to the extent that the person, property, or activity to which this Convention is being applied is connected with such exploration or exploitation. For example, the income earned by a ship and its employees engaged in taking seismograph soundings on the United States continental shelf will be treated for tax purposes the same as the income from a comparable activity on the land of one of the States of the United States. A comparable definition is used in the case of Belgium. The definition of the continental shelf in the case of the United States only includes the continental shelf surrounding the 50 States. Thus, for example, the continental shelf surrounding Puerto Rico is not included. If the treaty were extended beyond the 50 States and the District of Columbia (see Article 29—Extension to Territories) the continental shelf of the extended areas could also be covered. The defined continental shelf is only part of the United States or Belgium, as the case may be, in limited situations. It is included only to the extent that a person or property or activity to which the Convention is being applied is connected with exploration or exploitation of the continental shelf. The phrase "connected with" does not require physical attachment to the continental shelf to be within the scope of the definition.

The Article also defines "United States corporation" and "Belgian corporation." Because of the difference in concept, an entity could under Belgian law be considered to be a Belgian corporation and under United States law to be a United States corporation. For purposes of the proposed Convention, such a corporation would be treated as a corporation of neither State because of the provisions in the definitions of a corporation of the United States, and a corporation of Belgium, that an entity may not be considered a corporation of the United States, or Belgium, if it is a corporation of the other State under domestic law of that other State. While the benefits of the Convention would generally be unavailable in such cases, it is relatively easy for taxpayers to avoid dual residency.

ARTICLE 4. FISCAL DOMICILE

This Article sets forth rules for determining "fiscal domicile" or residence of individuals, corporations and other persons for purposes of the proposed Convention. Residence is important because, in general, only a resident of one of the Contracting States may qualify for the benefits of the Convention. This Article is patterned generally after the fiscal domicile article of the OECD Model Convention.

The term "a resident of Belgium" means a corporation of Belgium as defined in Article 3 (General Definitions) and any person (other than a corporation) who is a resident of Belgium for purposes of its tax. The term "a resident of the United States" means a United States corporation as defined in Article 3 (General Definitions) and any person (except a corporation or any other entity treated as a corporation for United States tax purposes) resident in the United States for purposes of its tax. The language in parentheses is intended to deal with the problem of dual residency of a corporation. An entity which would be considered a Belgian corporation under Belgian law and a United States corporation under United States law would, under Article 3 (General Definitions) of the Convention, be neither a Belgian corporation nor a United States corporation. Therefore, it was necessary to make clear that such an entity is not included within the term "any person" for purposes of the second part of the definitions. In addition, the parenthetical language in the definition of a resident of the United States is intended to make clear that a foreign corportaion, or other entity treated as a foreign corporation for United States tax purposes, which is a resident of the United States for certain purposes of its income tax law is not, under the Convention, a resident of the United States.

In the case of the United States, the definition provides that a partnership, estate, or trust is treated as a resident only to the extent that the income derived by such person is subject to United States tax as the income of a resident. This language, although different from the Income Tax Convention between the United States and France, signed July 28, 1967, is intended to achieve the same result. Under United States law, a partnership is never, and an estate or trust is often not, taxed as such. Under the proposed Convention, in the case of the United States, income received by a partnership, estate, 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. With respect to income taxed in the hands of the estate or trust, the residence of the estate or trust is determinative. This provision is nonreciprocal because of the absence of a similar problem under Belgian law.

An individual who is a resident of both States under the rules of domestic law employed by such States for determining residence will be deemed to be a resident of the State in which he has his permanent home, his center of vital interests (closest economic and personal relations), his habitual abode, or his citizenship, in the order listed. If the issue is not settled by these tests, the competent authorities will decide by mutual agreement the one State of which he will be considered to be a resident. Thus for purposes of the Convention, including the savings clause of Article 23(1), an individual can be resident in Belgium or the United States, but not both.

ARTICLE 5. PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment." The existence of a permanent establishment is, under the terms of the proposed Convention, a pre-

requisite 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 Article 10 (Dividends), Article 11 (Interest), Article 12 (Royalties), and Article 13 (Capital Gains). The definition of "permanent establishment" is a modernized version of the definition found in some of our older treaties including the 1948 Convention with Belgium. The new definition is similar to the definition found in our French Convention.

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." Ilustrations 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 installation project which exists for more than 12 months. As a general rule, any fixed facility through which an individual, corporation or other person conducts industrial or commercial activity will be treated as its permanent establishment unless it falls in one of the specific exceptions described below. The proposed Convention uses the term "a seat of management" which was the term used in our Convention with France. The technical explanation of our French Convention explains the definition of the term "a seat of management" and its difference in meaning from the term "a place of management" as follows:

> 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.

That explanation is applicable to the proposed Belgian Convention.

This Article specifically provides that a permanent establishment does not include a fixed place of business of a resident of one of the Contracting States which is located in the other Contracting State if it is used only for one or more of the following—(1) the use of facilities for the purpose of storage, display, or delivery of goods or merchandise belonging to the resident; (2) the maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display, or delivery; (3) the maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person; (4) the maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the resident; (5) the maintenance of a fixed place of business for the purpose of advertising, or the supplying of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the resident; or (6) the maintenance of a building site or construction or installation project which does not exist for more than 12 months. The building site or construction or installation project exception is merely a clarification of the rule that such an activity for more than 12 months is a permanent establishment and, accordingly, such an activity for 12 months or less is not a permanent establishment. These exceptions are cumulative and a site or facility used solely for more than one of these purposes will not be considered a permanent establishment under the proposed Convention. The 12-month construction project rule is a physical test under which the resident must be actively engaged in the project during that 12-month period.

This Article also provides that notwithstanding the provisions described in the preceding paragraph if three conditions are met, a resident of one State will have a permanent establishment in the other State. The conditions are:

1. The resident has a fixed place of business in that other State (a) which consists of facilities for the storage, display or delivery of goods or merchandise belonging to the resident; (b) which consists of a stock of goods or merchandise belonging to the resident which is held for processing by another person; or (c) which is used for the purpose of purchasing goods or merchandise for the resident;

2. The goods or merchandise described in paragraph 1 above are either subject to substantial processing in that State (whether or not purchased there) or are purchased in that other State (and are not thereafter subject to substantial processing in another State); and

3. All or part of such goods or merchandise is sold by the resident or his agent for use, consumption, or disposition in that other State.

Under this rule, the taxpayer will have a permanent establishment whether or not he maintains a sales office in the other State.

Thus, for example, if an independent agent acting for a United States corporation arranges the sales of the corporation's goods in Belgium, the United States corporation will, nevertheless, be deemed to have a permanent establishment in Belgium if those goods were purchased in Belgium through a fixed place of business of the corporation (ordinarily a purchasing office would not constitute a permanent establishment) and then resold therein without having been subjected to processing outside Belgium prior to such resale.

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 an independent agent, who has and regularly exercises authority to conclude contracts in the name of such person unless the agent only exercises such authority to purchase goods or merchandise.

With respect to an independent agent, 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 engages in industrial or commercial activity 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 his business. This rule does not apply with respect to a broker or agent acting on behalf of an insurance company if such broker or agent has, and habitually exercises, an authority to conclude contracts in the name of that company. It was agreed, however, that an insurance company of one State writing reinsurance contracts in the other State would not for that reason be treated as having a permanent establishment, but since it was understood that foreign companies writing reinsurance on Belgian risks do not authorize Belgian brokers or agents to conclude reinsurance contracts in the name of the foreign reinsurance company, it was not necessary to specifically exclude reinsurance contracts from the exception.

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 of such resident with respect to a resident of the other State or with respect to a person which engages in industrial or commercial activity in that other State (whether through a permanent establishment or otherwise).

Although this Article is generally drafted with reference to a resident of one of the States engaging in industrial or commercial activity in the other State, for certain purposes the proposed Convention deals with a nonresident engaging in industrial or commercial activity in one of the States or a resident of one of the States engaging in industrial or commercial activity in a third State. For these purposes, the principles set forth in Article 5 are to be applied in determining whether there is a permanent establishment.

ARTICLE 6. INCOME FROM REAL PROPERTY

This Article which is similar to an article in the existing treaty provides that a resident of one State may be subject to tax in the other State on income from real property and royalties in respect of natural resources if the property or natural resource is located in such other State. This Article does not, as do the existing treaty and the 1967 treaty between the United States and France, provide for an election by the resident to compute his tax on such income on a net basis since under the internal laws of Belgium and, since 1967, the United States this can be done. The income referred to in this Article includes gain from the sale or exchange of such property or such natural resource rights, but does not include interest on mortgages and similar instruments. The latter type of income is covered by Article 11 (Interest).

ARTICLE 7. BUSINESS PROFITS

This Article sets forth the typical treaty rule that industrial or commercial profits of a resident of one State are taxable in the other State only if the resident has a permanent establishment in that other State. Where there is a permanent establishment only the profits attributable to the permanent establishment can be taxed by that other State. For purposes of Article 23 (Relief From Double Taxation) which, among other things, provides that a foreign tax credit will be allowed by the United States, such profits are considered to be from sources within the State in which the permanent establishment is located.

While under the existing Belgian Convention, as under the old French Convention, industrial or commercial profits are not taxed in the absence of a permanent establishment, once there is a permanent establishment the existing Convention, as did the old French Convention, provides that the provisions reducing the tax rates on interest and dividends and exempting royalties are not applicable. This rule is known as the "force of attraction" principle and is replaced in the proposed Convention, as in our new treaty with France, with the effectively connected concept. Under the new approach, only those interest, dividends and royalties which are effectively connected with the permanent establishment are taxable as part of the industrial or commercial profits and do not benefit from the reduced rate or exemption.

In determining the proper attribution of industrial or commercial profits under the proposed treaty, the permanent establishment is generally 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. However, it is not necessary to allow a profit to the head office for ancillary services furnished to the permanent establishment as long as the permanent establishment is allowed to deduct the allocable costs incurred by the head office.

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.

While some of our more recent conventions attempt a broad definition of "industrial or commercial profits" by setting forth examples of activities which will be considered as giving rise to such profits, this Convention is limited to setting forth three rules of inclusion and exclusion. In spite of the difference in approach, the term "industrial or commercial profits" has a meaning generally similar to that in our other recent treaties. It includes income derived from manufacturing, mercantile, agricultural, fishing, or mining activities, from the operation of ships or aircraft, from the furnishing of personal services of others, from the rental of tangible personal property, and from insurance activities.

This Article specifically provides that the term "industrial or commercial profits' 'includes rents or royalties derived from motion picture films or films or tapes used for radio or television broadcasting or from copyrights thereof and rents derived from the leasing of tangible personal property.

The Article further provides that the term does not include items of income specifically dealt with in other articles of this Convention except as provided in such articles. Thus, income derived from real property and natural resources and dividends, interest, royalties (as defined in paragraph (2) of Article 12 (Royalties)), capital gains, and income described in Article 22 (Income Not Expressly Mentioned) constitute industrial or commercial profits only if the right or property giving rise to such amounts is effectively connected with a permanent establishment which the recipient, being a resident of one of the States, has in the other State. Where such amounts do not constitute industrial or commercial profits, they may be taxed separately or together with industrial or commercial profits in accordance with the laws of the State whose tax is being determined, but the limits on the rate of taxation to which such amounts may be subject must be observed.

For example, if a Belgian bank without a permanent establishment in the United States loaned money to a United States manufacturer in the United States, the interest paid by the United States manufacturer to the Belgian bank would be treated as interest and not as industrial or commercial profits and would be governed by Article 11 (Interest) of the proposed Convention which provides for either an exemption or a 15-percent withholding rate.

In the reverse situation where a United States bank with a branch in Belgium derives interest from Belgium which is not effectively connected with its Belgian branch, Belgium could tax the interest together with the income of the permanent establishment as long as the rate of tax on the gross amount of the interest did not exceed the 15-percent limitation.

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Income from independent and dependent personal services are specifically dealt with in Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services) and, therefore, are not treated as business profits. It is noted that in some of our other recent conventions, there is an express provision excluding such services from the terms "industrial or commercial profits." While there is no such provision in the Belgian Convention, the result is the same.

ARTICLE 8. SHIPPING AND AIR TRANSPORT

This Article provides that, notwithstanding the rules of Article 7 (Business Profits) and Article 13 (Capital Gains), income which a resident of one of the States derives from the operation in international traffic of ships registered in that State and gains which a resident of one of the States derives from the sale, exchange, or other disposition of ships operated in international traffic by such residents and registered in that State shall be exempt from tax by the other State.

A resident of one of the States will also be exempt from tax in the other State on income derived from the operation in international traffic of aircraft registered in either State or in a State with which the other State has an income tax convention exempting such income. Gains which a resident of one of the States derives from the sale, exchange, or other disposition of aircraft are accorded the same treatment. An exchange of notes specifically exempting income from the operation of aircraft from tax in the respective States is not considered as an income tax convention exempting such income.

This Article also will apply to income derived from the leasing, to a person engaged in the operation of ships or aircraft, of a ship or aircraft under a full or bareboat charter, where the lessor is engaged in the operation of ships or aircraft if such lease is ancillary to the lessor's other operations. For example, if an airline of one of the Contracting States which has excess equipment in the winter months leases several aircraft which are excess during that period to an airline in the other Contracting State, the lessor is not subject to tax by that other Contracting State.

The exemption provided by this Article is also applicable to profits derived from any activities incidental to the operation of ships or aircraft in internatonal traffic. Thus, for example, commissions derived by a Belgian international aircarrier from the sale of passenger tickets in the United States as agent for other persons operating ships or aircraft, if incidental to its own international operations, will be exempt from United States tax under Article 8. Further, a Belgian airline company might have facilities at an international airport in the United States which are used to service and maintain its own aircraft. In order to make maximum use of the facilities, the company might also service and maintain aircraft of other companies. The profits derived from the furnishing of such services to others would be exempt under Article 8 unless such activity ceased to be only an incidental activity. However, income derived by a Belgian airline company from the operation of a hotel in the United States would not be incidental to the operation of aircraft and would not be exempt.

ARTICLE 9. ASSOCIATED ENTERPRISES

This Article complements section 482 of the Internal Revenue Code of 1954 and confirms the power of each government to allocate items of income, deduction, credit, or allowance 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. This provision is similar to the provision contained in the OECD Model Convention.

Provision is made in Article 25 (Mutual Agreement Procedure) for consultation and agreement between the two States where an allocation by either State results or would result in double taxation.

ARTICLE 10. 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 former State at a rate not in excess of 15 percent. The proposed Convention continues the 15 percent rate on dividends.

As indicated above, the proposed Convention abandons the "force of attraction" concept in the existing Convention by providing that the reduced rate of tax on dividends is denied only if the shares with respect to which the dividends are paid are effectively connected with a permanent establishment which the recipient has in the State of source. 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 establishment in the State of source. In those cases where the shares with respect to which the dividends are paid are so effectively connected, the dividends may be taxed as industrial and commercial profits under Article 7 (Business Profits). Income which is so effectively connected may be taxed at the normal rates applicable to such income in the State of source. This does not prevent Belgium from imposing its movable property prepayment in accordance with Belgian law, and this would be credited against the tax owed by the permanent establishment.

The dividend Article of the proposed Convention is patterned generally after the OECD Model Convention. However, the proposed Convention additionally provides that the term "dividends" includes income from invested capital received by members of Belgian companies other than companies with share capital where, under Belgian law, such income is taxable in the same way as dividends. These are companies whose shareholders are restricted to individuals and are generally similar to partnerships. Such companies are not entitled to an interest deduction on a loan made by a shareholder to the company. Interest payments by such a company to a shareholder are treated similarly to dividends for purposes of Belgian law and are treated as dividends under the proposed treaty. The companies covered by this latter rule are Sociétiés de Personnes à Responsabilité Limiteé. Sociétes en nom Collectif, Sociétés en Commandite Simple, and Sociétés Coopératives.

Under Belgian law dividends paid to an individual from sources outside of Belgium which are received within Belgium are subject to a 20-percent precompte mobiliere. The precompte is used by Belgium as a collection device since most securities are in bearer form and the residency of the owner is not readily determinable. Belgium has agreed under this Article to waive collection of the precompte on dividends paid by United States corporations to an individual who is a resident or citizen of the United States and not a resident of Belgium. Such individual when he goes to a Belgian bank to collect on a dividend will have to substantiate his citizenship (where applicable) and residency and it is anticipated that the Belgian Government will verify the fact that such person is the proper recipient of the dividend by submitting their names to the Internal Revenue Service.

In other cases, dividends paid by a corporation of one of the States to a person other than a resident of the other State are exempt from tax by the other State unless the dividends are effectively connected with a permanent establishment of the recipient maintained in the other State or the dividends are paid by a United States corporation and are received within Belgium by a person other than a citizen or resident of the United States.

ARTICLE 11. 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 retains the 15 percent rate on interest replacing the "force of attraction" principle by the effectively connected approach. In four important cases, however, the proposed Convention provides for exemption in the State of source. First, interest is exempt at source if it arises out of commercial credit—including credit which is represented by commercial paper—resulting from deferred payments for goods or merchandise or services supplied by a resident of one of the States to a resident of the other State. This exception would apply to interest derived by a bank or other financial institution which purchases paper which arose out of commercial credit which the seller of goods or services discounted at such bank or financial institution. It would also apply to interest derived by a finance company which is a subsidiary of a selling company and which is used by the parent to finance its sales. Second, interest paid between banks is exempt except on loans represented by bearer instruments.

Under this provision, interest on advances between banks would be exempt as would interest on a loan from a United States bank to a Belgian bank, assuming that there was not a bearer instrument representing the indebtedness. Third, an exception is provided for interest arising from deposits, not represented by bearer instruments, made in banks or other financial institutions. Fourth, interest beneficially derived by one of the States, or by an instrumentality of that State, not subject to tax by that State on its income, would be exempt from tax by the other State. Under this rule, interest income derived by the Export-Import Bank of the United States on loans made to Belgian residents would be exempt from tax in Belgium. This would still be the case if the Export-Import Bank sold interest-participation certificates on such a loan. On the other hand, this rule would not apply if the Export-Import Bank discounted or sold the instrument representing the loan. However, in such a case the exception for interest arising out of commercial credit may be applicable.

As noted above, 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 with such permanent establishment. In such a case, the interest may be taxed as industrial or commercial profits.

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 according to the law of the State from which the interest is derived. In the case of excess interest derived from the United States, the excess interest may be taxed as dividend. Under Belgian law, the excess interest is disallowed as a deduction, but, in the hands of the recipient, continues to retain its character as interest. However, the recipient is not entitled to the benefits of this Article with respect to such excess.

Thus, for example, in the case of the United States the rules provided in section 482 of the Internal Revenue Code would be applicable if excess interest is paid between related persons. On the other hand, if a Belgian resident pays excess interest to a United States related person, the Belgian tax authorities would disallow such excess as a deduction to the Belgian resident, and would continue to treat such excess as interest, and subject such excess to the 20-percent rate of withholding, as provided under Belgian domestic law, since such excess is not entitled to treaty benefits.

The term "interest" does not include amounts which are considered as dividends as discussed above in connection with Article 10 (Dividends). In the case of Belgium, the term "interest" includes prizes on lottery bonds.

Interest is from sources within a State when the payor is that State, a political subdivision, a local authority thereof or a resident of that State. However, if the payor has a permanent establishment in one of the States and the indebtedness on which the interest is paid is effectively connected with such permanent establishment and the interest is borne by such permanent establishment, such interest shall be deemed to be sourced within the State in which the permanent establishment is located. In addition, if a permanent establishment which a resident of one of the Contracting States has in a third State borrows money from a resident of the other Contracting State, for purposes of the treaty, the interest paid by the permanent establishment will be treated as from sources within the third State if the loan is effectively connected with, and interest is borne by, such permanent establishment.

In other cases, interest paid by a resident of one of the States to a person other than a resident of the other State is exempt from tax by the other State unless the interest is effectively connected with a permanent establishment of the recipient maintained in the other State or the interest is paid by a United States corporation and is received within Belgium by a person other than a citizen or resident of the United States.

As in the case of dividends, the interest Article also contains a special rule dealing with interest from sources within the United States which is received within Belgium by a resident of the United States or a citizen of the United States who is not a resident of Belgium. In such a case Belgium has agreed to waive its withholding tax.

ARTICLE 12. ROYALTIES

The existing Convention provides that royalties derived from sources within one of the States by a resident of the other State shall be exempt from tax by the former State. The proposed Convention continues this exemption for royalties.

The term "royalties" is defined to include (a) payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works (but not including copyrights of motion picture films or films or tapes used for radio or television broadcasting), patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights, or knowledge, experience, or skill (know-how) and (b) gains derived from the sale, exchange or other disposition of such rights or property, but only if payment is contingent on productivity, use, or disposition of the property. If the payments are not so 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 rights or property giving rise to the royalty is effectively connected to such permanent establishment. In such a case, the royalty may be taxed as industrial or commercial profits under Article 7 (Business Profits). Thus, the "force of attraction" principle is also abandoned with respect to royalties.

The source rule on royalties is different from the source rule found in most of our recent treaties and the rule in section 861(a)(4) of the Internal Revenue Code. The proposed Convention provides that royalties shall be treated as income from sources within one of the States if paid by such State, a political subdivision, or a local authority thereof, or by a resident of that State. However, (a) if the person paying the royalty has a permanent establishment in one of the States with which the right or property giving rise to the royalty is effectively connected and such royalties are borne by such permanent establishment, or (b) if the person paying the royalty is a resident of one of the Contracting States and has a permanent establishment in a third State with which the right or property giving rise to the royalty is effectively connected and such royalties are borne by such permanent establishment—such royalties are deemed to be from sources within the State in which the permanent establishment is located. This source rule is similar to the interest source rule found in Article 11 (Interest) of the proposed Convention and to the source rule for royalties under Belgian domestic law. On the United States side, since royalties are exempt at source, the source rule on royalties is relatively unimportant. However, on the Belgian side, because of the treatment given under Belgian law for excessive royalty payments, the source of the royalty has importance. Under the proposed Convention, if excessive royalties are paid because the payor and the recipient are related, the provisions of the royalty Article apply only to so much of the royalty as would have been paid to an unrelated person. The excess payment may be taxed according to its own law by the State from which the royalty is derived. In the case of Belgium, Belgium would deny a deduction for the excess royalty payments, but, in the hands of the recipient, the payment would still be considered to be a royalty under Belgian domestic law. However, the recipient is not entitled to the benefits of this article with respect to such excess.

If a nonresident has a permanent establishment in Belgium or the United States, royalties attributable to (effectively connected with) such permanent establishment are not subject to withholding but are subject to tax in Belgium or the United States at the rates normally applicable to industrial or commercial profits.

ARTICLE 13. CAPITAL GAINS

The existing Convention provides no special rules for gains derived in one State from the sale or exchange of stock, securities, commodities, or other capital assets by a resident of the other State. The proposed Convention provides that such gains shall be exempt from tax by the State of source. However, the exemption does not apply if (1) the gain derived by a resident of one State arises out of the sale or exchange of property described in Article 6 (Income from Real Property) which is situated within the other State, (2) the recipient of the gain has a permanent establishment or maintains a fixed base in that other State and the property giving rise to the gain is effectively connected with such permanent establishment or such fixed base, or (3) the recipient of the gain being an individual resident of the first State is present in that other State for a period or periods aggregating 183 days or more in the taxable year.

Gains which are effectively connected with a permanent establishment may be taxed as industrial or commercial profits under Article 7 (Business Profits). Gains on real property are subject to the provisions of Article 6 (Income from Real Property) which permits taxation of such gains by the State in which the real property is situated. The Belgians do not tax capital gains of individuals arising from a casual sale of nonbusiness assets.

ARTICLE 14. INDEPENDENT PERSONAL SERVICES

The existing Convention provides that an individual resident of one State shall be exempt from tax by the other State if he meets either of two conditions: (a) he is present in that other State for not more than 183 days and his compensation is for services performed as a worker or employee of, or under contract with, a resident of the first State who bears the actual burden of the remuneration; or (b) he is temporarily present within that other State for a period or periods not exceeding 90 days during the calendar year and the compensation received for such services does not exceed $3,000 in the aggregate. The 90-day, $3,000 rule under the existing Convention does not apply to remuneration of "administrateurs," "commissaires," or "liquidateurs" of, or of other individuals exercising similar functions in, corporations created or organized in Belgium, nor to remuneration of officers and directors of United States corporations.

The proposed Convention generally deals with personal services in two articles and creates a distinction based upon whether the services are independent or dependent personal services. The proposed Convention also provides a special rule for independent individuals who are artists or athletes, and a separate Article dealing with directors' fees. Thus, for example, a doctor or lawyer typically renders independent personal services. Also an entertainer who under common law concepts is an independent contractor is considered as rendering independent personal services.

Generally, under Article 14 of the proposed Convention, income earned by an individual resident of one State from independent personal services performed in the other State may not be taxed in that other State. However, such income will be subject to tax in the State of source (i.e., where the services are performed) if the recipient is present in that State for a period or periods aggregating 183 days or more in the taxable year or if the individual maintains a fixed base in that other State for a period or periods aggregating 183 days or more in the taxable year and the income is attributable to such fixed base.

Independent personal services means services performed by an individual for his own account where he receives the proceeds or bears the losses arising from such services. Commercial, industrial, or agricultural activities are not considered independent personal services and the income therefrom is taxed as industrial or commercial profits under Article 7 (Business Profits).

Thus, for example, if a physician, resident in one State, has an office available in the other State for a period aggregating 183 days or more during the taxable year, the income he earns from the performance of services within the other State will be subject to tax in that other State regardless of whether he is physically present in that other State for 183 days or more during the taxable year and regardless of whether others make use of his office in his absence.

An individual who derives income from independent personal services as a public entertainer is nevertheless subject to tax in the other State if his stay in such State exceeds 90 days during the taxable year or his income is in excess of $3,000 or its equivalent in Belgian francs during the taxable year.

ARTICLE 15. DEPENDENT PERSONAL SERVICES

Generally, under the proposed Convention income from labor or personal services as an employee may be taxed in the State in which such labor or personal services are performed (except as provided in Article 20 (Teachers) and Article 21 (Students and Trainees)). However, such income will be exempt from tax in the State of source if (1) the recipient, being a resident of one of the Contracting States, is present in the State of source for a period or periods aggregating less than 183 days during the taxable year; (2) the recipient is an employee of a resident of the State of his residence (or a permanent establishment located in the State of his residence); and (3) the remuneration is not borne as such by a permanent establishment which the employer has in the State of source. Thus,

the rule applicable to dependent personal services is similar to that contained in the existing Convention. However, income from personal services performed in Belgium by a United States resident who is employed by a Belgian permanent establishment maintained by a United States corporation would no longer be exempt from tax in Belgium (nor would there be an exemption from United States tax in the reverse situation). In addition, the proposed Convention would eliminate the rule in the existing Convention generally exempting a resident of one State from taxation by the other State of compensation received for services performed in the other State where such resident is temporarily present in the other State for a period aggregating 90 days or less during the taxable year and the compensation received for such services is not in excess of $3,000. The proposed Convention also adds a rule that income from personal services aboard ships or aircraft registered in one State and operated by a resident of that State in international traffic will not be taxed in the other State so long as the services are rendered by a member of the regular complement of the ship or aircraft.

This Article of the proposed Convention is substantially similar to the OECD Model Convention except that, under the proposed Convention, an individual temporarily present in one State who is an employee of a permanent establishment located in the other State and maintained by a corporation of the first-mentioned State will be exempt from taxation by the first-mentioned State on wages earned while temporarily present therein if the other requirements are met.

ARTICLE 16. DIRECTOR'S FEES

Under the existing Convention, compensation received by an individual who is a resident of one State as a director of a corporation of the other State is taxable by the other State. This result is obtained by the exclusion of such individuals from the 90-day, $3,000 rule. The proposed Convention continues this treatment, in part, in a specific Article dealing with the treatment of director's fees. The Article provides that a director's fee derived by an individual who is a resident of one of the States in his capacity as a member of the board of directors of a corporation of the other State may be taxed by the other State. This rule is limited to fees which an individual receives as a director as contrasted to fees that he might receive as an officer or employee of a corporation, by providing that a director's fee does not include fixed or contingent payments derived by an individual in his capacity as an officer or employee of a corporation. Further, to be a director's fee the payment must be of the type which cannot be taken as a deduction by the corporation paying the fee but is treated as a distribution of profits. These types of payments are typically made by Belgian corporations.

Director's fees taxable by Belgium under this Article are treated as Belgian source income for purposes of the United States foreign tax credit limitation regardless of where such services as a director are performed. This rule, which differs from the normal United States source rule, is designed to avoid double taxation.

ARTICLE 17. SOCIAL SECURITY PAYMENTS

This Article provides that social security payments paid by one State to an individual who is a resident of the other State will be taxed, if at all, by the payor State. Also included under this Article are other public pensions such as railroad retirement benefits. Neither the existing Convention nor the OECD Model Convention contains a comparable provision.

ARTICLE 18. 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 in the State of source. 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 the State of residence. However, pensions coming within the scope of Article 19 (Governmental Functions) will be taxable only by the State making payment.

The proposed Convention also provides that alimony paid to a resident of a State will be taxable only in the State of residence. A United States resident making alimony payments to a Belgian resident may deduct such payments (unless section 71(d) or 682 of the United States Internal Revenue Code applies).

The term "annuities" is defined as a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than for services rendered). The term "pensions" is defined as periodic payments made after retirement or death in consideration for services rendered, or by way of compensation for injuries received in connection with past employment.

The effect of this proivsion is generally the same as that of the OECD Model Convention.

ARTICLE 19. GOVERNMENTAL FUNCTIONS

The existing Convention exempts compensation including pensions and annuities paid by one of the States or a political subdivision or territory thereof to a citizen of that State residing in the other State (whether or not also a citizen of the other State) from taxation by that other State. The proposed Convention continues the exemption but adds a specification that the compensation must be paid in connection with the discharge of functions of a governmental nature. Compensation paid in connection with industrial or commercial activity is treated the same as compensation received from a private employer. The provisions relating to dependent personal services, private pensions and annuities, and social security payments would apply in such a case.

The proposed Convention extends the category of individuals who are eligible for the exemption to citizens of a third State who come to a State expressly for the purpose of being employed by the other State, a political subdivision, or a local authority thereof.

ARTICLE 20. TEACHERS

The existing Convention provides that teachers who are citizens of one State and who, pursuant to agreements between the States or teaching establishments in the States, accept a teaching position at an educational institution in the other State shall be exempt from taxation in such other State on remuneration received for such teaching, for a maximum period of two years.

The proposed Convention continues and broadens the 2-year exemption period for visiting teachers. This exemption applies to an individual who is a resident of one State at the time he is invited by the other State or by a recognized educational institution of the other State to teach or do research in the other State and temporarily comes to such other State in order to engage in such teaching or research. Invitation may be by the Government or a university or other recognized educational institution and research or teaching must be done at such university or other recognized educational institution. For purposes of the United States, the term "recognized" will be construed to mean accredited. However, the exemption does not apply to income from research undertaken not in the public interest but primarily for private benefit of a specific person or persons. If the individual's visit exceeds a period of 2 years from the date of arrival, the exemption applies to the income received by the individual before the expiration of such 2-year period.

ARTICLE 21. STUDENTS AND TRAINEES

Under the existing Convention remittances received from within one State by citizens of that State residing in the other State for the purpose of study are exempt from tax by the other State. The OECD Model Convention includes a similar provision.

The proposed Convention expands the exemption available to students by providing that an individual who is a resident of one State at the time he becomes temporarily present in the other State for the purpose of studying at a university or other recognized institution, of securing training for qualification in a profession or of studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational institution is exempt fom tax in the host State on:

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

(2) The grant, allowance, or award;

(3) Income from personal services performed in the host State not in excess of $2,000 (or its equivalent in Belgian 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 20 (Teachers) for more than a total of 5 taxable years from the date of arrival.

In addition, a resident of one State employed by or under contract with a resident of that State who, at the time he is a resident of that State, becomes temporarily present in the other State for the purpose of sudying or acquiring technical, professional, or business experience from a person other than a resident of the first-mentioned State or a person related to such resident, is exempt from tax in the host State on income not in excess of $5,000 (or its equivalent in Belgian francs) from personal services rendered in the host State. The individual is exempt for a period of 12 consecutive months which period commences with the first month in which he begins working or receives compensation.

Also, an individual who is a resident of one State and who is temporarily present in the host State as a participant in a government program of the host State for the primary purpose of training, research, or study is entitled to an exemption by the host State with respect to his income from personal services relating to such training, research, or study performed in the host State in an amount not in excess of $10,000 (or its equivalent in Belgian francs). To be entitled to this exemption the program must be a program which does not exceed 1 year in duration. If this qualification is met, then the income from personal services received with respect to such program is exempt.

If an individual qualifies for the benefits of more than one of the provisions of the personal services articles, he may choose the provision most favorable to him, but he may not claim the benefits of more than one provision in any taxable year as a means of avoiding the limitations provided.

ARTICLE 22. INCOME NOT EXPRESSLY MENTIONED

This Article of the proposed Convention contains a general rule that items of income of a resident of one of the States which are not expressly mentioned in the foregoing articles of the proposed Convention shall be taxable only in that State except that, if such income is derived from sources within the other State, that other State may also tax such income. This rule provides for the same result as found in paragraph (1) of Article 22 (General Rules of Taxation) of our French Convention which provides that 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 generally covered by the Convention, such income will ordinarily be taxed in accordance with the internal law of the State from which such income is derived. However, this Article does not apply to industrial and commercial profits attributable to a permanent establishment since such income is expressly covered in Article 7 (Business Profits). The existing Convention does not contain an express statement of this general rule. The OECD Model Convention differs on this point and provides that income which is not expressly mentioned will be taxable only in the State of residence. In any event it should be noted that the proposed Convention specifically covers most types of income.

ARTICLE 23. RELIEF FROM DOUBLE TAXATION

Under the existing Convention the United States provides relief from double taxation by allowing a credit for Belgian tax which credit shall not exceed that proportion of the United States tax which the net income from sources within Belgium bears to the total net income of such citizen or resident.

The proposed Convention employs the same method of avoiding double taxation. It provides that subject to the provisions of United States law applicable for the taxable years, a credit against United States tax will be allowed to a citizen or resident of the United States for Belgian tax paid. The credit is based upon the amount of tax paid to Belgium but may not exceed the amount of United States tax attributable to such income. Except for the special source rules provided by the Convention, this provision does not add to the rights which a United States citizen or resident has to the foreign tax credit, but is for the purpose of giving treaty recognition to such rights. Modifications in United States law after the effective date of the Convention which concern the foreign tax credit will be applicable with respect to Belgian source income if such modifications do not contravene the general principle of the 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 policies reflected

in the Convention. Thus, the savings clause does not affect the provisions with respect to the foreign tax credit, social security payments, nondiscrimination, or mutual agreement procedure. Moreover, the savings clause will not deny the benefits of the Convention to governmental employees or teachers or students unless such individuals are citizens of the United States or have immigrant status in the United States.

In the case of Belgium the Article provides a detailed procedure for the avoidance of double taxation. Generally, the method used is the exemption method but in some circumstances, it is the credit method. This system of avoidance of double taxation is similar to that found in the existing Convention. The provisions are based upon the law of Belgium relating to the imposition of tax on Belgians receiving income from outside Belgium. However, under this Article, present Belgian statutory law is liberalized with respect to (1) United States source dividends received by a Belgian corporation, (2) United States source business and personal services income, and (3) certain items of United States source income received by a citizen of the United States who is a resident of Belgium. These provisions are contained in paragraph (3) of Article 23 of the proposed Convention. Subparagraph (a) of paragraph (3) corresponds to subparagraph (f) of paragraph (3) of Article 12 of the existing Convention. Under this provision, items of income which are not subject to the provisions of subparagraphs (b) through (d) and which have been taxed by the United States in accordance with the provisions of Articles 6 through 21, are exempt by Belgium from tax. But, Belgium may take such items of income into account for the purpose of determining the rate of tax which is to be applied against the remaining income. The items of income included in this provision are (1) industrial and commercial profits subject to United States tax by reason of their being attributable to the maintenance by the taxpayer of a permanent establishment in the United States; (2) income from real property situated in the United States; (3) salaries, pensions, and annuities paid by the United States or by any political subdivision thereof to United States citizens or other individuals who qualify for the governmental exemption and reside in Belgium; (4) compensation for labor or personal services performed in the United States and taxed by the United States in accordance with the dependent or independent personal services Articles, and (5) any other business or personal service income which may be taxed by the United States in accordance with the Convention. Also included within the scope of subparagraph (a) are items of income that are covered by subparagraph (g) of the existing Convention. These items are interest, dividends, and royalties which are taxed by the United States by reason of the fact that they are effectively connected with a permanent establishment in the United States maintained by a Belgian taxpayer.

Subparagraph (b) conforms generally to subparagraphs (c) and (d) of the existing Convention. Subparagraph (b) grants a credit based upon existing Begian law subject to any subsequent modification thereof which, however, may not affect the principles of existing law, for dividends received by an individual and interest and royalties received by any resident of Belgium. The credit is allowed against the tax imposed on the net amount of dividends from corporations in the United States as well as of interest and royalties from sources in the United States which have been taxed there. At the present time the credit is an amount equal to 15 percent. This is fixed by Belgian law regardless of the amount of tax paid.

Subparagraph (c) is a new provision dealing with income not expressly mentioned which is taxable by the State of source under Article 22 (Income Not Expressly Mentioned). Under this provision where a resident of Belgium receives income which has been taxed by the United States under Article 22 (Income Not Expressly Mentioned) the amount of Belgian tax proportionately attributable to such income shall not exceed the amount which would be imposed in accordance with Belgian law if such income were taxed as earned income derived from sources outside Belgium and subject to foreign tax. In the case of corporations, the rate would be one-fourth the normal rate. In the case of individuals, the rate would be one-half the normal rate.

Subparagraph (d) corresponds to subparagraph (a) of the existing Convention. This provision has the effect of incorporating into the Convention the present statutory treatment of corporations or other entities. It provides that dividends taxed by the United States under paragraph (2) of Article 10 (Dividends) of the Convention at the reduced 15-percent rate shall be exempt

from Belgian corporate income tax to the extent that such exemption would be granted under Belgian law if both corporations were Belgian corporations subject to the Belgian corporate income tax. The Belgian law to be applied is the Belgian law applicable at the time the dividends were received by the Belgian corporation. Under present Belgian law the amount of the exemption is 95 percent (90 percent in the case of portfolio holding companies) of the amount of the dividend after reduction for all taxes including the United States withholding tax and the Belgian personal property prepayment (précompte mobilier). This provision does not prohibit the withholding from these dividends of such précompte as imposed by Belgian law. The present rate of tax is 10 percent of the amount of the dividend actually received by the Belgian corporation.

Subparagraph (e) corresponds generally to subparagraph (b) of the existing Convention and provides an exception in favor of United States source dividends to the rules provided in subparagraph (d) dealing with the imposition by Belgium of the tax on dividends (précompte mobilier) received by a Belgian corporation or other entity subject to Belgian corporate tax. This exception is in addition to the exemption provided in subparagraph (d). Under this provision a Belgian corporation which receives dividends from a United States corporation on stock which has been directly owned by that Belgian corporation during the whole of the accounting period of the United States corporation which is subject in the United States to tax on its profits may elect to have such dividends exempted from the Belgian personal property prepayment (précompte mobilier) ordinarily applicable to such dividends. A Belgian corporation may elect this treatment by making a written request for such exemption when filing its annual tax return or before the expiration of the period allowed for the filing of such return. Under this provision the Belgian corporation deriving a dividend from a United States corporation (after the withholding of United States tax at the source at the 15-percent treaty rate) (1) will not be required to pay the personal property prepayment otherwise due on receipt, and (2) will be permitted to calculate its statutory corporate income tax exemption (as provided in subparagraph (d)) on the full dividend received. This permits the qualified Belgian corporation receiving dividends from United States corporations to accumulate or reinvest a larger portion of such dividends than would be the case under Belgian law in the absence of this treaty provision. However, dividends accorded this exemption can not be deducted for purposes of determining the personal property prepayment applicable to dividends distributed by the recipient corporation or other entity to its shareholders or members. This provision differs from the existing provision in that, if Belgian legislation ever imposed a 10-precent ownership requirement for eligibility of the 90 and 95 percent dividend exemption for intercorporate dividends, then such similar 10-percent ownership requirement would also apply in order for a Belgian corporation to obtain the benefits of this provision.

Subparagraph (f) is generally comparable to subparagraph (e) of the existing Convention. This provision contains special relief with respect to certain income derived by a citizen of the United States who is a resident of Belgium and thus liable to income tax in both States on a worldwide basis. The existing provision provides that the Belgian individual income tax proportionately attributable to dividends, interest, pensions, annuities, or royalites received by a citizen of the United States residing in Belgium from sources within the United States may not exceed 15 percent of that income after allowance of the lump sum foreign tax credit. Though residence in Belgium would ordinarily entitle individuals to an exemption from, or reduction in the rate of, United States tax on specified items of income under the Convention, such benefits are not available to United States citizens. The existing and proposed provisions provide a measure of relief in these circumstances by reducing the amount of Belgian tax which can be imposed on the specified items of income. The proposed provision provides that the Belgian income tax proportionately attributable to the dividends, interest, or royalties received by a citizen of the United States residing in Belgium from sources within the United States may not exceed 20 percent of that income after allowance of the lump-sum foreign tax credit. The existing provision was based on a personal property prepayment at the rate of 15 percent, which is now 20 percent. In the case of other income concerned, the amount of tax which would be imposed is the amount which would be imposed if such income were taxed as earned income derived from sources outside Belgium and subject to a foreign tax. This provision only applies to income

which is not exempt from Belgian tax under subparagraph (a) or covered by subparagraph (c) which covers items of income not expressly mentioned.

Subparagraph (g) generally corresponds to subparagraph (h) of the existing Convention. Proposed subparagraph (g) provides that when, in accordance with Belgian law, losses incurred by a resident of Belgium in a permanent establishment situated in the United States have been effectively deducted from the profits of that resident for purposes of his taxation in Belgium, the exemption provided in subparagraph (a) should not apply in Belgium to the profits of other taxable periods attributable to the permanent establishment to the extent that those profits have also been reduced for United States tax purposes by reason of allowance of such losses.

Paragraph (4) provides for relief from double taxation in accordance with the principles of paragraphs (2) and (3) in the case of a corporation which is treated as a United States corporation for United States tax purposes and a Belgian corporation for Belgian tax purposes.

ARTICLE 24. NONDISCRIMINATION

Paragraph (3) of Article 20 of the existing Convention provides that citizens or corporations or other juridical persons of one State will not be subjected to more burdensome taxes in the other State than are imposed on the citizens or corporations or other juridical persons 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. Thus, for example, a citizen of Belgium who is a resident of the United States and who meets the requirements specified in section 911 of the Internal Revenue Code would, under this Article of the proposed Convention, be eligible for the benefits of section 911 although he is not also a citizen of the United States.

This Article provides, however, that a State may accord special treatment to its own residents on the basis of civil status or family responsibility.

This Article also deals with the fact that Belgian domestic law provides for a lower rate on distributed earnings of a Belgian corporation (30% basic rate) than on retained earnings of a Belgian corporation (up to 35% basic rate) and applies only the higher rate to the income of a Belgian permanent establishment of a foreign corporation. This is recognized as discriminatory and the proposed Convention provides that in the case of a Belgian permanent establishment of a United States corporation the lower rate for retained earnings will apply to that part of the earnings of the permanent establishment deemed distributed. It is provided in this Convention that the permanent establishment is deemed to distribute the same percentage of its earnings as the corporation of which it is a part distributes of its earnings. The provision permits Belgium, however, to impose its surcharge on the higher rate consistent with its domestic law.

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 Model includes a provision concerning Stateless persons which has been omitted from the proposed Convention.

ARTICLE 25. MUTUAL AGREEMENT PROCEDURE

This Article modernizes the mutual agreement procedures found in the existing Convention by adopting provisions similar to those in the recent amendments to our Conventions with the Netherlands, the United Kingdom, and the Federal Republic of Germany and in our recently revised Convention with France. When a resident of one State considers that action of one or both States has resulted, or will possibly result, in taxation contrary to the provisions of the proposed Convention, such resident may present his case to the competent authority of the State of which he is a resident within 2 years from the date the resident is notified (or collection is made at the source) of the tax (or, where the problem arises from inconsistent action of both States, within two years from the date the resident is notified, or from collection at source, of the tax which has been last asserted or collected). This remedy is in addition to any remedy provided by the national laws of either State.

This Article contemplates that the competent authorities of the two States will endeavor to settle by mutual agreement such cases of taxation not in accordance with the Convention as well as any other difficulties or doubts arising as to the application of the Convention. Some particular areas on which the competent authorities may consult and reach agreement are the amount of industrial and commercial profits to be attributed to a permanent establishment, the allocation of income, deductions, credits, or allowances between a resident and a related person, the determination of source of particular items, and the meaning of any term used in the Convention.

In implementing the provisions of this Article, the competent authorities will communicate with each other directly and meet together for an exchange of oral opinions when advisable.

In cases in which the competent authorities reach agreement with respect to a particular matter, taxes will be adjusted and refunds or credits allowed in accordance with such agreement. This provision permits the issuance of a refund or credit notwithstanding procedural barriers otherwise existing under a State's law, such as the Statute of Limitations.

This provision will apply only where agreement or partial agreement has been reached between the competent authorities and will apply in the case of any such agreement after the Convention goes into effect even though the agreement may concern taxable years prior thereto.

Revenue Procedure 70–18 sets forth the procedure followed by the United States in implementing its obligations under this type of Article.

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 faciliate the administration of the Convention and to prevent fraud and the avoidance of taxes to which the Convention relates.

Information exchanged is treated as secret and may not be disclosed to any persons other than those (including a court or administrative body) concerned with the assessment, collection, enforcement, or prosecution of taxes subject to the Convention, but this does not prohibit disclosure in the course of a court proceeding. In no case does this Article impose an obligation on either State to disclose trade secrets or similar information or to carry out administrative measures or supply particulars where such action would be at variance with the laws or administrative practice of that State, or contrary to public policy. In general, the standard for the exchange of information is the standard used by the States in the enforcement of their own laws by administrative and judicial authorities.

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 provision contained in the existing Convention.

ARTICLE 27. ASSISTANCE IN COLLECTION

This Article, substantially similar to the assistance in collection Article in the existing Convention, provides for mutual assistance in the collection of taxes where required to avoid an abuse of the Convention. The provision is intended merely to insure that the benefits of the Convention will only be available with respect to persons entitled to such benefits; it does not in any way alter rights under other provisions of the Convention.

The Article provides that each State will endeavor to collect for the other State such amounts as may be necessary to insure that any exemption or reduced rate of tax granted under the proposed Convention will not be availed of by persons not entitled to those benefits. However, this Article will not require a State, in order to collect taxes which are imposed by the other State, to undertake any administrative measures that differ from its internal regulations or practices nor will this Article require a State to undertake any administrative or judicial measures which are contrary to that State's sovereignty, security, or public policy.

ARTICLE 28. MISCELLANEOUS

This Article contains provisions normally found in other parts of tax conventions to which the United States is a party. Paragraph (1) is identical to Article

28 of the French Convention. This paragraph preserves the existing fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements. Paragraph (2) is substantially identical to paragraph (3) of Article 22 of the French Convention. This continues the general rule of taxation found in most tax conventions 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 except that, to the extent a Convention specifically provides, it may be necessary to waive certain rights as a condition of claiming more advantageous treaty benefits. Paragraph (3) provides that the competent authorities of the two States may communicate with each other directly for the purpose of carrying out the provisions of this Convention.

ARTICLE 29. EXTENSION TO TERRITORIES

This Article provides a method for extending the Convention, either in whole or in part or with such modifications as may be found necessary for special application in a particular case, to all or any areas for whose international relations the United States is responsible and which area imposes taxes substantially similar in character to those which are the subject of the Convention. It is limited to extension by the United States since Belgium no longer has any colonies or territories.

Extension to an area may be accomplished through a written notification given to Belgium through diplomatic channels. Belgium shall indicate its acceptance by a written communication through diplomatic channels. When the notification and communication have been ratified in accordance with the constitutional procedures of each State and instruments of ratification exchanged, the extension will take effect from the date of, and be subject to such conditions as are specified in, the notification. Without such acceptance and exchange of instruments of ratification in respect of an area, none of the provisions of the Convention shall apply to such areas.

Either of the States may terminate an extension with respect to any area by 6 months' prior written notice of termination given to the other State at any time after the date of entry into force of the extension. The termination will take effect for taxable years beginning on or after the first day of January next following the expiration of the 6-month period. The termination of an extension to a particular area will not affect the application of the Convention to the United States, Belgium, or any other area to which the Convention has been extended.

Termination of the Convention by either State in accordance with Article 31 (Termination) shall, unless otherwise expressly agreed by both States, terminate the application of the Convention to any area to which the Convention has been extended under this Article.

ARTICLE 30. 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 shall first have effect with respect to income of calendar years or taxable years beginning (or in the case of taxes payable at source, payments made) on or after January 1, 1971.

The entry into force of the proposed Convention will terminate the Convention of October 28, 1948, the Supplementary Conventions of September 9, 1952, and August 22, 1957, as well as the Protocol of May 21, 1965.

ARTICLE 31. TERMINATION

The Convention will continue in effect indefinitely, but may be terminated by either State at any time after the year 1975. A State seeking to terminate the Convention must give notice at least 6 months before the end of the calendar

year through diplomatic channels. If the Convention is terminated, such termination will be effective with respect to income of calendar years or taxable years beginning (or, in the case of taxes payable to source, payments made) on or after January 1 next following the expiration of the 6-month period. However, upon prior notice to be given through diplomatic channels, the provisions of Article 17 (Social Security Payments) may be terminated by either State at any item after this Convention enters into force.

OCTOBER 6, 1970.

TECHNICAL EXPLANATION OF PROPOSED UNITED STATES-FINLAND INCOME TAX CONVENTION, SIGNED MARCH 6, 1970

(Department of the Treasury)

ARTICLE 1. TAXES COVERED

This Article designates the taxes of the respective States which are the subject of the proposed Convention. With respect to the United States, the taxes included are the United States Federal income taxes imposed by the Internal Revenue Code. This includes, for example, the surtax and would also include such taxes as the temporary surcharge which was in force from 1968 to 1970. However, the Convention is not intended to apply to taxes which are in the nature of a penalty such as the taxes imposed under section 531 (accumulated earnings tax) and section 541 (personal holding company tax) of the Internal Revenue Code.

With respect to Finland, the taxes included are the State (national) income and capital tax, the Communal tax, and the Sailors' tax. The national income tax is levied at graduated rates on the worldwide income of resident individuals and corporations. The capital tax is levied at graduated rates on the worldwide net wealth of resident individuals and on nonresident individuals owning real property located in Finland, shares of stock in a Finnish corporation or other personal property exclusive of bonds, bank accounts, and foreign trade credits. The Church tax, a local income tax levied at rates ranging from 1 to 2 percent from members of the Evangelical Lutheran and Greek Orthodox churches and from resident corporations, is not included in the category of taxes covered; it is among the taxes included in the nondiscrimination article, however. The Communal tax, also a local income tax levied against resident individuals and corporations at rates which vary from 8.5 percent to 16 percent, is covered. The Sailors' tax is deducted at the source from compensation of seamen employed aboard Finnish ships. It is imposed in lieu of the State income tax and the Communal tax. The effect of including the Communal and Sailors' taxes in the Treaty is to broaden the Finnish taxes against which Finland will give a credit for United States taxes. It does not expand the credit allowed in the United States since we already give a credit under our statute for these taxes.

The present Finnish Convention includes within the category of Finnish taxes covered only the national income tax.

The present Finnish Convention enumerates within the category of United States taxes covered also the surtax and excess profits tax. The "surtax" was eliminated as unnecessary and possibly confusing in view of the enactment of the "surcharge"; the excess profits tax has been repealed. In addition, the accumulated earnings and personal holding company tax were specifically excluded from the taxes covered in the proposed Convention in order to avoid uncertainty as to status of these taxes.

Pursuant to paragraph (2) of this Article the proposed Convention would also apply to taxes substantially similar to those enumerated which are imposed, in addition to or in place of the existing taxes, after the date of signature of this Convention (March 6, 1970).

For purposes of Article 7 (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. A number of important terms, however, are defined elsewhere in the Convention.

Any term used in this Convention which is not defined therein shall, unless the context otherwise requires, have the meaning which it has under the laws of the State which is imposing the tax. The proposed Convention also provides a procedure under which a common definition may be arrived at by the competent authorities of Finland and the United States in order to prevent double taxation or further any other purpose of this Convention, if the definition of such term under the respective internal laws of the States differs. The common meaning is to be arrived at by means of the mutual agreement procedure which is described in Article 28 (Mutual Agreement Procedure) of the proposed Convention.

ARTICLE 3. FISCAL DOMICILE

This Article sets forth rules for determining "fiscal domicile" or residence of individuals, corporations and other persons for purposes of the proposed Convention. Residence is important because, in general, only a resident of one of the Contracting States may qualify for the benefits of the Convention. This Article is patterned generally after the fiscal domicile article of the OECD Model Convention.

The term "a resident of Finland" means a corporation of Finland as defined in Article 2 (General Definitions) and any person (except a corporation or any entity which under Finnish law is treated as a corporation) who is a resident of Finland for purposes of its tax. The term "a resident of the United States" means a United States corporation as defined in Article 2 (General Definitions) and any other person (except a corporation or any other entity treated under United States law as a corporation) who is a resident in the United States for purposes of its tax.

The parenthetical language in the definition of a resident of the United States is intended to make clear that a foreign corporation for United States tax purposes, which is a resident of the United States for certain purposes of its income tax law is not, under the Convention, a resident of the United States. A similar rule was needed in the case of Finland.

In the case of the United States and Finland, the definition provides that 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.

This language, although different from the Income Tax Convention between the United States and Belgium, signed July 9, 1970, is intended to achieve the same result. Under United States law, a partnership is never, and an estate or trust is often not, taxed as such. Under the proposed Convention, in the case of the United States, income received by a partnership, estate, 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. With respect to income taxed in the hands of the estate or trust, the residence of the estate or trust is determinative. This provision is reciprocal because of the presence of a similar problem under Finnish law.

An individual who is a resident of both States under the rules of domestic law employed by such States for determining residence will be deemed to be a resident of the State in which he has his permanent home, his center of vital interests (closest economic and personal relations), or his habitual abode, in the order listed. If the issue is not settled by these tests, the competent authorities will decide by mutual agreement the one State of which he will be considered to be a resident. Thus for purposes of the Convention, including the savings clause of Article 4(3), an individual can be resident in Finland or the United States but not both.

ARTICLE 4. GENERAL RULES OF TAXATION

The present Convention sets forth in a separate article the general rules of taxation applicable under the Convention. The general rules of taxation applicable under the proposed Convention are as follows:

A resident of one State may be taxed by the other State only on income from sources within that other State (including industrial or commercial profits attributable to a permanent establishment located in that other State), subject to the limitations set forth in this Convention. The jurisdictional rules of the proposed Convention parallel those set forth in section 872(a) of the United States Internal Revenue 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 existing Finnish Convention contains the "force of attraction" doctrine, under which all Finnish source income of a resident of the United States having a permanent establishment in Finland is attributed to the permanent establishment and subject to tax at ordinary rates. In the converse case the existing treaty provides that United States source income of a Finnish resident is subject to United States tax at ordinary rates. However, under the changes in United States statutory law made by the Foreign Investors Tax Act of 1966, only the investment income in fact attributable to the permanent establishment is taxed at ordinary rates. Other United States source income of a foreigner having a permanent establishment in the United States may qualify for the reduced rates provided by a tax convention.

The proposed Convention contains a similar but more inclusive rule. Only that business and investment income effectively connected with the permanent establishment is taxed as part of the income of the permanent establishment and loses the exemptions and reduced rate benefits otherwise provided by the treaties.

Both the proposed Convention and the existing Convention contain the general rule of taxation (also found in our new French Convention) 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, except that to the extent a convention specifically provides, it may be necessary to waive certain rights as a condition to claiming more advantageous treaty benefits.

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 policies reflected in the Convention. Thus, the savings clause does not affect the provisions with respect to the foreign tax credit, social security payments or nondiscrimination. Although the provisions dealing with the mutual agreement procedure are not specifically excepted from the savings clause, agreements made by the competent authorities may nevertheless inure to the benefit of a citizen or resident of the United States or a resident of Finland. Moreover, the savings clause will not deny the benefits of the Convention to governmental employees or teachers or students unless such individuals are citizens of the United States or have immigrant status in the United States. The savings clause is nonreciprocal because Finland imposes tax on the basis of residence rather than citizenship.

The benefits of paragraph (3) of Article 23 (Rules Applicable to Personal Income Articles) are not excepted from the savings clause. As noted hereinafter, that paragraph provides that a teacher, student, or apprentice of one of the States, temporarily present in the other State and who is entitled to exemption from tax in the other State under the Convention, shall be allowed by the State of residence as deductions from taxable income travel and living expenses (in the minimum amount of 30 percent) incurred while temporarily present in the other State. The purpose of paragraph (3) of Article 23 (Rules Applicable to Personal Income Articles) is to relieve some of the burden of Finnish taxes imposed on Finnish teachers, students, and apprentices who come to the United States to study or work. Although this provision is reciprocal in form, it is not applicable to United States citizens and residents. The taxability of scholarship and fellowship grants and of compensation received by United States citizens and residents who go to Finland to study or work is determined under sections 61, 117, and 911 of the Internal Revenue Code.

The last paragraph of this Article provides that 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 on this point and provides that income which is not expressly mentioned will be taxable only in the State of residence. It should be noted that the proposed Convention specifically covers most types of income.

ARTICLE 5. RELIEF FROM DOUBLE TAXATION

Under the existing Convention, the United States provides relief from double taxation by allowing a credit for Finnish 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 to a United States citizen or resident for Finnish income tax paid but not in excess of the portion of United States tax which net income from Finnish sources bears to total net income. Except for the special source rules provided by the Convention, this provision does not add to the rights that a United States citizen or resident has to the foreign tax credit, including his right under current law to elect the overall limitation, but is for the purpose of giving treaty recognition to such rights. Modifications in United States law after the effective date of the Convention which concern the foreign tax credit will be applicable with respect to Finnish source income if such modifications do not contravene the general principles of the Convention.

In the case of Finland, generally double taxation will be avoided by a combination of three methods: exemption, tax credit, and exemption with progression. With respect to United States source income (other than dividend income) or capital which under the treaty is taxable in both States paragraph (2)(a) provides that Finland will give a credit against Finnish income or capital tax for the amount of the Finnish income or capital tax attributable to such United States source income or capital. Although written in the form of a credit, the effect of this provision is to exempt from tax in Finland income and capital which under the Convention is taxable in the United States; for example, real property income and personal services income. With respect to United States source dividends (other than intercorporate dividends) paragraph (2)(b) provides that Finland will allow a credit for the United States tax withheld on such dividends but not in excess of that portion of Finnish tax which the United States source dividends bear to total Finnish taxable income. Under Finnish law intercorporate dividends are tax exempt. Paragraph (2)(c) of the proposed Convention extends this exemption to dividends paid by a United States subsidiary to a Finnish parent corporation as long as Finland retains the rule of exemption for intercorporate dividends received by Finnish corporations. With respect to income or capital which under the treaty is exempt from Finnish tax, Finland retains the right to take the amount of exempt income or capital into account when determining the graduated rate of Finnish tax to be imposed on total taxable income and net wealth. This is the exemption with progression method of providing relief from double taxation. Examples of income and capital included in this category are industrial and commercial profits and capital attributable to a United States permanent establishment, income and capital attributable to ships and aircraft registered in the United States, and Government salaries and social security payments.

The operation of the Finnish combined exemption and credit method may be illustrated by the following example. A resident of Finland receives $6,500 income from United States sources. This is his total income from all sources. The $6,500 consists of $5,000 salary, $500 rental income, and $1,000 dividends. He pays a total United States tax of $350 of which $200 is attributable to salary and rental income and $150 is withheld on the dividends. In the absence of a treaty he would pay a total Finnish tax of $550 of which $465.38 $\frac{(\$5{,}500 \times \$550)}{\$6{,}500}$ is attributable to salary and rental income. Under paragraph (2)(a) of this Article the Finnish resident is entitled to a credit for the full amount of the $465.38 of Finnish tax attributable to the salary and rental income—which, in effect, exempts such income from Finnish tax. Under paragraph (2)(b) the Finnish resident is also entitled to a deduction from his Finnish tax on the $1,000 dividend received from the United States in an amount equal to the United States tax paid on such

dividends. However, under the limitation of the second sentence of paragraph (2)(b), the amount by which the United States tax attributable to such dividend ($150) exceeds the Finnish tax attributable to such dividend ($84.62) cannot be set off against Finnish tax attributable to the salary and rental income.

ARTICLE 6. SOURCE OF INCOME

The present Finnish Convention does not specify the rules for determining the source of the different kinds of income covered by the Treaty. This Article sets forth in a single provision all of the various rules which are to be applied to determine the source of the different kinds of income covered by the treaty: dividends, interest, royalties, income from real property, including gains derived from the sale of such property, and compensation for personal services. These rules affect the application of Article 4 (General Rules of Taxation) and Article 5 (Relief from Double Taxation).

The source of any kind of income not covered by the treaty shall be determined under the local law of the two States. In the case of different source rules applicable to an item of income the competent authorities of the two States under the mutual agreement procedure may establish a common source for the item of income.

The 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 conforms to both United States and Finnish statutory law. The source rule under which dividends paid by a corporation of any State are treated as from sources within one of the States if, during the previous 3 years, the corporation had a permanent establishment in that State and more than 80 percent of such corporation's income was attributable to such permanent establishment conforms to some extent to United States statutory law. Under section 861(a)(2)(B) of the Internal Revenue Code if more than 50 percent of a foreign corporation's income is effectively connected with a United States business, a pro rata share of such corporation's dividends are treated as from sources within the United States. The difference will result in the United States imposing tax in fewer cases under the Convention source rule than under the statutory source rule.

The source rule under which interest paid by a resident of one of the States, including a political subdivision of such State is treated as from sources within that State and interest paid by a resident or political subdivision of any other State is treated as from sources outside that State conforms to both United States and Finnish statutory law. The source rule under which interest paid by a resident, individual, or corporation, of any State is treated as from sources within one of the States if, during the previous 3 years, the resident has a permanent establishment in that State and more than 80 percent of such corporation's income was attributable to such permanent establishment represents a combination and modification of the two source rules of section 861(a)(1)(B) and (C) of the Internal Revenue Code.

Royalties paid for the use, or right to use, property (as defined in Article 14 (Royalties)) in a State are treated as from sources within that State. Income from real property (including the sale of such property) located in a State is treated as from sources within that State. These source rules correspond to that found in section 861(a)(4) and (5) of the Internal Revenue Code.

Personal service income is treated as from sources within the State where the services are performed. This source rule corresponds to the general rule of section 861(a)(3) of the Internal Revenue Code.

Industrial and commercial profits attributable to a permanent establishment, and dividends, interest, royalties, real property income, and capital gains derived from rights or property effectively connected with a permanent establishment are treated as from sources within the State where such permanent establishment is located. In general the factors which under the proposed Convention determine whether the property giving rise to the investment-type income is effectively connected with a permanent establishment are the same as the factors which under section 864(c) of the Internal Revenue Code determine whether fixed or determinable annual or periodical income is effectively connected with the conduct of a trade or business in the United States.

ARTICLE 7. NONDISCRIMINATION

The existing Convention provides that citizens of one State will not be subjected to more burdensome taxes in the other State than are imposed on the citizens of such other State. The term "citizen" is defined to include all legal persons, partnerships, and associations created or organized under the laws of the respective States.

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. Thus, for example, a citizen of Finland who is a resident of the United States and who meets the requirements specified in section 911 of the Internal Revenue Code would, under this Article of the proposed Convention, be eligible for the benefits of section 911 although he is not also a citizen of the United States.

This Article provides, however, that a State may accord special treatment to its own residents on the basis of civil status or family responsibility.

The ban on discrimination extends to all taxes without regard to subject matter and whether imposed at national, State, or local level.

This Article is substantially similar to the nondiscrimination Article of the OECD Model Convention except that the model includes a provision concerning Stateless persons which has been omitted from the proposed Convention.

ARTICLE 8. BUSINESS PROFITS

This Article sets forth the typical treaty rule that industrial or commercial profits of a resident of one State are taxable in the other State only if the resident has a permanent establishment in that other State. Where there is a permanent establishment only the profits attributable to the permanent establishment can be taxed by that other State. For purposes of Article 5 (Relief From Double Taxation) which, among other things, provides that a foreign tax credit will be allowed by the United States, such profits are considered to be from sources within the State in which the permanent establishment is located.

While under the existing Finnish Convention, as under the old French Convention, industrial or commercial profits are not taxed in the absence of a permanent establishment, once there is a permanent establishment the existing Convention, as did the old French Convention, provides that the provisions reducing the tax rates on interest and dividends and exempting royalties are not applicable. This rule is known as the "force of attraction" principle and is replaced in the proposed Convention, as in our new treaty with France, with the effectively connected concept. Under the new approach, only interest, dividends and royalties which are effectively connected with the permanent establishment are taxable as part of the industrial or commercial profits and do not benefit from the reduced rate or exemption.

In determining the proper attribution of industrial or commercial profits under the proposed treaty, the permanent establishment is generally 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. However, it is not necessary to allow a profit to the head office for ancillary services furnished to the permanent establishment as long as the permanent establishment is allowed to deduct the allocable costs incurred by the head office.

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.

Paragraph (5) of this article defines the term "industrial or commercial profits of a resident" as including, *inter alia*, income derived from agricultural activity, the furnishing of personal services of others, the rental of tangible personal property, insurance activities and from rents or royalties derived from motion picture films or films or tapes of radio or television broadcasting.

The inclusion of rents and royalties from motion pictures and related activities represents a change from the existing Convention. The existing Convention

allows Finland to tax Finnish source motion picture rents and royalties paid to United States distributors whether or not the distributors operate through a permanent establishment in Finland. The inclusion of motion picture royalties in industrial and commercial profits conforms to the rule in our new French treaty. Its effect is to provide on a reciprocal basis that motion picture royalties will be taxable by the source State only if they are attributable to a permanent establishment located in such State.

The definition of "industrial and commercial profits" specifically includes investment income if the right or property giving rise to the income is effectively connected with 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.

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 9. 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 Article 12 (Dividends), Article 13 (Interest), Article 14 (Royalties), and Article 16 (Capital Gains). The definition of "permanent establishment" is a modernized version of the definition found in some of our older treaties. The new definition is similar to the definition found in our French Convention.

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 permanent establishment 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 installation project which exists for more than 12 months. The 12-month construction project rule is a physical test under which the resident must be actively engaged in the project during that 12-month period. As a general rule, any fixed facility through which an individual, corporation or other person conducts industrial or commercial activity will be treated as its permanent establishment unless it falls in one of the specific exceptions described below. The proposed Convention uses the term "a seat of management" which was the term used in our Convention with France. The technical explanation of our French Convention explains the definition of the term "a seat of management" and its difference in meaning from the term "a place of management" as follows:

> 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 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.

That explanation is applicable to the proposed Finnish Convention.

This Article specifically provides that a permanent establishment does not include a fixed place of business of a resident of one of the Contracting States which is located in the other Contracting State if it is used only for one or more of the following—(1) the use of facilities for the purpose of storage, display, or delivery of goods or merchandise belonging to the resident; (2) the maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display, or delivery; (3) the maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person; (4) the maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the resident; or (5) the maintenance of a fixed place of business for the purpose of advertising, or the supplying of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the resident. These exceptions are cumulative and a site or facility used solely for more than one of these purposes will not be considered a permanent establishment under the proposed 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 an independent agent, who has and regularly exercises authority to conclude contracts in the name of such person unless the agent exercises such authority only to purchase goods or merchandise. The existing Convention likewise provides that a purchasing agent is not a permanent establishment.

With respect to an independent agent, 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 carries on 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 his 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 of such resident with respect to a resident of the other State or with respect to a person who engages in industrial or commercial activity in that other State (whether through a permanent establishment or otherwise).

ARTICLE 10. SHIPPING AND AIR TRANSPORT

This Article provides that, notwithstanding the rules of Article 8 (Business 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, including capital gain derived from the sale of a ship or aircraft, registered in the former State. This Article is substantially the same as Article V of the existing Convention.

This Article also will apply to income derived from the leasing, to a person engaged in the operation of ships or aircraft, of a ship or aircraft under a full or bareboat charter, where the lessor is engaged in the operation of ships or aircraft if such lease is ancillary to the lessor's other operations. For example, if an airline of one of the Contracting States which has excess equipment in the winter months leases several aircraft which are excess during that period to an airline in the other Contracting State, the lessor is not subject to tax by that other Contracting State.

The exemption provided by this Article is also applicable to profits derived from any activities incidental to the operation of ships or aircraft in international traffic. Thus, for example, commissions derived by a Finnish international air-carrier from the sale of passenger tickets in the United States as agent for other persons operating ships or aircraft, if incidental to its own international operations, will be exempt from United States tax under Article 8. Further, a Finnish airline company might have facilities at an international airport in the United States which are used to service and maintain its own aircraft. In order to make maximum use of the facilities, the company might also service and maintain aircraft of other companies. The profits derived from the furnishing of such services to others would be exempt under Article 8 unless such activity ceased to be only an incidental activity. However, income derived by a Finnish airline company from the operation of a hotel in the United States would not be incidental to the operation of aircraft and would not be exempt.

ARTICLE 11. RELATED PERSONS

This Article complements section 482 of the Internal Revenue Code of 1954 and confirms the power of each government to allocate items of income, deductions, credits, or allowances 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. This provision is similar to the provision contained in the OECD Model Convention.

Provision is made in Article 28 (Mutual Agreement Procedure) for consultation and agreement between the two States where an allocation by either State results or would result in double taxation.

ARTICLE 12. 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 former State at a rate not in

excess of 15 percent. In the case of intercorporate dividends, however, if the recipient owns 95 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 maximum rate of tax is 5 percent. The proposed Convention continues the 15 percent rate with respect to dividends on portfolio investments and the 5 percent rate with respect to direct investments with the further requirement that in the case of Finnish source dividends, the combined dividend tax and capital tax on the capital stock of the paying corporation owned by the United States resident cannot exceed the specified maximum rates. The proposed Convention reduces the stock ownership requirement for direct investment dividends from 95 percent to 10 percent.

The proposed Convention abandons the "force of attraction" concept in the existing Convention by providing that the reduced rate of tax on dividends is denied only if the shares with respect to which the dividends are paid are effectively connected with a permanent establishment which the recipient has in the State of source. If so connected, the dividends are taxed as industrial or commercial profits under Article 8 (Business Profits).

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 establishment in the State of source. In those cases where the shares with respect to which the dividends are paid are effectively connected with a permanent establishment, the dividends may be taxed as industrial or commercial profits under Article 8 (Business Profits). The policy reflected in the abandonment of the "force of attraction" principle is also embodied in the recent revisions of the German, Dutch, and United Kingdom Conventions, our new Convention with France, and in the Foreign Investors Tax Act of 1966.

In the absence of a Convention, Finland would withhold at a rate of 15 percent of dividends paid by a Finnish corporation to a United States resident. The capital stock of a Finnish corporation owned by a United States resident would also be subject to the annual Finnish capital tax at graduated rates which range from .52 percent to 2.5 percent. In the absence of the Convention the United States would withhold at a rate of 30 percent on dividends paid by a United States corporation to a Finnish resident.

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 received by the Finnish corporation paying dividends from 50 percent or more owned subsidiaries are not considered passive income.

ARTICLE 13. 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 exempt from tax in the former State.

The proposed Convention retains this rule on interest replacing the "force of attraction" principle by the effectively connected approach.

Thus, the reduced rates of tax applicable to the 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 with such permanent establishment. In such case, the interest may be taxed as industrial or commercial profits.

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 because the payor and the recipient are related, the provisions of the interest Article apply only to so much of the interest as would have been paid to an unrelated person. The excess payment may be

taxed according to the law of each contracting State subject to the other provisions of the proposed Convention where applicable.

In the absence of a convention interest income derived from Finland by nonresidents is exempt from the national income tax and all local income taxes. This includes interest on bonds, bank accounts, and accounts originating from international trade. Likewise, such bonds and accounts are exempt from the capital tax if owned by nonresidents.

In the absence of a convention the United States would generally withhold tax at 30 percent from interest income derived by a nonresident from sources within the United States unless such nonresident was engaged in trade or business in the United States and such income was effectively connected to such trade or business; in the latter case, interest income would not be subject to withholding but would be subject to tax at ordinary rates.

ARTICLE 14. ROYALTIES

The existing Convention applies only to copyright royalties (not including motion picture royalties) and provides that they shall be exempt by the State of source provided the recipient does not have a permanent establishment in the source State. Patent and trademark royalties are not covered by the existing Convention. The proposed Convention Article, which is substantially the same as the OECD Model Convention, continues the rule of exemption at source. It also extends the definition of royalties to include (in addition to copyrights, artistic or scientific works) patents, designs or models, plans, secret processes or formulae, trademarks, and industrial, commercial, or scientific equipment, knowledge, experience, or skill (know-how); it also includes gains from the sale or exchange of the property described in the Article provided the payment is contingent on productivity, use, or disposition of the property. If the payments are not so contingent, Article 16 (Capital Gains) applies. This all inclusive definition is based on the royalties Article in the new French Convention.

Under the proposed Convention, if excessive royalties are paid because the payor and recipient are related, the provisions of the royalties Article apply only to so much of the royalty as would have been paid to an unrelated person. The excess payment may be taxed by each State, according to its own law including the provision of the proposed Convention where applicable.

In the absence of a convention, a nonresident of Finland receiving royalties, including film royalties, from Finland is deemed by Finland to be engaged in business in Finland and, consequently, is subject to income tax on net profit from the royalties at the regular corporate or individual rates. For the purposes of taxing film royalties, the net profit is presumed to be 7 percent of gross.

Under the proposed Convention film royalties are treated as industrial or commercial profits and exempt from tax in the State of source unless the recipient has a permanent establishment in that State to which the royalties are effectively connected.

Royalties are not subject to withholding tax at source in Finland. However, nonresident taxpayers receiving such income are preassessed on the basis of the last year's income (with adjustments in certain cases) at the current year's rate. In the absence of a convention, the United States would withhold tax at a rate of 30 percent from royalties paid to a nonresident unless such nonresident were engaged in business in the United States and such royalties were effectively connected to such business; in the latter case, such amounts would not be subject to withholding but would be subject to tax at ordinary rates in the United States.

ARTICLE 15. INCOME FROM REAL PROPERTY

This Article which is similar to an article in the existing treaty provides that a resident of one State may be subject to tax in the other State on income from real property and royalties in respect of natural resources if the property or natural resource is located in such other State. This Article does not, as do the existing treaty and the 1967 treaty between the United States and France, provide for an election by the resident to compute his tax on such income on a net basis since under the internal laws of Finland and, since 1967, the United States this can be done. The income referred to in this Article includes gain from the sale or exchange of such property or such natural resource rights, but does not include interest on mortgages and similar instruments. The latter type of income is covered by Article 13 (Interest).

ARTICLE 16. CAPITAL GAINS

The existing Convention provides no special rules for gains derived in one State from the sale or exchange of stock, securities, commodities or other capital assets by a resident of the other State. The proposed Convention provides that such gains shall be exempt from tax by the State of source. However, the exemption does not apply if (1) the gain derived by a resident of one State arises out of the sale or exchange of property described in Article 15 (Income from Real Property) which is situated within the other State; (2) the recipient of the gain has a permanent establishment or maintains a fixed base in that other State and the property giving rise to the gain is effectively connected with such permanent establishment or such fixed base; or (3) the recipient of the gain being an individual resident of the first State is present in that other State for a period or periods aggregating 183 days or more in the taxable year. Gains which are effectively connected with a permanent establishment may be taxed as industrial or commercial profits under Article 8 (Business Profits). Gains on real property are subject to the provisions of Article 15 (Income from Real Property) which permits taxation of such gains by the State in which the real property is situated.

ARTICLE 17. CAPITAL TAXES

The existing Convention does not contain an Article relative to capital taxes since they are not one of the taxes covered by the Convention. The proposed Convention provides, on a reciprocal basis, that a resident of one State shall be exempt from capital tax by the other State on all nonbusiness property (excluding real property) and on property pertaining to the operation of ships and aircraft.

Since the United States does not impose a separate capital (net wealth) tax, this Article represents a unilateral concession by Finland. In the absence of a convention individuals who are not residents of Finland are subject to the national net wealth tax with respect to their net wealth situated in Finland with the exception of bonds, bank accounts, and foreign trade credits. The rate is graduated from 0.52 percent to 2.5 percent. The national net wealth tax was repealed for all corporations effective January 1, 1968.

ARTICLE 18. INDEPENDENT PERSONAL SERVICES

The existing Convention does not distinguish between income from the performance of personal services in an independent capacity or a dependent capacity. It provides on a reciprocal basis that compensation for personal services shall be exempt from tax by the source State (where earned) if the resident is temporarily present in that State for not more than 183 days and if the resident either (1) is employed by a resident (including a corporation) of the other State or (2) does not earn more than $10,000.

The proposed Convention generally deals with personal services in two articles and creates a distinction based upon whether the services are independent or dependent personal services. Generally, income from independent activities may be taxed in the State in which such activities are exercised. Such income will be exempt from tax in the State of source if the recipient is present there for not more than 183 days during the taxable year.

Independent personal services means services performed by an individual for his own account independently where he receives the proceeds or bears the losses arising from such services. Thus, for example, a doctor or lawyer typically renders independent personal services. Also, an individual who under common law concepts is an independent contractor is considered as rendering independent personal services.

This Article produces the same result as the independent activities Article of the OECD Model Convention except that a 183-day rule is substituted for the fixed base rule of the OECD Model as a qualification for exemption of personal service income in the State of source.

ARTICLE 19. DEPENDENT PERSONAL SERVICES

Generally, under the proposed Convention income from labor or personal services as an employee 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 (1) the recipient, being a resident of one of the Contracti

States, is present in the State of source for a period or periods aggregating less than 183 days during the taxable year; (2) the recipient is not an employee of a resident of the State of source; and (3) the remuneration is not borne as such by a permanent establishment which the employer has in the State of source. The proposed Convention also adds a rule that income from personal services 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 the services are rendered by a member of the regular complement of the ship or aircraft.

This Article of the proposed Convention is substantially similar to the OECD Model Convention.

ARTICLE 20. TEACHERS

The existing Convention covers teaching but not research and provides for a 2-year exemption for income received from teaching.

The proposed Convention continues and broadens the 2-year exemption period for visiting teachers. This exemption applies to an individual who is a resident of one State at the time he is invited by the other State or by an accredited educational institution of the other State to teach or do research in the other State and temporarily comes to such other State in order to engage in such teaching or research. Invitation may be by the Government or a university or other accredited educational institution of the other State and research or teaching may be done at such educational institution. However, the exemption does not apply to income from research undertaken not in the public interest but primarily for private benefit of a specific person or persons. If the individual's visit exceeds a period of 2 years from the date of arrival, the exemption applies to the income received by the individual before the expiration of such 2-year period.

ARTICLE 21. 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 an individual who is a resident of one State at the time he becomes temporarily present in the other State for the purpose of studying at a university or other accredited institution, of securing training for qualification in a profession or of studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational institution is exempt from tax in the host State on:

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

(2) The grant, allowance, or award;

(3) Income from personal services performed in the host State not in excess of $2,000 (or its equivalent in Finnish markkas) 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 20 (Teachers) for more than a total of 5 taxable years from the date of arrival.

In addition, a resident of one State employed by or under contract with a resident of that State who, at the time he is a resident of that State, becomes temporarily present in the other State for the purpose of studying or acquiring technical, professional, or business experience from a person other than a resident of the former State or a corporation 50 percent or more of the voting stock of which is owned by that resident of the former State is exempt from tax in the host State on income not in excess of $5,000 (or its equivalent in Finnish markkas) from personal services rendered in the host State. The individual is exempt for a period of 12 consecutive months which period commences with the first month in which he begins working or receives compensation.

Also, an individual who is a resident of one State at the time he becomes temporarily present in the other State and who is temporarily present in the host State as a participant in a government program of the host State for the primary purpose of training, research, or study is entitled to an exemption by the host State with respect to his income from personal services relating to such training, research, or study performed in the host State in an amount not in excess of $10,000 (or its equivalent in Finnish markkas). To be entitled to this exemption the program must be a program which does not exceed 1 year in duration. If

this qualification is met then the income from personal services received with respect to such program is exempt.

If an individual qualifies for the benefits of more than one of the provisions of the personal services articles, he may choose the provision most favorable to him but he may not claim the benefits of more than one provision in any taxable year as a means of avoiding the limitations provided.

ARTICLE 22. GOVERNMENTAL FUNCTIONS

The existing Convention provides that compensation, including pensions, paid by one State or a political subdivision thereof to its citizens residing in the other State (other than citizens of such other State) shall be exempt from tax by the State of residence. The proposed Convention continues the exemption but adds a specification that the compensation must be paid in connection with the discharge of functions of a governmental nature. Compensation paid in connection with industrial or commercial activity is treated the same as compensation received from a private employer. The provisions relating to dependent personal services, private pensions and annuities, and social security payments would apply in such a case.

ARTICLE 23. RULES APPLICABLE TO PERSONAL INCOME ARTICLES

This Article extends the benefits of the personal services income Articles (Articles 18 through 22) to reimbursed travel expenses. However, such reimbursed expenses will not be taken into account in computing the maximum amount of exemptions specified in Article 21 (Students and Trainees). If an individual qualifies for the benefits of more than one of the provisions of Articles 18 through 22, he may choose the provision most favorable to him but the benefits claimed must be reduced by any benefits previously allowed with respect to the same income.

Paragraph (3) of this Article is a new provision not previously included in any convention signed by the United States. It was inserted at the request of Finland and is designed to relieve Finnish exchange students and teachers from Finnish tax on income earned while temporarily present in the United States. Although reciprocal in form, the provision is not reciprocal in substance since the United States, under the savings clause, retains the right to tax its citizens and residents as if the Convention were not in effect.

Under the new provision, an individual of one of the Contracting States temporarily present in the other Contracting State as a teacher, student, or trainee would be allowed as deductions by the former State, for purposes of computing his income tax therein, all travel expenses (including travel fares, meals and lodging, and expenses incident to travel) incurred while traveling between the two States and all ordinary and necessary living expenses (including meals and lodging) incurred while temporarily present in such other Contracting State. It is presumed, for the purposes of this rule, that the deductible expenses of the individual amount to at least 30 percent of the income from personal services which he derives as a teacher, student, or trainee in the latter country and which is exempt from tax in that country under Article 20 (Teachers) or 21 (Students and Trainees). It is contemplated that the effect of this deduction will be such that the Finnish tax borne by Finns on the income which they derive while temporarily present in the United States as teachers, students, and trainees will be roughly the same as the United States tax which they would have incurred but for the treaty.

ARTICLE 24. 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 source 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 the State of residence. However, pensions coming within the scope of Article 22 (Governmental Functions) will be taxable only by the State making payment.

The proposed Convention also provides that alimony paid to a resident of a State will be taxable only in the State of residence.

The term "annuities" is defined as a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered). The term "pensions" is defined as periodic payments made after retirement in consideration for services rendered, or by way of compensation for injuries received in connection with, past employment.

The effect of this provision is generally the same as that of the OECD Model Convention.

ARTICLE 25. SOCIAL SECURITY PAYMENTS

This Article provides that social security payments paid by one State to an individual who is a resident of the other State will be taxed, if at all, by the payor State. Also included under this Article are other public pensions such as railroad retirement benefits. Neither the existing Convention nor the OECD Model Convention contains a comparable provision.

ARTICLE 26. DIPLOMATIC AND CONSULAR OFFICERS

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

ARTICLE 27. INVESTMENT OR HOLDING COMPANIES

This Article denies the benefits of the dividends, interest, and royalties Articles to a corporation of one of the States deriving such income from sources within the other State if (1) such corporation is entitled to special tax benefits which result in the tax imposed on such income being substantially less than the tax generally imposed on corporate profits in such State, and (2) 25 percent or more of the capital of the corporation is owned directly or indirectly by one or more persons who are not individual residents of such State or, in the case of a Finnish corporation, are citizens of the United States.

The purpose of this Article is to deal with a potential abuse which could occur if one of the States provided preferential rates of tax for investment or holding companies. In such a case, residents of third countries could organize a corporation in the State extending the preferential rates for the purpose of making investments in the other State. The combination of the low tax rates in the first State and the reduced rates or exemptions in the other State would enable the third-country residents to realize unintended benefits.

ARTICLE 28. MUTUAL AGREEMENT PROCEDURE

This Article modernizes the mutual agreement procedures found in the existing Convention by adopting provisions similar to those in the recent amendments to our Conventions with the Netherlands, the United Kingdom, and the Federal Republic of Germany, and in our recently revised Convention with France. When a resident of one State considers that the action of one or both States has resulted, or will possibly result, in taxation contrary to the provisions of the proposed Convention, such resident may present his case to the competent authority of the State of which he is a resident.

This Article contemplates that the competent authorities of the two States will endeavor to settle by mutual agreement such cases of taxation not in accordance with the Convention as well as any other difficulties or doubts arising as to the application of the Convention. Some particular areas on which the competent authorities may consult and reach agreement are the amount of industrial and commercial profits to be attributed to a permanent establishment, the allocation of income, deductions, credits, or allowances, between a resident and a related person, and the determination of source of particular items.

In implementing the provisions of this Article, the competent authorities will communicate with each other directly and meet together for an exchange of oral opinions where advisable.

In cases in which the competent authorities reach agreement with respect to a particular matter, taxes will be adjusted and refunds or credits allowed in accordance with such agreement. This provision permits the issuance of a refund or credit notwithstanding procedural barriers otherwise existing under a State's law, such as the Statute of Limitations.

This provision will apply only where agreement or partial agreement has been reached between the competent authorities and will apply in the case of any

such agreement after the Convention goes into effect even though the agreement may concern taxable years prior thereto.

Revenue Procedure 70–18 sets forth the procedure followed by the United States in implementing its obligations under this type of article.

ARTICLE 29. 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.

Information exchanged is treated as secret and may not be disclosed to any persons other than those (including a court or administrative body) concerned with the assessment, collection, enforcement, or prosecution of taxes subject to the Convention, but this does not prohibit disclosure in the course of a court proceeding. In no case does this Article impose an obligation on either State to disclose trade secrets or similar information or to carry out administrative measures or supply particulars where such action would be at variance with the laws or administrative practice of that State, or contrary to public policy. In general, the standard for the exchange of information is the standard used by the States in the enforcement of their own laws by administrative and judicial authorities.

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 provision contained in the existing Convention.

In addition, paragraphs (4) and (5) of this Article specifically provide 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 the 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.

ARTICLE 30. ASSISTANCE IN COLLECTION

This Article, substantially similar to the assistance in collection Article in the existing Convention, provides for mutual assistance in the collection of taxes where required to avoid an abuse of the Convention. The provision is intended merely to insure that the benefits of the Convention will only be available with respect to persons entitled to such benefits; it does not in any way alter rights under other provisions of the Convention.

The Article provides that each State will endeavor to collect for the other State such amounts as may be necessary to insure that any exemption or reduced rate of tax granted under the proposed Convention will not be availed of by persons not entitled to those benefits. However, this Article will not require a State, in order to collect taxes which are imposed by the other State, to undertake any administrative measures that differ from its internal regulations or practices nor will this Article require a State to undertake any administrative or judicial measures which are contrary to that State's sovereignty, security, or public policy.

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 two months after the date of exchange of such instruments. However, the provisions of the proposed Convention shall be effective:

In the case of Finland to taxes which are levied for the taxable year beginning on or after January 1, following the year in which the instruments of ratification are exchanged;

In the case of the 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, following the year in which the instruments of ratification are exchanged.

The entry into force of the proposed Convention will terminate the Convention of December 18, 1952.

ARTICLE 32. TERMINATION

The Convention will continue in effect indefinitely, but may be terminated by either State at any time after the year 1973. A State seeking to terminate the Convention must give notice at least 6 months before the end of the calendar year through diplomatic channels.

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

In the case of Finland to taxes which are levied for taxable years beginning on or after January 1 of 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.

However, upon prior notice to be given through diplomatic channels, the provisions of Article 25 (Social Security Payments) may be terminated by either State at any time after this Convention enters into force.

OCTOBER 6, 1970.

TECHNICAL EXPLANATION OF PROPOSED U.S.-TRINIDAD AND TOBAGO INCOME TAX CONVENTION, SIGNED JANUARY 9, 1970

(Department of the Treasury)

ARTICLE 1. TAXES COVERED

This Article designates the taxes of the respective States which are the subject of the proposed Convention. With respect to the United States, the taxes included are the United States Federal income taxes imposed by the Internal Revenue Code. This includes, for example, the surtax and would also include such taxes as the temporary surcharge which was in force from 1968 to 1970. However, the Convention is not intended to apply to taxes which are in the nature of a penalty such as the taxes imposed under section 531 (accumulated earnings tax) and section 541 (personal holding company tax) of the Internal Revenue Code. These two taxes were expressly excluded to avoid uncertainty as to their status.

With respect to Trinidad and Tobago, the taxes included are the corporation tax and the income tax.

Pursuant to paragraph (2) of this Article the proposed Convention would also apply to taxes substantially similar to those enumerated which are imposed, in addition to or in place of the existing income taxes, after the date of signature of this Convention (January 9, 1970).

For purposes of Article 6 (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 sets forth rules for determining fiscal domicile or residence for purposes of the proposed Convention. A number of important terms, however, are defined elsewhere in the Convention.

Any term used in this Convention which is not defined therein shall, unless the context otherwise requires, have the meaning which it has under the laws of the State which is imposing the tax. The proposed Convention also provides a procedure under which a common definition may be arrived at by the competent authorities of the United States and Trinidad and Tobago, in order to prevent double taxation or further any other purpose of this Convention, if the definition of such term under the respective internal laws of the States differs or if the term is not readily definable under the laws of one or both of the States. The common meaning is to be arrived at by means of the mutual agreement procedure which is described in Article 23 (Mutual Agreement Procedures) of the proposed Convention. While treaties in the past did not specify the power of the competent authorities to resolve such differences in definitions, this power is nevertheless inherent in the authority set forth in the mutual agreement articles of these treaties to resolve "difficulties or doubts."

This Article defines geographical Trinidad and Tobago and geographical United States to include their respective continental shelves. The addition of a definition of the continental shelf is intended to clarify what the Contracting States consider to be included within their respective jurisdictions to tax. The United States continental shelf is defined as the seabed and subsoil of the adjacent submarine areas beyond the territorial sea over which the United States exercises exclusive rights in accordance with international law for the purpose of exploration and exploitation of the natural resources of such area, but only to the extent that the person, property, or activity to which this Convention is being applied is connected with such exploration or exploitation. For example, the income earned by a ship and its employees engaged in taking seismograph soundings on the United States continental shelf will be treated for tax purposes the same as the income from a comparable activity on the land of one of the States of the United States. A comparable definition is used in the case of Trinidad and Tobago. The definition of the continental shelf in the case of the United States only includes the continental shelf surrounding the 50 States. Thus, for example, the continental shelf surrounding Puerto Rico is not included. If the Treaty were extended beyond the 50 States and the District of Columbia (see Article 29—Extension of Convention) the continental shelf of the extended areas could also be covered. While the territorial sea is part of the United States and Trinidad and Tobago for all purposes, the defined continental shelf is only part of the United States or Trinidad and Tobago, as the case may be, in limited situations. It is included only to the extent that a person or property or activity to which the Convention is being applied is connected with exploration or exploitation of the continental shelf. The phrase "connected with" does not require physical attachment to the continental shelf to be within the scope of the definition.

This Article also sets forth rules for determining residence for purposes of the proposed Convention. Residence is important because, in general, only a resident of the Contracting States may qualify for the benefits of the Convention.

A resident of one of the Contracting States is a corporation of that State (as defined in this Article) or any person (other than a corporation) who is a resident of that State for purposes of its tax. Specifically in the case of the United States the term "a resident of the United States" means a United States corporation and any person (except a corporation or any other entity treated as a corporation for United States tax purposes) resident in the United States for purposes of its tax. The parenthetical language in the definition of a resident of the United States is intended to make clear that a foreign corporation, or other entity treated as a foreign corporation for United States tax purposes, which is a resident of the United States for certain purposes of its income tax law is not, under the Convention, a resident of the United States. A similar rule was needed in the case of Trinidad and Tobago.

In the case of the United States, the definition provides that a partnership, estate, or trust is treated as a resident only to the extent that the income derived by such person is subject to United States tax as the income of a resident. This language, although different from the Income Tax Convention between the United States and France, signed July 28, 1967, is intended to achieve the same result. Under United States law, a partnership is never, and an estate or trust is often not, taxed as such. Under the proposed Convention, in the case of the United States, income received by a partnership, estate, 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. With respect to income taxed in the hands of the estate or trust, the residence of the estate or trust is determinative. This provision is reciprocal because of the presence of a similar problem under Trinidad and Tobago law.

Unlike our other conventions, the proposed Convention with Trinidad and Tobago does not provide a mechanism for determining a single residence for individuals who are treated by each State as being respectively resident therein. In addition, corporations could be treated by both States as being resident therein under the definitions set forth in the treaty. Dual residency in the case of corporations is a relatively easy situation for them to avoid.

This Article also provides that the terms "paid," "distributed," and "received" when applied to income shall include amounts which are "credited." This provision, which has not appeared in previous income tax conventions to which

the United States is a party, is intended to make clear that a dividend paid by a Trinidad and Tobago corporation includes an amount credited by such corporation.

ARTICLE 3. GENERAL RULES OF TAXATION

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

A resident of one State may be taxed by the other State only on income from sources within that other State (including industrial or commercial profits attributable to a permanent establishment located in that other State), subject to the limitations set forth in this Convention. The jurisdictional rules of the proposed Convention parallel those set forth in section 872(a) of the United States Internal Revenue 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 proposed Convention contains the general rule (also found in our new French Convention) that the Convention does not effect 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 a 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 except that, to the extent a convention specifically provides, it may be necessary to waive certain rights as a condition to claiming more advantageous treaty benefits.

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 policies reflected in the Convention. Thus, the savings clause does not affect the provisions with respect to the foreign tax credit, nondiscrimination, or tax deferral for technical assistance. Although the provisions dealing with the mutual agreement procedure are not specifically excepted from the savings clause, agreements made by the competent authorities may nevertheless inure to the benefit of a citizen or resident of the United States or a resdient of Trinidad and Tobago. Moreover, the savings clause will not deny the benefits of the Convention to governmental employees or teachers or students unless such individuals are citizens of the United States or have immigrant status in the United States. The OECD Model Convention does not contain a savings clause because it is oriented toward the residence principle of taxation.

This Article also provides that 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 OECD Model Convention differs on this point and provides that income which is not expressly mentioned will be taxable only in the State of residence. In any event it should be noted that the proposed Convention specifically covers most types of income.

Another general rule of taxation is that subject to the provisions of paragraph (4) a State may tax a resident of that State whether or not that person is also a resident of the other State.

ARTICLE 4. RELIEF FROM DOUBLE TAXATION

Under the existing Convention, the United States provides relief from double taxation by allowing a credit for Trinidad and Tobago tax subject to the provisions of the law of the United States.

The proposed Convention employs the same method of avoiding double taxation in providing that subject to the provisions of United States law in effect for the taxable year (which do not affect the general principle of the Article) credit will be allowed to a United States citizen or resident for Trinidad and Tobago tax paid but not in excess of the portion of United States tax which net income from Trinidad and Tobago sources bears to total net income. Except for the spe-

cial source rules provided by the Convention, this provision does not add to the rights that a United States citizen or resident has to the foreign tax credit, including his right under current law to elect the overall limitation, but is for the purpose of giving treaty recognition to such rights. Modifications in United States law after the effective date of the Convention which concern the foreign tax credit will be applicable with respect to Trinidad and Tobago source income if such modifications do not contravene the general principles of the Convention.

With respect to the treatment of dividends which are received by a United States corporation from a corporation resident in Trinidad and Tobago in which such United States corporation owns at least 10 percent of the voting power, the proposed Convention differs in one respect from the provisions which would be applicable to such dividend under the Internal Revenue Code. The proposed Convention provides that in the case of such a dividend such United States corporation must include in gross income the amount of Trinidad and Tobago tax which the Trinidad and Tobago corporation paid on the profits out of which such dividend is paid and which the recipient corporation is "deemed" to have paid. Thus, the dividend must be grossed up. Under the Internal Revenue Code, however, a dividend does not have to be grossed up in order for the recipient United States corporation to claim a deemed paid credit, if the dividend is paid by a less developed country corporation and most Trinidad and Tobago corporations will be considered less developed country corporations. Inasmuch as the computation of the deemed paid tax credit without gross-up under the Internal Revenue Code will often produce a more favorable result than the gross-up computation under the proposed Convention, it may be to the advantage of United States corporations in some cases to use the Code rules in computing the deemed paid credit. Of course, in these cases United States corporations may continue to use the Code rules rather than those found in the proposed Convention. In a case where the taxpayer follows the Code rules on gross-up, it may nevertheless use the source rules set forth in Article 5 of the proposed Convention.

The proposed Convention provides that Trinidad and Tobago will allow its residents a credit for the amount of income taxes paid to the United States. In the case of a Trinidad and Tobago corporation which receives a dividend from a United States corporation in which such recipient corporation controls, directly or indirectly, at least 10 percent of the voting power, such corporation will be allowed a credit against its Trinidad and Tobago tax for the amount of the United States tax paid on the corporate profits out of which such dividend is paid. This credit is, of course, in addition to the credit allowed for the taxes paid to the United States by the Trinidad and Tobago corporation. Under the internal law of Trinidad and Tobago the indirect credit would be allowed only if the recipient corporation owned at least 25 percent of the voting stock in the payor United States corporation. The foreign tax credit Trinidad and Tobago will allow is subject to a per-country limitation.

ARTICLE 5. SOURCE OF INCOME

This Article sets forth in a single provision all of the various rules which are to be applied to determine the source of the different kinds of income covered by the treaty: dividends, interest, royalties, income from real property, including gains derived from the sale of such property, and compensation for personal services. These rules affect the application of Article 3 (General Rules of Taxation) and Article 4 (Relief from Double Taxation).

The source of any kind of income not covered by the treaty shall be determined under the internal law of the two States. In the case of different source rules applicable to an item of income the competent authorities of the two States under the mutual agreement procedure may establish a common source for the item of income.

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 Trinidad and Tobago corporation shall be treated as income from sources within the United States if, for the 3-year period ending with the close of its taxable year preceding the declaration of such dividend (or for such portion of that period as the corporation has been in existence), such corporation (a) had a permanent establishment in the United States, and (b) derived 50 percent or more of its gross income from the industrial or commercial profits effectively connected with

the industrial or commercial activity engaged in through such permanent establishment. The provision was included to offset a provision in Trinidad and Tobago law which imposed a withholding tax on remitted profits of a United States permanent establishment in Trinidad and Tobago. However, the amount of the dividend to be treated as from United States sources under this provision is not to exceed an amount which bears the same ratio to the entire dividend as the gross income of the corporation for such period which is effectively connected with the commercial or industrial activity engaged in through such permanent establishment within the United States bears to its gross income from all sources. A further limitation is that in no case shall the amount of such dividend which is treated as income from sources within the United States exceed the net amount of money or money's worth transferred from such permanent establishment during such period. This rule as applied to dividends paid by a Trinidad and Tobago corporation conforms to United States statutory law except that, under section 861(a)(2)(B) of the Internal Revenue Code, there is no limitation regarding the net amount of money or money's worth transferred. This limitation which is similar to a provision in the laws of Trinidad and Tobago is intended to insure that the United States will not treat dividends paid by a Trinidad and Tobago corporation as income from United States sources to the extent the profits of a permanent establishment which such corporation maintains in the United States are retained and reinvested.

Interest paid by that State, including any local government within such State, or by a resident of such State is treated as from sources within that State. Interest paid by any other person will be treated as from sources outside that State. However, interest paid by a resident of any State with a permanent establishment in any other State, directly or indirectly, out of the funds of such permanent establishment will be treated as income from sources within the State where such permanent establishment is located. The rules set forth above in the first two sentences correspond generally to the Internal Revenue Code provision dealing with interest (other than interest on deposit with persons carrying on the banking business). The exception to this general rule, set forth above in the third sentence, is not contained in the Internal Revenue Code but is substantially similar to the same rule in the United States-Belgian Income Tax Convention signed July 9, 1970.

Royalties paid for the use of, or the right to use, property described in paragraph (4) of Article 14 (Royalties) in a State are treated as income from sources within that State.

Income from real property and royalty income from the operation of mines, quarries, or other natural resources are to be treated as income from sources within the State in which such property is located.

Income from the rental of tangible personal property is to be treated as income from sources within the State in which such property is located when rented. Notwithstanding some minor differences in terms compared with like provisions in recent treaties, this language is intended to reflect the rule of the Internal Revenue Code and recent treaties that the source of such rental income is the State in which the property is located during the period of the lease.

Compensation received by an individual for his performance of personal services and income received by a person from the furnishing of personal services of another are to be treated as income from sources within the State in which such services are performed. If services are performed partly within and patly outside any State, income from the performance or furnishing of such services shall be treated as income from sources partly within and partly outside that State. Compensation for personal services, and private pensions and annuities paid in respect of such services, performed aboard ships or aircraft operated in international traffic by a resident of a State and, in the case of the United States, registered in the United States, provided the services are performed by a member of the regular complement of the ship or aircraft, are to be treated as income from sources within that State.

Income from the purchase and sale of personal movable property is to be treated as income from sources within the State in which such property is sold. This rule conforms to the rule set forth in section 861(a)(6) of the Internal Revenue Code.

Notwithstanding the rules contained in paragraphs (1) through (7), industrial and commercial profits attributable to a permanent establishment which the recipient, being a resident of one State has in the other State, including

income dealt with in the articles pertaining to dividends, interest, royalties, and income from real property if from rights or property which are effectively connected with such permanent establishment, shall be treated solely as income from sources within that other State. The factors taken into account in determining whether such effective connection exists will include whether the income is derived from property used, or held for use, in the conduct of the commercial or industrial activities carried on through such permanent establishment or whether the commercial or industrial activities carried on through such permanent establishment were a material factor in the realization of the income. As previously noted under Article 3 (General Rules of Taxation), this source rule conforms to United States policy governing the taxation of business profits and investment income as expressed in the Foreign Investors Tax Act of 1966. Such policy is also reflected in the recent French Convention as well as the protocols to the German, Netherlands, and United Kingdom Conventions.

Several of the source rules set out in this Article differ to some degree from those existing in the Internal Revenue Code. Since Article 3 (General Rules of Taxation) provides that the Convention will not increase a person's United States tax, a taxpayer is entitled to use the more beneficial of the Code or Convention rules in calculating his income for United States tax purposes, or in the case of a citizen or resident of the United States, his foreign tax credit. The rule on interest in this Article permits Trinidad and Tobago, under the proper circumstances, to impose a tax on any interest paid by a permanent establishment in Trinidad and Tobago of a United States corporation. While the rule appears to be fully reciprocal, the United States will not, because of section 861(a)(1)(B) of the Code, impose on nonresident aliens and foreign corporations a tax on interest paid by a resident of the United States unless such resident derives 20 percent or more of its gross income from United States sources for the 3-year period ending with the close of the taxable year of such resident preceding the payment of such interest.

It should also be noted that the source rules do not serve to extend the benefits of this proposed Convention to persons other than residents of the two States. Generally, the rules are only applicable for taxing residents of either State and, therefore, are not applicable in determining source of income of residents of other States, although the income of such other residents is of a type referred to in this Article.

ARTICLE 6. NONDISCRIMINATION

The proposed Convention bans discrimination by one State against the nationals of the other State or of a permanent establishment of nationals or corporations of the other State. Thus, for example, a national of Trinidad and Tobago who is a resident of the United States and who otherwise meets the requirements specified in section 911 of the Internal Revenue Code would under this Article of the proposed Convention be eligible for the benefits of section 911 although such national is not a citizen of the United States.

This Article provides, however, that a State may accord special treatment to its own residents on the basis of civil status or family responsibility. This Article also provides that Trinidad and Tobago is not prohibited from imposing a branch profits tax in accordance with paragraph (5) of Article 12 (Dividends) and the United States from imposing a comparable tax burden on the income of a permanent establishment maintained by residents of Trinidad and Tobago in the United States.

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 Model includes a provision concerning Stateless persons which has been omitted from the proposed Convention.

ARTICLE 7. TAX DEFERRAL FOR TECHNICAL ASSISTANCE

This Article provides for a reciprocal tax deferral which will be applicable when patents, processes, know-how and similar items, and ancillary technical services rendered in connection with the furnishing of such property or information, are provided by a resident of one State to a corporation of the other State in return for stock of the corporation of such other State. Under paragraph (3) of Article 28 (Effective Dates and Ratification) this Article shall only be effective with respect to stock received on or after the date the proposed Convention was signed (January 9, 1970).

Under this provision, a resident of one of the States may elect not to include in income, both for United States and Trinidad and Tobago tax purposes, any amount otherwise includable by reason of the receipt of stock in return for the enumerated items of property, information, or ancillary services. In order to qualify for the deferral, such resident must receive stock of a corporation of the other State as consideration for providing to such corporation, for use in connection with a trade or business actively conducted in that other State by such corporation, any of the following properties, information, or services:

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

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

(3) Technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which are ancillary and subsidiary to the transfer of the property rights referred to in (1) or any information referred to in (2).

Where such an election is made, expenses allocable to amounts excluded from income may not be deducted currently. Where the stock received is later disposed of, the amount originally excluded will then be included in income in the manner in which it would have been included upon receipt of such stock. Where the stock is sold for less than the amount originally excluded, the amount actually received on the sale is included in income as it initially would have been in the absence of this deferral provision. When the stock is disposed of, deductions previously disallowed because allocable to excluded amounts will be allowed and any gain upon such disposition will be determined as if the gain had been included in income, and the deductions allowed, upon original receipt of the stock.

This provision is made subject to regulations to be issued by both parties to the treaty.

In the case of the United States the Secretary of the Treasury or his delegate may prescribe such regulations as are necessary to effectuate the provisions of this Article and to further define and determine the terms, conditions, and amounts referred to in this Article. In the case of Trinidad and Tobago the Minister of Finance or his authorized representative may prescribe such regulations as are necessary to effectuate the provisions of this Article and to further define the terms, conditions, and amounts referred to in this Article. In particular, the Minister of Finance or his authorized representative is specifically authorized to prescribe by regulation standards for determining whether services referred to in paragraph (1) of this Article are ancillary and subsidiary to the property rights or information referred to in that paragraph.

In such regulations, the Minister of Finance could provide that this provision will only apply to an equity interest in a Trinidad and Tobago corporation issued to the United States shareholder in conformance with the Trinidad and Tobago law dealing with the allowable extent of foreign equity interests in Trinidad and Tobago corporations.

Authorization is granted to each State to require, by regulations, that a portion of the stock received in return for the enumerated property, information, or services be deposited with a designated bank or other depository for the purpose of assuring collection of any taxes payable upon its disposition.

Under this provision, a United States corporation can make a transfer of property to a Trinidad and Tobago corporation in exchange for the stock of that Trinidad and Tobago corporation, without regard to the provisions of section 351 of the Code, and elect not to include in income for United States tax purposes any gain otherwise recognized (whether under sections 1231 or 1249 of the Code) as a result of such transfer. In addition, that United States corporation can furnish "know-how" to the Trinidad and Tobago corporation and obtain the deferral for United States tax purposes without initially having to consider whether such "know-how" constitutes property for purposes of the application of section 351 of the Code. It can also provide the enumerated services, to the extent that they are rendered in connection with and subsidiary to the furnishing of property rights or information which are covered under the Article, without having the value of the portion of such stock which is attributable to the services included in income. This elective deferral privilege, which avoids cash problems involved in having to pay a current tax on the receipt of stock where the recipient wishes to hold, rather than sell, such stock, would, of course, also apply for purposes of the imposition of any Trinidad and Tobago tax otherwise due by reason of the transaction. Thus, where the connected services are

rendered in Trinidad and Tobago and stock in the Trinidad and Tobago corporation to which such services are provided is taken in consideration thereof, the United States resident taking such stock is not subject to (1) Trinidad and Tobago tax, until later disposition of the stock, and (2) any United States tax otherwise due by reason of the receipt of such stock.

ARTICLE 8. BUSINESS PROFITS

This Article sets forth the typical treaty rule that industrial or commercial profits of a resident of one State are taxable in the other State only if the resident has a permanent establishment in that other State. Where there is a permanent establishment only the industrial or commercial profits attributable to the permanent establishment can be taxed by that other State.

This Article represents an acceptance by Trinidad and Tobago of the principle that investment income should be taxed separately from industrial and commercial profits where appropriate. Absent the provision, Trinidad and Tobago would tax all income directly or indirectly accrued in or derived from Trinidad and Tobago, whether or not effectively connected with a permanent establishment, at the regular rates.

Under most of the United States Conventions negotiated prior to the new French Treaty, industrial or commercial profits are not taxed in the absence of a permanent establishment. However, once there is a permanent establishment these conventions, and the old French Convention, provide that the provisions reducing the tax rates on interest and dividends and exempting royalties are not applicable. This rule is known as the "force of attraction" principle and is replaced in the proposed Convention, as in our new treaty with France, with the effectively connected concept. Under the new approach, only that interest, dividends and royalties which are effectively connected with the permanent establishment are taxable as part of the industrial or commercial profits and only such income does not benefit from the reduced rate or exemption.

In determining the proper attribution of industrial or commercial profits under the proposed Treaty, the permanent establishment is generally 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. However, it is not necessary to allow a profit to the head office for ancillary services furnished to the permanent establishment as long as the permanent establishment is allowed to deduct the allocable costs incurred by the head office.

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.

The term "industrial or commercial profits" means income derived from the active conduct of a trade or business. For example, it includes profits from manufacturing, mercantile, agricultural, fishing, and transportation activities. However, 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) or insurance premiums, are not included within the definition of industrial or commercial profits. Further, rentals from motion picture films or films or tapes for radio or television broadcasting are not included within the definition of the term industrial or commercial profits under the proposed Convention.

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 or commercial profits.

ARTICLE 9. 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 Article 12 (Dividends), Article 13 (Interest), and Article 14 (Royalties). The definition of "permanent establishment" is a modernized version of the definition found in some of our older treaties. The new definition is similar to the definition found in our French Convention.

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, an office, a store or other sales outlet, a workshop, a factory, a warehouse, a place of extraction of natural resources, or a building, construction, or installation project which is used for such purpose for 6 months or more. As a general rule, any fixed facility through which an individual, corporation or other person conducts industrial or commercial activity will be treated as its permanent establishment unless it falls in one of the specific exceptions described below. The proposed Convention uses the term "a seat of management" which was the term used in our Convention with France. The technical explanation of our French Convention explains the definition of the term "a seat of management" and its difference in meaning from the term "a place of management" as follows:

> 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.

That explanation is applicable to the proposed Trinidad and Tobago Convention.

This Article specifically provides that a permanent establishment does not include a fixed place of business of a resident of one of the Contracting States which is located in the other Contracting State if it is used only for one or more of the following:

> (a) the processing by another person, whether related or unrelated, under arrangements or conditions which are or would be made between independent persons, of goods or merchandise belonging to the resident;
>
> (b) the purchase, under arrangements or conditions which are or would be made between independent persons, of goods or merchandise for the account of the resident;
>
> (c) the storage and/or delivery of goods belonging to the resident, (other than goods or merchandise held for sale by such resident in a store or other sales outlet);
>
> (d) the collection of information for the resident;
>
> (e) advertising, the conduct of scientific research, the display of goods or merchandise, or the supply of information, if such activities have a preparatory and auxiliary character in the trade or business of the resident; or
>
> (f) construction, assembly, or installation projects if the site or facilities are used for such purposes for less than 6 months.

These exceptions are cumulative and a site or facility used solely for more than one of these purposes will not be considered a permanent establishment under the proposed Convention. The construction project rule is a physical test under which the resident must be actively engaged in the project during the specified period.

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 an independent agent, who has and regularly exercises authority to conclude contracts in the name of such person unless the agent only exercises such authority to purchase goods or merchandise. The proposed Convention further provides that a resident of one State will be considered to have a permanent establishment in the other State if such resident engages in business in such other State through a person, who maintains in that other State, a stock of goods or merchandise belonging to such resident from which such person regularly fills orders or makes deliveries. A resident of one State will also be considered to have a permanent establishment in the other State if such resident maintains equipment or machinery for rental or other purposes within that other State for a period of 6 months or more.

With respect to an independent agent, the proposed Convention also provides that a resident of one State will not be deemed to have a permanent establish-

ment in the other State if such resident engages in industrial or commercial activity 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 his 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 of such resident with respect to a resident of the other State or with respect to a person which engages in industrial or commercial activity in that other State (whether through a permanent establishment or otherwise).

The Article provides that a resident of one of the States has a permanent establishment in the other State if it sells in that other State goods or merchandise that are either (1) subjected to substantial processing in that other State (whether or not purchased in the other State) or (2) purchased in that other State and such goods or merchandise are not subjected to substantial processing outside the other State. Under this rule, which is similar to the rule contained in the proposed Belgian Convention the taxpayer will have a permanent establishment whether or not he maintains a sales office in the other State. Thus, where an independent agent acting for a United States corporation arranges for the sale of goods in Trinidad and Tobago, the United States corporation will nevertheless be deemed to have a permanent establishment in Trinidad and Tobago where those goods were purchased in Trinidad and Tobago for that corporation by the agent (or by any other person) and then resold by the corporation without having been subjected to processing outside Trinidad and Tobago prior to such resale. With respect to a United States corporation selling goods purchased outside Trinidad and Tobago (or produced outside Trinidad and Tobago), their resale (or sale) in Trinidad and Tobago will of itself give rise to a permanent establishment only if these goods are subjected to substantial processing in Trinidad and Tobago.

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

ARTICLE 10. SHIPS AND AIRCRAFT

This Article provides that, notwithstanding the rules of Article 8 (Business Profits), a resident of Trinidad and Tobago will be exempt from tax in the United States on income derived from the operation in international traffic of ships or aircraft, including capital gain derived from the sale of a ship or aircraft used in such traffic, and that a resident of the United States will be exempt from tax in Trinidad and Tobago on income derived from the operation in international traffic of ships or aircraft, including capital gain derived from the sale of a ship or aircraft used in such traffic, registered in the United States. It should be noted that the registration requirement is only applicable in the case of a resident of the United States.

This Article also will apply to income derived from the leasing, to a person engaged in the operation of ships or aircraft, of a ship or aircraft under a full or bareboat charter, where the lessor is engaged in the operation of ships or aircraft if such lease is ancillary to the lessor's other operations. For example, if an airline of one of the Contracting States which has excess equipment in the winter months leases several aircraft which are excess during that period to an airline in the other Contracting State, the lessor is not subject to tax by that other Contracting State.

ARTICLE 11. RELATED PERSONS

This Article complements section 482 of the Internal Revenue Code of 1954 and confirms the power of each government to allocate items of income, deduction, credit, or allowances in cases in which a resident of one State is related to any other person if such related persons impose conditions between themselves which are different from conditions which would be imposed between independent persons. This provision is similar to the provision contained in the OECD Model Convention.

Provision is made in Article 23 (Mutual Agreement Procedures) for consultation and agreement between the two States where an allocation by either State results or would result in double taxation.

ARTICLE 12. DIVIDENDS

The proposed Convention provides for unilateral reduction on the part of Trinidad and Tobago with respect to dividends which are derived from sources within Trinidad and Tobago by a resident of the United States. Thus, the United States withholding tax which is imposed at a 30-percent rate on non-effectively connected dividends paid by United States corporations to nonresidents of the United States is not affected by the proposed Convention. In the absence of a convention, Trinidad and Tobago imposes a 30-percent withholding tax on dividends and branch profits remitted to nonresidents of Trinidad and Tobago. To determine the source of a dividend for the purposes of this Article, the rules contained in paragraph (1) of Article 5 (Source of Income) are used.

Under the proposed Convention Trinidad and Tobago may impose a withholding tax of 25 percent on the gross amount actually distributed with respect to portfolio investment dividends. The proposed Convention further provides that Trinidad and Tobago may impose a maximum rate of 10 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 rate of withholding which is imposed by Trinidad and Tobago on profits of a branch of a United States corporation located in Trinidad and Tobago is also limited to 10 percent.

The proposed Convention abandons the "force of attraction" concept by providing that the reduced rate of tax on dividends is denied only if the shares with respect to which the dividends are paid are effectively connected with a permanent establishment which the recipient United States resident has in Trinidad and Tobago. In such a case the dividends may be taxed as business profits in accordance with Article 8 (Business Profits) of the proposed Convention.

The proposed Convention also provides specific definitions of the term "dividends" in the case of the United States and Trinidad and Tobago. These terms allow each State to treat those payments which, under their internal law are treated as dividends, to be so treated for purposes of the proposed Convention. This rule is directly related to the position adopted in the proposed Convention with respect to remittances of a branch of a United States corporation, located in Trinidad and Tobago, to such corporation.

The proposed Convention also provides that dividends paid by a corporation of one of the States to a person other than a resident of the other State (in the case of dividends paid by a Trinidad and Tobago corporation, other than to a citizen of the United States) shall be exempt from tax by that other State unless such dividends are treated as income from sources within that other State under Article 5 (Source of Income). Thus, for example, if dividends are paid by a Trinidad and Tobago corporation to an individual who is a resident of a third country and who is not a citizen of the United States, and such dividends are not effectively connected with a permanent establishment located in the United States, the United States will not be able to subject this dividend to tax unless the Trinidad and Tobago corporation had a permanent establishment in the United States for a 3-year period and derived at least 50 percent of its gross income from industrial and commercial profits which are effectively connected with such permanent establishment. In such a case, the only amount subject to tax would be the pro rata portion of the permanent establishment's income which is effectively connected with the United States trade or business. In no case will the amount of the dividend which was treated as income from sources within the United States exceed the net amount of money or money's worth transferred from such permanent establishment during the 3-year period.

The proposed Convention also provides that where a corporation of one State has a permanent establishment in the other State and derives profits or income which are effectively connected with that permanent establishment, any remittance of such profits or income by that permanent establishment may be taxed as a distribution in accordance with the law of the other State at a rate which will not exceed 10 percent. This 10-percent rate corresponds to the reduced rate which is applied to intercorporate dividends under paragraph (1)(b) of this Article. This provision has been included to take into account the taxation of such remittances under the tax laws of Trinidad and Tobago. This provision only applies to remittances that are attributable to gains, profits, or income which is effectively connected with the permanent establishment in Trinidad and Tobago. Thus, if there is a permanent establishment in Trinidad and Tobago

and no income is earned which is treated as effectively connected with that permanent establishment, no portion of any remittance from that permanent establishment to the United States home office would be subject to this 10-percent tax.

It should be noted that this provision in no way affects the United States taxation of such remittances. Thus, since the United States would not treat such remittances as a dividend, the 10-percent tax which is imposed would not be treated as a tax imposed on the operations of the corporation in Trinidad and Tobago through a permanent establishment.

It should also be noted that the proposed Convention does not contain an Article dealing with capital gains. Both Trinidad and Tobago and the United States have domestic rules which provide a large measure of exemption for foreigners deriving capital gains. In the case of the United States, a nonresident alien is exempt from tax on capital gains unless he is present in the United States for a period or periods aggregating 183 days or more during the taxable year. In the case of Trinidad and Tobago, capital gains are taxed at normal rates. However, if the holding period of the asset is longer than 12 months, the gain is not regarded as income and is exempt from taxation. Since the proposed Convention does not provide a special rule for capital gains, paragraph (2) of Article 3 (General Rules of Taxation) applies.

ARTICLE 13. INTEREST

The proposed Convention provides for a unilateral reduction by Trinidad and Tobago of the rate of withholding tax which is imposed on interest which is received from sources within Trinidad and Tobago by a resident of the United States which is either a bank or other financial institution not having a permanent establishment in Trinidad and Tobago. In the case of such residents of the United States the rate of tax imposed by Trinidad and Tobago shall not exceed 15 percent of the gross amount paid. For purposes of determining the source of an interest payment, the rule provided in paragraph (2) of Article 5 (Source of Income) shall be used. It should be noted that if the recipient of an interest payment from sources within Trinidad and Tobago is a resident of the United States, other than a bank or financial institution which does not have a permanent establishment in Trinidad and Tobago, the reduced rate of tax which is provided in the proposed Convention will not apply. The proposed Convention also provides that interest received by one of the States or any wholly owned instrumentality of that State is exempt from tax by the other State. Thus, for example, interest which is received from sources within Trinidad and Tobago by the Export-Import Bank of the United States would not be subject to Trinidad and Tobago tax under this Article.

As in the case of dividends, the United States has not reduced its rate of withholding on interest under the proposed Convention. Thus, the United States may impose its withholding tax at the statutory rate of 30 percent on noneffectively connected interest which is derived by residents or corporations of Trinidad and Tobago from sources within the United States, except that interest derived by the Government of Trinidad and Tobago or any of its wholly owned agencies is exempt from such tax.

Under Trinidad and Tobago income tax law any interest payment paid by a subsidiary to its nonresident parent or brother company is deemed to be a nondeductible distribution of profits. Paragraph (5) has been added so as to limit the application of this rule to situations where the taxpayer cannot demonstrate the absence of tax avoidance as the motive for making the interest payment. Under the proposed Convention where excess interest payments are made because the payor and the recipient are related, the provisions of this Article apply only to so much of the interest as would have been paid to an unrelated person. The excess payment may be taxed by each State according to its own law including the provisions of the proposed Convention where applicable.

This Article contains a provision which is comparable to that found in Article 12 (Dividends) which states that interest paid by a corporation of one of the States to a person other than a resident of the other State (and, in the case of interest paid by a Trinidad and Tobago corporation, other than a citizen of the United States) shall be exempt from tax by the other State, unless such interest is treated as income from sources within that other State under paragraph (2)(b) or (8) of Article 5 (Source of Income).

ARTICLE 14. ROYALTIES

The proposed Convention provides on a reciprocal basis an exemption for artistic and literary royalties but permits a tax to be levied at a maximum rate of 15 percent on other royalties.

The term "royalties" is defined to include payments of any kind made as consideration for the use of, or the right to use, copyrights, artistic or scientific works, patents, designs, plans, secret processes or formulae, trademarks or other like property or rights (not including motion picture films or films or tapes for radio or television broadcasting) or information concerning industrial, commercial, or scientific knowledge, experience, or skill.

For purposes of the proposed Convention, the term "royalties" does not include any royalties, rentals, or other amounts paid in respect of the operation of mines or quarries or other natural resources. The rules applicable to such income are contained in Article 15 (Income from Real Property) of the proposed Convention.

The provisions of this Article do not apply if the recipient of a royalty has a permanent establishment in a State of source and the rights or property giving rise to such royalty is effectively connected with such permanent establishment. In such a case, the royalty may be taxed as industrial or commercial profits under Article 8 (Business Profits). Thus, the "force of attraction" principle is also abandoned with respect to royalties. To determine the source of a particular royalty, the rules provided in paragraph (3) of Article 5 (Source of Income) shall be used.

Under the proposed Convention, if excess royalties are paid because the payor and recipient are related, the provisions of the royalties Article apply only to so much of the royalty as would have been paid to an unrelated person. The excess payment may be taxed by each State, according to its own law including the provisions of the proposed Convention where applicable.

ARTICLE 15. INCOME FROM REAL PROPERTY

This Article provides a resident who is subject to taxation on income from real property with an election to be taxed on a net basis. The election applies to income from real property, including gains derived from the sale or exchange of such property, and natural resource royalties. Each State retains the right to tax income from real property under paragraph (1) of Article 3 (General Rules of Taxation).

ARTICLE 16. INVESTMENT OR HOLDING COMPANIES

This Article denies the benefits of the dividends, interest, and royalties Articles to a corporation of one of the States deriving such income from sources within the other State if (1) such corporation is entitled to special tax benefits which result in the tax imposed on such income being substantially less than the tax generally imposed on corporate profits in such State, and (2) 25 percent or more of the capital of the corporation is owned directly or indirectly by one or more persons who are not individual residents of such State or, in the case of a Trinidad and Tobago corporation, are citizens of the United States.

The purpose of this Article is to deal with a potential abuse which could occur if one of the States provided preferential rates of tax for investment or holding companies. In such a case, residents of third countries could organize a corporation in the State extending the preferential rates for the purpose of making investments in the other State. The combination of the low tax rates in the first State and the reduced rates or exemptions in the other State would enable the third-country residents to realize unintended benefits.

ARTICLE 17. 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 such person is physically present there for not more than 183 days, in the aggregate, during the taxable year and either (1) such individual is an employee of a resident of a State other than the State of source (or an employee of a permanent establishment of a resident of the State of source located outside such State) and the amount of such income is not deducted in computing the profits of a permanent establishment of the State of source; or (2) such income does not exceed $3,000 or its equivalent in Trinidad and Tobago dollars.

Thus, if such individual's employment income does not exceed $3,000 or its equivalent in Trinidad and Tobago dollars, such individual need only satisfy the physical presence limitation in order to qualify for the exemption.

Compensation for services performed as a member of the regular complement aboard ships or aircraft operated in international traffic by a resident of one State (and in the case of the United States, registered in the United States) are exempt from tax in the other State. This exception does not limit a State's right to tax its own citizens or residents.

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

The exemption applicable to personal service income is limited in the case of (1) public entertainers, such as musicians, actors, or professional athletes, and (2) any person providing the services of a person described in (1) even though such income may otherwise be considered exempt under some other provision of this Convention. These persons are taxable if their income from such activities exceeds $100 (or its equivalent in Trinidad and Tobago dollars) for each day the individual is present for purposes of performing within the State.

ARTICLE 18. TEACHING AND RESEARCH

This Article of the proposed Convention provides a reciprocal exemption from tax for personal service income of visiting teachers or researchers. This exemption applies to an individual who is a resident of one State at the time he is invited by the Government of the other State or by an accredited educational institution of the other State to teach or do research in the other State and temporarily comes to such other State in order to engage in such teaching or research at such an accredited educational institution. However, the exemption does not apply to income (1) from research undertaken not in the public interest but primarily for private benefit of a specific person or persons or (2) in cases where an agreement exists between the Governments of States for the provision of the services of such individuals. If the individual's visit exceeds a period of 2 years from the date of arrival, the exemption applies to the income received by the individual before the expiration of such 2-year period.

ARTICLE 19. STUDENTS AND TRAINEES

This Article provides that an individual who is a resident of one State at the time he becomes temporarily present in the other State for the purpose of studying at a university or other accredited institution, of securing training for qualification in a profession or of studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational institution is exempt from tax in the host State on:

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

(2) The grant, allowance, or award;

(3) Income from personal services performed in the host State not in excess of $2,000 (or its equivalent in Trinidad and Tobago dollars) for any taxable year. The $2,000 exemption is increased to $5,000 if a resident is securing training required to qualify him to practice a profession or a professional specialty.

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 provision for more than a total of 5 taxable years from the date of arrival.

In addition, a resident of one State employed by or under contract with a resident of that State who, at the time he is a resident of that State, becomes temporarily present in the other State for the purpose of studying or acquiring technical, professional, or business experience other than from a resident of the first-mentioned State is exempt from tax in the host State on income not, in excess of $5,000 (or its equivalent in Trinidad and Tobago dollars) from personal services rendered in the host State. The individual is exempt for a period of one year which period commences with the first day of the first month in which he begins working or receives compensation.

Also, an individual who is a resident of one State at the time he becomes temporarily present in the other State for a period not exceeding one year

and who is temporarily present in the host State as a participant in a government program of the host State for the primary purpose of training, research or study is entitled to an exemption by the host State with respect to his income from personal services relating to such training, research, or study performed in the host State in an amount not in excess of $10,000 (or its equivalent in Trinidad and Tobago dollars).

If an individual qualifies for the benefits of more than one of the provisions of the personal services Articles, he may choose the provision most favorable to him but he may not claim the benefits of more than one provision in any taxable year.

ARTICLE 20. GOVERNMENTAL SALARIES

The proposed Convention provides that wages, salaries, and similar compensation, pensions, annuities, or similar benefits, which are paid by or from the public funds of one of the States to an individual who is a national of that State for services rendered to that State in the discharge of governmental functions shall be exempt from tax by the other State.

Unlike the French Convention the proposed Convention does not apply to political subdivisions of a State. Thus, for example, employees of a State or municipal government of the United States employed in Trinidad and Tobago will not be exempt from Trinidad and Tobago tax under the proposed Convention.

With respect to the application of this provision to Trinidad and Tobago, it should be noted that Trinidad and Tobago taxes on the basis of residence and not citizenship. Further, a person loses his resident status in Trinidad and Tobago for tax purposes if he remains outside the country for a continuous period of 6 months. Thus, a resident of Trinidad and Tobago employed abroad can be subject to tax in Trinidad and Tobago for no more than 6 months.

The proposed Convention also adds a specification that the compensation must be paid in connection with the discharge of functions of a governmental nature. Compensation paid in connection with industrial or commercial activity is treated the same as compensation received from a private employer. The provisions relating to dependent personal services, private pensions and annuities, and social security payments would apply in such a case.

ARTICLE 21. RULES APPLICABLE TO PERSONAL INCOME ARTICLES

This Article extends the benefits of the personal services Articles (Articles 17 through 20) to reimbursed travel expenses. However, such reimbursed expenses will not be taken into account in computing the maximum amount of exemptions specified in Articles 17 (Income from Personal Services) and 19 (Students and Trainees). If an individual qualifies for the benefits of more than one of the provisions of Articles 17 through 20, he may choose the provision most favorable to him but he may not claim the benefits of more than one Article with respect to the same income in any one taxable year.

ARTICLE 22. PRIVATE PENSIONS AND ANNUITIES

The proposed Convention provides that private pensions, private life annuities, and alimony which are paid to an individual who is a resident of one of the States shall be exempt from tax in the State of source.

The term "life annuities" is defined to mean a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make payments in return for adequate and full consideration in money or money's worth.

The term "pension" is defined as periodic payments made after retirement or death in consideration for services rendered, or by way of compensation for injuries received in connection with past employment.

The term "alimony" is defined as periodic payments made pursuant to a decree of divorce or of separate maintenance which are taxable to the recipient under the internal laws of the State of which he is a resident. Thus, the term "alimony" would not include a payment which would not be taxable to the recipient under the laws of the State in which he is a resident even though such payment is made pursuant to a decree of divorce or of separate maintenance.

The effect of this provision is the same as that of the OECD Model Convention.

ARTICLE 23. MUTUAL AGREEMENT PROCEDURES

This Article provides that the competent authorities of the States may prescribe regulations for implementing the present Convention within their respective States and may communicate with each other directly for the purpose of carrying out and giving effect to the provisions of this Convention.

This Article also provides that the competent authorities of the two States will endeavor to settle by mutual agreement cases of taxation not in accordance with the Convention as well as any other difficulties or doubts arising as to the application of the Convention. Some particular areas on which the competent authorities may consult and reach agreement are (1) the amount of industrial and commercial profits to be attributed to a permanent establishment, (2) the allocation of income, deductions, credits, or allowances between a resident and any related person, and (3) the determination of the source of particular items of income in accordance with the rules set forth in Article 5 (Source of Income).

In implementing the provisions of this Article, the competent authorities will communicate with each other directly and meet together for an exchange of oral opinions where advisable.

In cases in which the competent authorities reach agreement with respect to a particular matter, taxes will be adjusted and refunds or credits allowed in accordance with such agreement. This provision permits the issuance of a refund or credit notwithstanding procedural barriers otherwise existing under a State's law, such as the Statute of Limitations.

This provision will apply only where agreement or partial agreement has been reached between the competent authorities and will apply in the case of any such agreement after the Convention goes into effect even though the agreement may concern taxable years prior thereto.

Revenue Procedure 70–18 sets forth the procedures followed by the United States in implementing its obligations under this type of article.

ARTICLE 24. 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.

Information exchanged is treated as secret and may not be disclosed to any persons other than those (including a court or administrative body) concerned with the assessment, collection, enforcement, or prosecution of taxes subject to the Convention, but this does not prohibit disclosure in the course of a court proceeding. In no case does this Article impose an obligation on either State to exchange information which would disclose trade secrets or similar information. Further, information shall not be exchanged unless that information is available to a Contracting State under its taxation laws and administrative procedures.

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.

ARTICLE 25. ASSISTANCE IN COLLECTION

This Article provides for mutual assistance in the collection of taxes where required to avoid an abuse of the Convention. The provision is intended merely to insure that the benefits of the Convention will only be available with respect to persons entitled to such benefits; it does not in any way alter the rights under other provisions of the Convention.

The Article provides that each State will endeavor to collect for the other State such amounts as may be necessary to insure that any exemption or reduced rate of tax granted under the proposed Convention will not be availed of by persons not entitled to those benefits. However, this Article will not require a State, in order to collect taxes which are imposed by the other State, to undertake any administrative measures that differ from its internal regulations or practices nor will this Article require a State to undertake any administrative or judicial measures which are contrary to that State's sovereignty, security, or public policy.

ARTICLE 26. TAXPAYER CLAIMS

This Article provides for the administrative review of taxpayer claims. Thus, when a resident of one State considers that action 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 law of either State. The competent authority of the State to which the claim is made shall, if he thinks the claim has merit, endeavor to settle this claim with the competent authority of the other State. In cases in which the competent authorities reach agreement with respect to a particular matter, taxes will be imposed and refunds or credits allowed (as provided in Article 24 (Mutual Agreement Procedures)) in accordance with such agreement.

ARTICLE 27. 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. 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 28. EFFECTIVE DATES AND RATIFICATION

This Article provides for the ratification of the proposed Convention and for the exchange of instruments of ratification. The proposed Convention will have effect for taxable years beginning on or after the first day of January of the year in which the instruments of ratification are exchanged. However, (1) the provisions of paragraph (2) of Article 7 (Tax Deferral for Technical Assistance) shall be effective with respect to stock received on or after the date of the signing of the Convention and (2) Trinidad and Tobago agrees, following the signing of this Convention, to take all steps that are necessary to give effect to the provisions of Article 12 (Dividends) so that the provisions of that Article shall be effective from January 1, 1970, and shall terminate on December 31, 1970, unless this Convention has been ratified by both States. This provision was added in order to authorize Trinidad and Tobago to reduce the rate of its withholding on dividends as soon as the Convention is signed and not postpone this reduction until the Convention is ratified.

This Article also provides rules for terminating the Convention. The Convention will continue in effect indefinitely, but may be terminated by either State at any time after 5 years from the first day of January of the year in which the instruments of ratification are exchanged. A State seeking to terminate the Convention must give notice at least 6 months before the end of the calendar year through diplomatic channels. If the Convention is terminated such termination shall be effective for taxable years beginning on or after the first day of January next following the expiration of the 6-month period.

ARTICLE 29. EXTENSION OF CONVENTION

This Article provides a method by which either State may extend the Convention, either in whole or in part or with such modification as may be found necessary for special application in a particular case, to all or any areas for whose international relations the State is responsible and which area imposes taxes substantially similar in character to those which are the subject of this Convention.

Extension to an area may be accomplished by a State through a written notification given to the other State through diplomatic channels. The other State shall indicate its acceptance by a written communication through diplomatic channels. When the notification and communication have been ratified in accordance with the constitutional procedures of each State and instruments of ratification exchanged the extension will take effect for the date specified in, and be subject to such conditions as are specified in, the notification. Without such acceptance and exchange of instruments of ratification in respect of an area, none of the provisions of this Convention shall apply to such areas.

Either of the States may terminate an extension with respect to an area by 6 months prior written notice of termination given to the other State at any time after the date of entry into force of the extension. The termination will take effect for taxable years beginning on or after the first day of January next

following the expiration of the 6-month period. The termination of an extension to a particular area shall not affect the application of the Convention to the United States, Trinidad and Tobago, or any other area to which the Convention has been extended.

OCTOBER 6, 1970.

TECHNICAL EXPLANATION OF PROPOSED UNITED STATES-NETHERLANDS ESTATE TAX CONVENTION

(Department of the Treasury)

INTRODUCTION

The proposed Estate Tax Convention and Protocol with the Netherlands is the first estate tax convention to be sent to the Senate since the Convention between the United States and Canada, which was ratified on January 31, 1962. That Convention replaced an earlier estate tax convention between the two countries. Prior to that the most recent estate tax convention forwarded to the Senate was with Italy. It was ratified on July 29, 1955.

The proposed Convention is substantially different from the twelve existing tax conventions[1] principally because of two significant developments since the negotiation of our last estate tax convention. The new convention is the first to reflect changes and the policies underlying those changes in United States estate taxation of nonresident aliens contained in the Foreign Investors Tax Act of 1966. The proposed convention is also based, in part, on the provisions of the OECD Model Estate Tax Convention (entitled Draft Double Taxation Convention on Estates and Inheritances), published in 1966 by the Organization for Economic Co-operation and Development, to the extent consistent with the laws and policies of the United States and the Netherlands. The United States played a substantial part in the drafting of the model convention. As the United States nears the completion of its income tax convention network in Western Europe (based on the OECD Model Income Tax Convention), we are seeking a complementary estate tax convention system. The proposed convention reflects a coordination and rationalization of the Netherlands succession and transfer duties (typical of Western European legal systems) with the United States estate tax.

However, most of the provisions in the proposed convention are found in the existing conventions and only a few provisions are new, such as Article 4, which provides rules designed to ameliorate tax problems of persons temporarily present in a foreign country, and Article 10(1), which provides for a marital exemption.

The provisions of the proposed Convention are discussed article by article below, after brief summaries of the Federal estate tax, the Dutch succession and transfer duties, and the general approaches of existing United States estate tax conventions and the OECD Model Convention.

FEDERAL ESTATE TAX

The Federal estate tax is imposed with respect to the worldwide estates of decedents who were citizens or residents of the United States at death and on the estates of nonresidents who were not citizens (referred to hereafter as nonresident aliens) with respect to their property deemed situated in the United States. For Federal estate tax purposes, a resident of the United States is a domiciliary therein, *i.e.*, a person residing in the United States who has the intention to remain in the United States indefinitely or a person who has lived in the United States with such an intention and who subsequently left the United States without having the intention to remain indefinitely in the country of his new residence. In other words, while the term "resident" is used in the estate tax laws, it is generally defined in terms of the common law rules with respect to domicile.

For situs rules of United States domestic law, see sections 2104 and 2105 of the Internal Revenue Code of 1954 (the "Code") and the regulations thereunder; for a discussion of the more important types of property taxable on the basis of

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[1] The United States has estate tax conventions in force with Australia, Canada, Finland, France, Greece, Ireland, Italy, Japan, Norway, Switzerland, the Republic of South Africa, and the United Kingdom.

situs under these rules but exempt under the Convention see the commentary on Article 8 in this technical explanation.

Estates of citizens or residents are allowed: (a) a $60,000 exemption; (b) a marital deduction for property passing to the surviving spouse of the decedent of up to 50 percent of the adjusted gross estate; and (c) deductions for debts, funeral and administration expenses, and claims against, and losses of, the estate. The taxable estate is taxed at rates progressing from 3 to 77 percent. Credits are allowable for foreign death taxes with respect to property which is considered under United States situs rules to be situated in the taxing foreign country and which is included in the gross estate for Federal estate tax purposes.

Since the enactment of the Foreign Investors Tax Act of 1966, estates of nonresident aliens are allowed a $30,000 exemption plus deductions for a proportion of the debts, funeral and administration expenses, claims, and losses (based on the proportion of the decedent's worldwide estate which is located in the United States). The United States estate is taxed at rates ranging from 5 percent to 25 percent. The lower rates are designed to compensate for the fact that no marital deduction is allowable. See Senate Report No. 1707, 89th Congress, 2d Session (1966), page 50.

NETHERLANDS SUCCESSION AND TRANSFER TAXES

The Netherlands imposes a succession duty with respect to the worldwide estates of residents of the Netherlands on each beneficiary of the estate. For this purpose, a decedent is considered a resident of the Netherlands if he had a habitual abode in the Netherlands, even though he had no intent to remain there indefinitely and was therefore not a domiciliary of the Netherlands under United States law. This is one of the basic differences in the assertion of taxes at death between the United States and the Netherlands. The proposed convention attempts to rationalize this difference on a more complete and equitable fashion then is found in existing conventions. Exemptions and rates under Netherlands law vary with the degree of relationship between the decedent and the beneficiary. The surviving spouse is entitled to an exemption equivalent to $69,450, while other beneficiaries have exemptions equivalent to from $139 to $2,778. The rates are progressive and range from 3 percent to 17 percent in the case of the spouse and children of the decedent and from 36 percent to 54 percent in the case of unrelated beneficiaries. Deductions are allowable for debts and funeral expenses. Administration expenses are not deductible but normally are smaller than in the United States. Foreign taxes are creditable against tax or deductible as debts, depending on the jurisdictional basis upon which they are imposed.

Citizens of the Netherlands who were not residents of the Netherlands at death but were residents thereof within 10 years of death are deemed residents of the Netherlands for purposes of the death duty. However, all taxes of the country of actual residence are credited rather than deducted in such cases.

A transfer duty at death is the only tax imposed with respect to estates of nonresidents and is only imposed on immovable (real) property, mortgages, business assets (including ships, boats, and aircraft), and certain types of business investments other than marketable securities, if deemed situated in the Netherlands. No deductions (other than for debts specifically related to taxable property) or exemptions are allowed with respect to the transfer duty, which is imposed at a rate of 6 percent.

EXISTING UNITED STATES CONVENTIONS AND OECD MODEL CONVENTION

Existing United States estate tax conventions provide for the taxation of the worldwide estates of decedents by the country of domicile or citizenship (nationality). Like United States domestic law, these conventions are based on the situs principle of taxation. That is, tax is imposed on estates of nonresident aliens with respect to property located in the taxing country, and a credit is granted by the country of which the decedent was a citizen or domiciliary for estate or inheritance taxes paid to the other country with respect to the property. In certain cases (for example, where the property is deemed situated in or outside both countries), existing conventions provide that the countries each gave a partial credit.

Such conventions provide comprehensive situs rules (more detailed than, and at times differing from, those contained in the Code) and state that situs shall

be "determined exclusively in accordance with" these rules. Accordingly, property considered under such a convention to be situated in a country may be taxable by it, notwithstanding that the property would not be taxed or taxable by that country under its domestic law in the absence of the convention. However, some conventions contain a provision, corresponding to Article 5(3) of the Convention, which limits the maximum amount of tax of a country under the convention to the amount of tax which would be imposed by the country in the absence of the convention.

On the other hand, Articles 5, 6, and 7 of the OECD Model Convention provide that certain specified categories of property *may be taxed* by a country in which the property is deemed located even though the decedent was neither a domiciliary nor a citizen of that country. Accordingly, it appears that the OECD Model Convention would not extend the taxing jurisdiction of the countries beyond that provided in their domestic laws.

The OECD Model Convention places principal emphasis on domicile of the decedent. It provides that all property shall be taxable by the country in which the decedent was domiciled at death. However, real (immovable) property and business assets other than ships and aircraft may also be taxed by the country in which they are situated. Ships and aircraft may also be taxed by the country where their effective management is located. In order to eliminate double taxation of such property, the country of domicile shall grant an exemption for such property or a credit for the other country's taxes thereon. Although the taxing rules relating to real property, business assets, and ships and aircraft are similar in effect to situs rules the former are more limited. Accordingly, taxing jurisdiction of a country in which the decedent was not domiciled is more limited under the OECD Model Convention than under the Code or existing United States tax conventions. In addition, the OECD Model Convention makes no provision for the taxation of the worldwide estates of decedents based upon citizenship or nationality. It does offer an alternative provision which might be used to authorize such taxation, but such provision would be subsidiary to taxation based on domicile and would require the country of citizenship in effect to relinquish primary taxing jurisdiction to the domiciliary country through an exemption or credit.

In determining domicile, the OECD Model Convention refers to the law of each of the countries. If both countries find domicile, the OECD Model Convention resorts to a sequence of tests, the application of which is intended to assure that there is one and only one domicile. This series of tests involves the concepts of permanent home, center of vital interests, habitual abode, and citizenship, in that order. If these tests do not solve the question of domicile in any given case, the OECD Model Convention provides that the countries shall settle the question by mutual agreement.

These concepts are highly uncertain in their actual application, involving factual determinations in each case which may be extremely difficult to make and very controversial. They follow the general European pattern of little more than residence giving rise to domicile for both estate and income tax purposes. The OECD Model Convention reflects the substantially different jurisdictional concepts of most European countries and the United States. The United States asserts primary taxing jurisdiction based on citizenship or domicile. European countries assert primary jurisdiction generally based on residence without regard to nationality or citizenship or domicile. The common law concept of "domicile" is generally unknown under European laws. See the commentary on Article 4.

Analysis of Proposed Convention:

ARTICLE 1. ESTATES COVERED

The Convention shall apply to estates of decedents which are subject to the taxing jurisdiction of the United States or the Netherlands by reason of the decedent's domicile therein or citizenship thereof at death. Because of the domestic laws of the two states, the Convention applies to the estate of a decedent who was either a domiciliary or a citizen of the United States or who was a domiciliary of the Netherlands. Dutch law does not provide for taxation based solely on citizenship. However, the estate of a nonresident citizen of the Netherlands is taxed on the basis of constructive residence in the Netherlands if the decedent had been a nonresident of the Netherlands less than 10 years at his death. See the discussion of the Dutch succession duty in the introduction and under Article 9 (relating to taxation on the basis of citizenship).

The Convention refers to citizenship (and domicile) *at death;* decedents described in section 2107 of the Internal Revenue Code of 1954 (relating to decedents who are United States expatriates and who relinquish United States citizenship for the principal purpose of avoiding taxes) are not United States citizens for this purpose. See also Article 9. However, the estate of a United States expatriate decedent who died domiciled in the Netherlands will be covered by the Convention on the basis of such domicile.

The second sentence of the article is necessitated by section 2209 of the Code. That sentence provides, in effect, that the Convention shall not apply to the estate of a citizen of the United States described in section 2209 (*i.e.*, a resident of a possession of the United States whose citizenship resulted solely from his citizenship of, or his birth or residence in, the possession and who is therefore not subject to federal estate tax as a citizen under the provision of section 2209 of the Code) unless his estate is subject to the taxing jurisdiction of the Netherlands by reason of his actual or deemed domicile therein at death.

Article I of the Protocol to the Convention which was executed at the signing of the Convention states that the Convention shall not affect property rights under laws relating to descent, distribution, succession, inheritance, or other similar matters.

ARTICLE 2. TAXES COVERED

This article designates the taxes of the United States and the Netherlands which are the subject of the Convention. With respect to the United States, the tax included is the Federal estate tax. With respect to the Netherlands, the taxes included are the succession duty and the transfer duty at death. The Convention also applies to subsequently enacted taxes on estates and inheritances imposed on the occasion of death, in the form of a tax on the corpus of the estate, a tax on inheritance, transfer duties, or taxes on donations *mortis causa.* It does not apply to such taxes as documentary stamp taxes with respect to transfers at death or income taxes on the appreciation of capital assets at death. Nor does it apply to taxes imposed by a State or local authority.

This article provides further that the competent authorities of the United States and the Netherlands shall notify each other of any substantial changes in their respective laws relating to taxes on estates and inheritances.

ARTICLE 3. GENERAL DEFINITIONS

This article defines the terms "State", "United States", "Netherlands", "tax", "credit", and "competent authority".

The term "State", as used in the Convention, refers to the United States of America (when used in the geographical sense it refers to the several States of the United States and the District of Columbia) and the part of the Kingdom of the Netherlands that is situated in Europe. The treaty does not cover Surinam or the Netherlands Antilles which are part of the Kingdom of the Netherlands. No reference is made to the continental shelf.

The article also provides that any term not otherwise defined in the Convention shall, unless the context otherwise requires, have the meaning which it has under the laws of the State whose tax is being determined. Article II of the Protocol provides that if the meaning of a term under the laws of one State is different from the meaning of the term under the laws of the other State; or if the meaning of such a term under the laws of one or both States is not readily determinable, the competent authorities of the States may, in order to prevent double taxation or to further any other purpose of the Convention, establish a common meaning of the term for purposes of the Convention.

ARTICLE 4. FISCAL DOMICILE

This article sets forth rules for determining fiscal domicile for purposes of the Convention. Fiscal domicile is important since the domicile of the decedent is a basis for imposing estate tax or succession duty on his entire estate wherever situated.

Article IV of the Protocol states that, as used in the Convention, the term "domicile" with respect to each of the States means residence for purposes of its tax.

Under the definition of fiscal domicile contained in this article each State looks first to its domestic law (however, see the discussion below of Article V of the Protocol, relating to the 10-year rule under Netherlands law). The defini-

tion then provides rules for determining a single domicile in cases in which both of the States regard the decedent as having been a domiciliary. (Existing conventions do not provide for the elimination of double domicile, but rather give relief from double taxation in double domicile cases by means of a prorated credit similar to that provided in Article 11(2)(c) of this Convention).

The proposed Convention provides that a decedent who at his death was a citizen of one of the States without being a citizen of the other State, and who would be considered as domiciled in both States under their respective laws, shall be deemed to have been domiciled only in the State of which he was a citizen if (1) he died when having been domiciled (for purposes of tax) in the other State in the aggregate less than 7 years during the 10-year period ending at his death, and (2) he was in the other State for business, professional, educational, training, tourism, or a similar purpose (or as the spouse or a dependent member of the family of a person who was in that other State for such a purpose), and if he did not have a clear intention to remain indefinitely in the other State. Unless all of the evidence considered together is clear and convincing to the contrary it shall be presumed that the decedent did not have a clear intention to remain indefinitely in the State of which he was not a citizen. The use of a 7-out-of-10 year rule rather than a simple period of time avoids issues arising from a relatively short change in status. (As a corollary to this 7-out-of-10 year rule, the State of citizenship yields priority of taxation (by means of a credit) to the other State after 7 years of domicile therein in a 10-year period. See Article 11(2)(a)). This rule conforms the Convention to some extent to the OECD Model Convention approach and recognizes that decedents who lived in a foreign country for a substantial number of years preceding death normally have significant ties with that country justifying the imposition of primary taxing jurisdiction by such country.

In the cases in which a single domicile is not determined under the above rules,[2] additional tests are set forth to resolve the decedent's domicile. These tests are based on the tests for determining domicile contained in the OECD Model Convention, with certain variations. The first such tests provides that the decedent shall be deemed to have been domiciled in the State in which he made his permanent home for 5 years or more immediately preceding his death. Article III of the Protocol provides that for this purpose a decedent shall not be deemed to have more than one permanent home. If that test does not determine the decedent's domicile, his domicile shall be deemed to be in the State in which his personal relations were closest. If that cannot be determined, his domicile shall be deemed to be in the State of which he was a citizen. If the decedent was a citizen of both States or neither of them, the competent authorities shall determine the State of his domicile by mutual agreement. Article VI of the Protocol provides that since it is intended by Article 4 to resolve all cases of double domicile, the competent authorities of the States shall resolve any dispute with respect to the domicile of the decedent for purposes of the Convention which is presented to one or both of them within the period of time prescribed under Article 12 for the filing of a claim for credit or refund of tax.

Article V of the Protocol provides that the Netherlands will not, for purposes of determining domicile under this article, assert its domestic 10-year rule presumptive of domicile with respect to decedents who were citizens of the Netherlands and who were in the United States for less than 10 years immediately preceding death, if the decedent had the intention to remain indefinitely in the United States. Accordingly, a citizen of the Netherlands, who at his death was in the United States with the intention of remaining indefinitely is considered a domiciliary of the United States for purposes of the Convention, although he did not have a permanent home here for 5 years. The Netherlands may, however, tax the worldwide estate of such a decedent pursuant to Article 9 of the Convention, relating to taxation based on citizenship. Double taxation is avoided through the credit provisions of Article 11.

ARTICLE 5. APPLICATION OF DOMESTIC LAWS

This article provides for the application of domestic law except as otherwise provided in the Convention. Accordingly, for example, the deductibility of debts is determined by each State under its domestic laws.

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[2] For example cases of double citizenship, citizenship in a third country, or a decedent i the State of which he was not a citizen for more than 7 out of 10 years without the cle intention to remain there indefinitely.

Under Netherlands laws debts secured by property described in Article 6 for 7 are deducted entirely from the value of the property to which they relate. Under United States law debts of the decedent are prorated among all of the assets of the estate for purposes of determining the taxable estates of nonresident aliens and the credit allowable with respect to estates of United States domiciliaries or citizens. See example (6) in the commentary on Article 11.

This article provides further that, in any case in which the laws of a State allocate deductions on the basis of the situs of property, property shall be deemed for the purpose of determining the amount of any deductions to have a situs in that State only if that State may tax it under the Convention. For example, in the case of a Dutch domiciliary and citizen who dies owning real property in the United States and stock of United States corporations, allocation of debts should be made under section 2106(a)(1) of the Internal Revenue Code of 1954 based solely on the ownership of the United States real property since the stock is not taxable by the United States under the Convention.

In order to allocate debts properly for credit purposes, this article further provides that property shall be deemed for the purpose of determining the amounts of any credits to have a situs in the other State only if a credit is allowable under the Convention for the tax of that other State with respect to the property.

Article 5 also preserves reporting and recordkeeping requirements of domestic law based upon situs with respect to property which Article 8 of the Convention exempts from tax. See section 6018 (a)(2) of the Internal Revenue Code of 1954 and §§ 20.6036–1(a) and 20.6325–1(b) of the Estate Tax Regulations. This provision relates specifically to information or tax returns or notices, transfer certificates, or maintenance of records, and provides that sanctions under domestic law (civil and criminal) shall not be affected by exemption under the Convention. In other words, in the preceding example, if the estate fails to file returns or notices or obtain transfer certificates, or maintain records, as would be required in the absence of exemption of the stock, then sanctions may be imposed to the same extent as if the Convention had not exempted the stock from tax. This provision is necessary in order to have effective sanctions since most civil sanctions are based upon the amount of the underpayment of tax, which in this case may be zero by reason of the Article 8 exemption.

One of the principal purposes of the proposed convention is the prevention of fiscal evasion. Even though the United States relinquishes jurisdiction to tax certain property, such as stock of United States companies, retention of the above requirement and sanctions is designed to prevent evasion of Netherlands tax. In the event that any of these requirements or sanctions proves to be unnecessary it may be removed or modified by regulations.

Finally, this article provides that the Convention shall not result in an increase in the amount of the tax imposed by either State (except to the extent that the increase results from the reduction under the Convention of the tax paid to the other State for which credit is allowable).

ARTICLE 6. IMMOVABLE PROPERTY

Article 6 provides that immovable property may be taxed by a State if the property is situated in that State. The United States has no law defining "immovable property". The term as applied to United States property is considered to mean real property for purposes of the Convention. Security interests are not deemed real property for this purpose.

The last paragraph of Article 6 (and of Article 7), together with the usage of the permissive words "may be taxed" in the first paragraph, precludes any extension of a State's taxing jurisdiction under this article beyond that provided in its domestic law.

ARTICLE 7. BUSINESS PROPERTY OF A PERMANENT ESTABLISHMENT AND ASSETS PERTAINING TO A FIXED BASE USED FOR THE PERFORMANCE OF PROFESSIONAL SERVICES

This article provides that assets (other than ships, boats, and aircraft operated in international traffic, movable property related thereto, and immovable property) which form part of the business property of a permanent establishment may be taxed by a State if the permanent establishment is situated in that State. The article applies to such assets to the extent they were used or held for use in the conduct of the business of the permanent establishment.

The article defines the term "permanent establishment". The definition is an updated adaptation of the definition found in the Income Tax Convention between the United States and the Netherlands. As so defined, the term "permanent establishment" means a fixed place of business through which a decedent was engaged in trade or business. This includes a decedent's interest in a partnership or other unincorporated association (which is not taxed as a corporation). The term "fixed place of business" includes a branch, an office, a factory, a workshop, a sales outlet, a mine, quarry, or other place of extraction of natural resources, and a building site or a construction or assembly project which exists for more than 12 months (including any period of existence after the decedent's death).

The article specifically excludes from the definition of permanent establishment a fixed place of business used solely for one or more of the following activities: (1) The storage, display, or delivery of goods or merchandise belonging to the decedent; (2) the maintenance of a stock of goods or merchandise belonging to the decedent for the purpose of storage, display, or delivery; (3) the maintenance of a stock of goods or merchandise belonging to the decedent for the purpose of processing by another; (4) the purchase of goods or merchandise, or the collection of information, for the decedent; (5) advertising, supplying information, conducting scientific research, or similar activities which had a preparatory or auxiliary character, for the decedent; or (6) the maintenance of a fixed place of business (by a person acting in a capacity other than that of a dealer) for the purpose of investing or trading in stocks, securities, or commodities for the decedent's own account, whether directly or through a broker or other agent.

The decedent will be considered to have had a permanent establishment if he engaged in business through an agent (other than an independent agent acting in the ordinary course of his business or an agent described in (6) of the preceding paragraph) who had and regularly exercised authority to conclude contracts in the name of the decedent, unless the agent only exercised such authority to purchase goods or merchandise for the decedent. On the other hand, the decedent is not deemed to have had a permanent establishment merely because he carried on a trade or business through an independent agent acting in the ordinary course of the agent's business.

The fact that the decedent controlled a corporation shall not be taken into account in determining whether the decedent had a permanent establishment. Thus, for example, an activitiy of the decedent will not be deemed a permanent establishment by reason of the fact that the decedent controlled a corporation operating (through a permanent establishment or otherwise) in the same State.

Assets (other than immovable property) of a fixed base used for the performance of professional services or similar activities may be taxed by a State if the fixed base is situated therein.

ARTICLE 8. TAXATION ON THE BASIS OF DOMICILE

This article authorizes the State of which the decedent was a domiciliary at death to tax all property in the estate wherever situated (if taxable under the domestic law of the State), and prohibits a State of which the decedent was neither a citizen nor a domiciliary from taxing property (or taking property into account in determining the rate of tax) except to the extent provided in Article 6 or 7. Under this provision, and subject to the provisions of Article 9, a State of which the decedent was not a domiciliary may not tax such property as stock, bonds, life insurance proceeds, jewlery, art objects, or immovable property situated in another country, unless the property is taxable by it under Artcile 7. Nor may such a State tax ships or aircraft operated in international traffic or movable property pertaining to their operation.

ARTICLE 9. TAXATION ON THE BASIS OF CITIZENSHIP

This article provides that a State may tax property in accordance with its laws in the case of an estate of a decedent who is a citizen of that State at his death, notwithstanding that the property is not property enumerated in Article 6 or 7 or that the decedent was not domiciled in the State. This article preserves the right of the United States and the Netherlands to tax the worldwide estates of their citizens. The Netherlands may tax its citizens under it even though its tax is based on constructive domicile in the Netherlands (under thet Dutch 10-year rule) rather than citizenship and the decedent is treated under Article 4 of the Convention (by reason of Article V of the Protocol) as not having been domiciled in the Netherlands.

ARTICLE 10. EXEMPTIONS

Paragraph (1) of this article provides for an exemption which roughly corresponds to the marital deduction provided in section 2056 of the Internal Revenue Code of 1954. The exemption applies to separate property which passes to the surviving spouse from a decedent, if the decedent was a domiciliary or citizen of the United States, and if the property may be taxed by the Netherlands solely by reason of Article 6 or 7 (*i.e.*, is not taxable on the basis of the decedent's citizenship or domicile in the Netherlands). Such property shall be included in the estate subject to the Netherlands transfer duty only to the extent that its value exceeds 50 percent of the value of all property included in the Dutch estate. The value of the Dutch estate and of property which passes to the surviving spouse is determined after taking into account any applicable deductions but, as provided in Article VII of the Protocol, before allowance of the $30,000 exemption provided in paragraph (2) of this article.

The exemption described above is inapplicable during any period when the laws of the United States make the tax imposed by it with respect to estates of nonresident aliens substantially less favorable in relation to the tax imposed by it with respect to estates of its citizens or domiciliaries than is the case when the Convention was signed (July 15, 1969).

Paragraph (2) of this article provides that where a State may tax solely by reason of Article 6 or 7 that State shall not impose any tax if the aggregate value of the property included in the estate subject to its tax (after taking into account any applicable deductions and after taking into account the marital exemption, but before taking into account any other exemptions) does not exceed $30,000. If the value so determined exceeds $30,000, the tax imposed shall not exceed the lesser of 50 percent of the value in excess of $30,000 or the amount of the tax determined in accordance with the provisions of the Convention (taking into account any exemptions allowable under the laws of the State).

This exemption relieves an estate of $30,000 or less which is not taxable by the Netherlands under Article 8 or 9, of liability for Dutch tax. It applies to a lesser extent, by reason of its 50 percent limitation and the 6 percent Netherlands rate, to estates of up to $34,090. By operation of section 2106(a)(3) of the Internal Revenue Code of 1954 and Article 10(2)(b), the United States provides a flat $30,000 exemption with respect to its tax on estates not taxable by the United States under Article 8 or 9.

The application of the provisions of Article 10 may be illustrated by the following examples:

Example (1). D, a U. S. citizen and domiciliary, owned Dutch immovable property (his only Dutch property) valued under Dutch law at $200,000 and subject to a $150,000 mortgage. D devised the property, which was not community property, to W, his wife. Under Dutch law, the mortgage is entirely deductible from the Dutch property in determining the taxable estate. Accordingly, the net Dutch estate is $50,000. Under Article 10(1), a marital exemption of 50 percent of that amount, or $25,000, is allowable. The $30,000 exemption eliminates the remaining $25,000 of the estate so there is no taxable estate for purposes of the Dutch transfer duty.

Example (2). Assume the same facts as in example (1) except that D owned additional immovable property in the Netherlands (unmortgaged) valued at $75,000 which he devised to S, his son. The marital exemption allowable under Article 10(1) in this case would be the full $50,000 net value of property passing to W since this amount does not exceed 50 percent of $125,000 (the net value of the total Dutch estate). The exemption of Article 10(2) is inapplicable in this case because the Dutch taxable estate of $75,000 (after allowance of the marital exemption) exceeds $30,000, and the transfer duty on the estate (6 percent × $75,000=$4,500) is less than 50 percent of the difference between the Dutch taxable estate ($75,000) and $30,000.

ARTICLE 11. CREDITS

This article provides that a State taxing on the basis of the decedent's citizenship or domicile is to allow a credit for taxes paid to the other State with respect to property taxable by that other State in accordance with Article 6 or 7. For this purpose, reference to property taxable by a State in accordance with Article 6 or 7 includes property which would be taxable by that State under the terms

of one of those articles if taxable by the State under its laws, whether or not it is also taxable on the basis of the decedent's domicile or citizenship at death.

Subject to other limitations described herein, if both States tax a decedent's worldwide estate, then with respect to property not taxable by either in accordance with Article 6 or 7:

(1) If at death the decedent was a citizen of only one State, was a domiciliary of the other State, and under the domestic law of such other State had been domiciled therein in the aggregate 7 or more years during the 10-year period ending at his death, then the State of which he was a citizen shall allow a credit equal to the amount of the tax imposed by such other State;

(2) If at death the decedent was a citizen of both States and a domiciliary of one State, then the State of which he was not a domiciliary shall allow a credit equal to the amount of the tax imposed by the other State; or

(3) In other cases, each State shall allow a credit in the amount which bears the same proportion to the amount of its tax attributable to such property, or to the amount of the other State's tax attributable to the same property, whichever is less, as the former amount bears to the sum of both amounts.

The first situation described above provides for the State of citizenship to yield priority of taxation (as a correlative to the 7-out-of-10-year domiciliary rule in Article 4). The second situation provides for priority of taxation to the State of which the decedent was both a citizen and a domiciliary. The third situation provides for a splitting of the credit. The most common case expected to come within the latter situation is that of a decedent who was a citizen of one State who was permanently living ("domiciled") in the other State for less than 7 years at his death.

Notwithstanding these provisions the total amount of all credits allowed by a State pursuant to the Convention or under its laws or other conventions with respect to all property in respect of which a credit is allowable under this Convention shall not exceed that part of the tax of the crediting State which is attributable to such property. For purposes of this determination, all property for which credit is given under the Convention is aggregated and not treated individually. See example (5) hereinafter. This limitation is not applicable to the third situation described above since that situation has such a limitation built into its credit formula, and since inclusion in the computaton of property to which that provision applies might result in excessive credits for other property.

The article provides that in determining the amount of the tax imposed by a State with respect to or attributable to property there shall be subtracted from the gross tax so imposed all credits allowed by the State with respect to the property except credits which are allowable under this article.

No credit is to be finally allowed until the tax for which the credit is allowable (reduced by any credit allowable with respect thereto) has been paid. Credits for the tax imposed by the other State will be tentatively allowed pending proof of payment thereof.

Any credits under this article are in lieu of any credits authorized by the respective laws of the States for the taxes of the other State.

The operation of Article 11 may be illustrated by the following examples (in which references to domicile assume resolution of possible double domicile under Article 4):

Example (1). D, a citizen and domiciliary of the Netherlands, owned immovable property in the United States, immovable property in the Netherlands, and corporate stock (property not described in Article 6 or 7). The Federal estate tax imposed with respect to the immovable property in the United States is $11,000, and the portion of the Netherlands' succession duty attributable to that property is $10,000. Under Article 11(1), the Netherlands must allow a credit of $11,000 on its succession duty. However, under Article 11(3) the amount of the credit is reduced to $10,000, the succession duty attributable thereto.

Example (2). D, a citizen of the United States and domiciliary of the Netherlands for 12 years at his death, owned immovable property in the United States, the Netherlands, and Country X, and stock of three corporations. The amount of the Federal estate tax imposed with respect to each piece of immovable property and each block of stock is $11,000, while the succession duty with respect to each is $10,000. Country X imposed $8,000 in death taxes with respect to the immovable property therein, for which the United States and the Netherlands each gave a full tax credit under their internal laws. In addition, under Article 11(1) the United States must allow a credit of $10,000 for the Netherlands tax with respect to immovable property in the Netherlands, and under

Article 11(2)(a) credits of $30,000 for the Netherlands tax with respect to the three blocks of stock and $2,000 ($10,000–$8,000) for the residual Netherlands tax on the immovable property in Country X, or total credits under Article 11 of $42,000. Under Article 11(1) the Netherlands must allow a credit for the United States tax with respect to the immovable property in the United States, a credit which under Article 11(3) shall be limited to the amount of Netherlands tax attributable to the property ($10,000).

Example (3). The facts are the same as in example (2) except that D was a citizen of both the United States and the Netherlands and a domiciliary of the Netherlands for only 6 months at his death. The credits allowable under Article 11(1) are unaffected by these changes, and the credit allowable by the United States under Article 11(2)(a) is replaced by a credit in an equal amount allowable by the United States under Article 11(2)(b).

Example (4). The facts are the same as in example (2) except that D had been domiciled in the Netherlands for 4 years at his death. The credits allowable under Article 11(1) are unaffected by this change, but the credit allowable by the United States under Article 11(2)(a) is no longer applicable. Instead, under Article 11(2)(c) of the United States must allow a credit for $16,941 ($\$32{,}000 \times \frac{\$36{,}000}{\$36{,}000+\$32{,}000}$) and the Netherlands must allow a credit for $15,059 ($\$32{,}000 \times \frac{\$32{,}000}{\$32{,}000+\$36{,}000}$).

Example (5). D, a domiciliary and citizen of the United States, owned two parcels of immovable property in the Netherlands. Transfer duties in the amount of $5,000 were paid to the Netherlands with respect to each parcel. No Federal estate tax was paid with respect to one of the parcels because it was left to a charity, but $8,000 Federal estate tax was paid with respect to the other. Under Article 11(3), the amount of the credit to be allowed by the United States for Netherlands tax is limited to $8,000, the amount of the Federal estate tax attributable to all property taxable by the Netherlands under Article 6 or 7. The fact that the Dutch tax with respect to the only property that the United States taxed is less than $8,000 ($5,000) is irrelevant since the credit computations are based upon the total tax of the other State with respect to all property for which credits are allowable.

Example (6). D, a domiciliary and citizen of the United States, owned immovable property in the United States valued at $50,000 and subject to a mortgage of $30,000. He also owned unmortgaged immovable property in the Netherlands valued at $10,000 and corporate stock valued at $40,000. The administration expenses of his estate totalled $10,000. Under Article 5(1), the Netherlands allocates deductions according to its own law for purposes of the imposition of its transfer duty. Under this principle the Netherlands would impose a transfer duty on the full $10,000 value of the Dutch immovable property, unreduced by any deductions. Under Article 11, the United States in determining for credit purposes the amount of its tax attributable under its law to the Dutch immovable property would allocate $4,000 of the debts and administration expenses ($40,000 total deductions times $10,000 value of Dutch property divided by $100,000 value of all property) to the Dutch immovable property. Accordingly, the United States would limit its credit for the Dutch transfer duty to the Federal estate tax attributable to $6,000 ($10,000 minus $4,000 debts and administration expenses).

Example (7). The facts are the same as in example (6) except that D was a domiciliary of the Netherlands for 5 years at his death. In this case, under Article 11(1), the Netherlands will allow a credit for the lesser of the Federal estate tax and the Dutch succession duty attributable to the net value of the immovable property in the United States of $20,000 ($50,000 minus $30,000) and the United States would again allow a credit for the lesser of the two taxes attributable to $6,000. In addition, under Article 11(2)(c) each State will allow a proportionate credit with respect to the corporate stock.

ARTICLE 12. LIMITATION ON CLAIMS FOR CREDIT OR REFUND

This article imposes a limitation on the period of time during which claims for credit or refund may be made. Under this provision the period for making such a claim is longer than the period under the Internal Revenue Code of 1954, but only if the claim is founded on the provisions of the Convention. Such a claim may be made any time before the expiration of the latest of:

(1) The time for making a claim for refund of tax under the laws of the State to which a claim for credit or refund is made;

(2) Five years from the date of the death of the decedent in respect of whose estate the claim is made; or

(3) One year after final determination (administrative or judicial) and payment of tax for which any credit under Article 11 is claimed, provided that the determination and payment are made within 10 years of the date of death of the decedent.

The article provides that any refund based on the provisions of the Convention is to be made without interest.

ARTICLE 13. COMPETENT AUTHORITIES

This article provides for the consideration by the competent authorities of the States of cases in which a person considers that taxation not in accordance with the Convention will result for him from the actions of one or both of the States. It provides further that the competent authorities shall endeavor to resolve any difficulties or doubts about the interpretation or application of the Convention. It also provides that each competent authority may prescribe such regulations and forms as may be necessary or appropriate to give effect to and implement the provisions of the Convention.

ARTICLE 14. EXCHANGE OF INFORMATION

This article provides for a system of administrative cooperation between the competent authorities of the two States. It provides for the furnishing of such information as is pertinent to carrying out the Convention or preventing fraud or fiscal evasion (including information with respect to property which is exempt under Article 8 from the tax of the furnishing State). However, information is not required of a competent authority with respect to exempted property if the information is not in the possession of that State. The furnishing of information may be either on a routine basis or on request. Information which is provided is to be treated as secret.

The article does not impose on the States the obligation to carry out administrative measures at variance with the laws or administrative practice of that or the other State, to supply particulars which are not obtainable under the laws or in the normal course of the administration of that or the other State, or to supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

Article VIII of the Protocol provides that it is understood that the Netherlands cannot disclose information obtained from banks and certain similar institutions, including insurance companies. This results from the treatment under Dutch law of such information as confidential. This exception does not apply if the bank or other institution is the executor or administrator of the estate.

Also, it has been agreed that there will be an exchange between the competent authorities containing the substance of the following provision:

It is understood that Article 14 of the Convention does not require that a State furnish information to the other State with respect to securities issued by residents (corporate or otherwise) of that other State (other than securities taxable by that other State under Article 7) included in the estate of a domiciliary of the first-mentioned State who is not a citizen of that other State.

ARTICLE 15. DIPLOMATIC AND CONSULAR OFFICIALS

This article preserves the existing fiscal privileges of diplomatic and consular officials and officials of international organizations. It provides further that the right to tax estates of such persons shall be reserved to the country in whose service the persons are employed and that such persons shall not be deemed to be domiciled in the receiving State. Accordingly, diplomats of a "third country" domiciled in one of the States, but exempt from tax therein because of such status, cannot assert rights under the Convention as domiciliaries with respect to taxes imposed by the other State.

ARTICLE 16. ENTRY INTO FORCE

This article and Article X of the Protocol provide for the ratification of the Convention and Protocol and for the exchange of instruments of ratification as soon as possible. The Convention and Protocol will enter into force on the date on which the instruments of ratification are exchanged and their provisions will apply to estates of persons dying on or after that date.

ARTICLE 17. TERRITORIAL EXTENSION

This article provides a method for extending the Convention to the countries of Surinam or the Netherlands Antilles and to all or any of the territories for whose international relations the United States is responsible (such as Puerto Rico), if the country or area concerned imposes a tax substantially similar in character to those to which the Convention applies. The procedure prescribed is an exchange of notes through diplomatic channels. The notes are subject to ratification, however, and the instruments of ratification must be exchanged.

Unless otherwise specified in the notice of termination referred to in Article 18, the termination of the Convention will not also terminate the application of the Convention to any country or area to which it has been extended.

ARTICLE 18. TERMINATION

The Convention will continue in effect indefinitely, but may be terminated by either State as of the end of any calendar year, providing that the termination date does not occur earlier than 5 years after the effective date of the Convention. The termination may be effected by giving at least 6 months' notice in writing of the termination. If the Convention is terminated, the termination shall be effective with respect to estates of decedents dying after the expiration of the calendar year with respect to the end of which the Convention has been terminated.

Article IX of the Protocol provides that if the effects of the Convention are substantially altered as a result of changes made in the laws of either State, then at the request of either State, the two States shall consult together with a view to making appropriate modifications in the Convention.

PROPOSED INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND BELGIUM

(Memorandum Prepared by the Staff of the Joint Committee on Internal Revenue Taxation)

The existing income tax convention between the United States and Belgium was signed on October 28, 1948. This convention was modified by supplementary conventions of September 9, 1952, and August 22, 1957, and by a protocol of May 21, 1965. These conventions and protocol will be replaced by the proposed convention.

The revision of the existing Belgian income tax treaty is desirable for a number of reasons. Over the years various changes have been made in the internal tax laws of the two countries, especially by the United States in the Foreign Investors Tax Act of 1966 which significantly changed our tax laws relating to treatment of foreign persons. There also has been a trend in recent years toward modernizing and standardizing international tax relationships. This is seen in the model income tax convention of the Organization for Economic Cooperation and Development (OECD) and in the revisions in recent years of other U.S. income tax treaties.

The proposed convention with Belgium, in general, follows the approach of other U.S. income tax treaties. The most significant change made by the proposed convention is the adoption of the "effectively connected concept" in place of the so-called "source of attraction doctrine." Accordingly, a resident of one country who derives investment income from the other country will be entitled to the reduced rates of, or exemptions from, tax provided by the proposed convention even though he has a permanent establishment in the source country as long as the income is not effectively connected with the permanent establishment. This change follows the approach embodied in the Foreign Investors Tax Act of 1966 and other recent U.S. tax treaties.

The other more important features of the proposed convention are the following:

(1) The United States and Belgium are defined to include their respective continental shelves insofar as income arising from the exploration and exploitation of natural resources on the continental shelf is concerned. The effect of this provision is to extend a country's jurisdiction to tax under, and the benefits provided by, the proposed convention to income arising in connection with natural resources activities on the country's continental shelf. Although a definition of this type is not found in our other income tax treaties (other than the proposed treaty with Trinidad and Tobago), a similar provision was added to the Internal Revenue Code by the Tax Reform Act of 1969.

(2) Specific provision is made for the two countries to mutually agree on common meanings for undefined terms which are used in the proposed convention. This provision, which will help insure the

availability of the benefits provided by the proposed convention, is not contained in other recent U.S. income tax treaties (other than the proposed conventions with Trinidad and Tobago and Finland).

(3) The reciprocal exemption for income from shipping and air transportation is extended to gains arising on the sale of the ships or aircraft.

(4) Dividends paid by a U.S. corporation to a U.S. citizen or resident, which at present are subject to a 20 percent Belgian tax if they are collected in Belgium, will be exempted from Belgian tax even though collected in Belgium.

(5) Although the generally applicable 15 percent rate of source country withholding tax on interest is continued, the proposed convention further provides for an exemption from source country tax where the interest is received by the government of the other country, is interest on commercial credit arising from sales transactions between residents of the two countries, or is interest on bank deposits or interbank loans.

(6) A rule for determining the source of nonmineral royalty income is provided which differs from that contained in the Internal Revenue Code and our other income tax treaties. Under the proposed convention, this type of royalty will be considered from sources within the country of residence of the payor. The normal rule is that the income has its source in the country in which the property right giving rise to the royalty is used.

(7) An exemption from source country tax is provided for capital gains (other than on real property) which are not effectively connected with a source country permanent establishment (or fixed base). In addition, nonbusiness capital gains of an individual who is not present in the source country for 183 days or more during the year will be exempt from tax by that country.

(8) The limitation on the foreign tax credit provided under the proposed convention by the United States for Belgian income taxes is not formulated in terms of a specific type of limitation. Our other income tax treaties normally impose a per-country limitation on the foreign tax credit. Thus, a U.S. taxpayer claiming the foreign tax credit under the proposed convention will be subject to the limitation applicable to that year under the Internal Revenue Code (at present the per-country limitation or the overall limitation).

(9) Business profits (and other income) which Belgium may tax under the proposed convention are treated as from sources within Belgium, even though under the Internal Revenue Code source rules the income might be treated as from sources outside Belgium. This will help insure that a U.S. taxpayer who incurs Belgian taxes under the terms of the proposed convention will be entitled to a foreign tax credit for those taxes where the per-country limitation on the credit is utilized.

A detailed explanation of the proposed convention on an article by article basis is presented below.

Article 1. Personal scope

The proposed convention provides that it is generally applicable to persons who are residents of either the United States or Belgium, or of both countries. This provision, which is based on the OECD model convention, is not found in other U.S. income tax treaties. It does not,

however, result in any substantive difference since the specific provisions of our other income tax treaties generally are limited in application to residents of the two treaty countries.

Article 2. Taxes covered

The proposed convention applies to the U.S. Federal income tax. In the case of Belgium, it applies to the various Belgian income taxes, including prepayments of these taxes and surcharges on these taxes.

The proposed convention also contains the provision generally found in U.S. income tax treaties to the effect that the convention will apply to substantially similar taxes which either country may subsequently impose.

In addition, it is provided that the countries are to inform each other of amendments of their tax laws or the adoption of any substantially similar taxes, and of applicable interpretations of the proposed convention. Other recent U.S. income tax treaties contain a similar provision for the exchange of legal information.

Article 3. General definitions

The standard definitions found in most of our income tax treaties are contained in the proposed convention.

In addition, the proposed convention contains a provision which is not found in the existing convention or other U.S. tax treaties (except for the proposed treaty with Trinidad and Tobago) which includes within the definition of the term "United States" the territorial sea of the United States and the continental shelf of the United States insofar as the exploration and exploitation of natural resources on the continental shelf is concerned. This expanded definition, however, is applicable for purposes of the proposed convention only to the extent that the person, property, or activity of concern is connected with the exploration and exploitation of natural resources. A similar definition of Belgium is contained in the proposed convention. The definition of continental shelf areas contained in the proposed convention is similar to that contained in the proposed convention with Trinidad and Tobago and to that provided in the Internal Revenue Code (as amended by the Tax Reform Act of 1969) except that under the Code the continental shelf definitions apply only with respect to mines, oil and gas wells, and other natural deposits. Under the proposed convention, the applicability of the definition is not expressly restricted in this manner since it applies with respect to the exploration for or exploitation of any natural resource. In practical operation, however, the applicability of the provision usually will be similarly restricted. The activity of fishing is not intended to be considered the exploration or exploitation of natural resources of the continental shelf, and thus the definition of continental shelf is not to apply with respect to this activity.

The proposed convention also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the convention. It is further provided, however, that under the mutual agreement procedure of the proposed convention (Article 25) the competent authorities may establish a common meaning for an undefined term.

This provision is similar to those contained in the proposed conventions with Trinidad and Tobago and Finland. Although most of our other income tax treaties contain a mutual agreement procedure, generally, they do not have a specific agreement provision relating to definitional matters.

Article 4. Fiscal domicile

The benefits of the proposed convention generally are available only to residents of the two countries. The proposed convention defines "resident of Belgium" and "resident of the United States," and in addition provides a set of rules to determine residence for purposes of the convention in the case of an individual with dual residence. This provision of the proposed convention is based on the fiscal domicile article of the OECD model convention and is similar to the provision found in the French treaty and the proposed Finnish treaty.

Under the proposed convention, an individual whom both countries consider to be a resident according to their general rules for determining residence will be deemed for all purposes of the convention to be a resident of the country in which he has his permanent home, his center of vital interests, his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement.

Article 5. Permanent establishment

The existing convention contains a limited definition of the term "permanent establishment." The permanent establishment concept, of course, is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. Moreover, the permanent establishment concept is significant in determining whether the reduced rates of, or exemptions from, tax provided by the convention for dividends, interest, royalties, and capital gains are applicable.

A new definition of the term "permanent establishment" is contained in the proposed convention. This definition generally follows that contained in the OECD model convention and other recent U.S. income tax treaties. Basically, the proposed convention expands the definition to clarify the situations in which business activities carried on by a resident of one country in the other country will be considered a permanent establishment in that other country.

Generally, any fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country will be considered a permanent establishment. This includes a seat of management, an office, a factory, and a building site or construction or installation project which exists for more than twelve months. This general rule is modified by providing that a fixed place of business which is used for any or all of a number of specified activities will not be considered a permanent establishment. These activities include the purchase of goods and the warehousing of goods for purposes of storage, display, delivery, or processing by another person.

Under the proposed convention, it is further provided that, notwithstanding the specifically exempted activities, a resident of one country will be deemed to have a permanent establishment in the other country if it has a fixed place of business in that country and sells goods or merchandise for use or disposition in that country which either were subjected to processing in that country by another person (wherever purchased) or were purchased in that country and not subjected to processing outside of that country. This provision, although not contained in other U.S. income tax treaties, is similar to a provision contained in the proposed Trinidad and Tobago convention.

The proposed convention also provides that a resident of one country will be deemed to have a permanent establishment in the other country if it has an agent in that country who has and habitually exercises a general contracting authority (other than for the purchase of merchandise). This agency rule does not apply, however, if the agent is a broker, general commission agent, or any other agent of an independent status, provided the agent is acting in the ordinary course of his business.

The proposed convention further provides that this independent agent exception will not apply in the case of an agent acting on behalf of an insurance company who has, and habitually exercises, a general contracting authority. Accordingly, an insurance company of one country will be deemed to have a permanent establishment in the other country if it has an agent with general contracting authority in that country, regardless of whether the agent is of dependent or independent status. Other U.S. income tax treaties do not contain a similar provision.

Article 6. Income from real property

The existing convention generally provides that real property and natural resources rentals or royalties and other real property income (not including income derived from obligations secured by the property) may be taxed in the country where the real property or natural resource is located. In addition, it provides that a Belgian resident who derives this type of rental or royalty income from the United States may elect to be subject to U.S. tax on that income as if he were engaged in a trade or business in the United States through a permanent establishment.

A similar provision is included in the proposed convention. The principal change made by this provision is the elimination of the provision dealing with the net basis election allowed Belgian individuals with respect to real property income from U.S. sources. This provision is no longer necessary in view of the similar election added to the Internal Revenue Code by the Foreign Investors Tax Act of 1966.

Accordingly, under the proposed convention, real property income and natural resources royalties (including gains from the sale or exchange of the property or right giving rise to the royalty, but not including interest on debts secured by real property or a royalty interest) will be taxable by the country in which the property or natural resource is located.

Article 7. Business profits

The existing convention provides that a resident of one country is taxable by the other country on industrial and commercial profits only

to the extent the profits are allocable to a permanent establishment in the other country.

The proposed convention, in general, continues this rule with various revisions which conform it to the treatment of business profits in other recent U.S. tax conventions and under the Internal Revenue Code. This includes the adoption of the effectively connected concept (i.e., elimination of the force of attraction idea).

Under the proposed convention, business profits of a resident of one country are taxable in the other country to the extent they are attributable to a permanent establishment which the resident has in the other country. In computing the business profits which are subject to tax, the proposed convention allows the deduction of all expenses, wherever incurred, which are reasonably connected with the business profits.

It is further provided that the purchase of merchandise by a permanent establishment, or by the resident of which it is a permanent establishment, for the account of the resident will not of itself cause profits to be attributed to the permanent establishment.

The proposed convention does not follow the approach of our other recent income tax treaties which set forth several types of income that are included within industrial and commercial profits. Rather, as a general rule, the proposed convention provides that industrial and commercial profits do not include items of income specifically dealt with by other articles of the convention except to the extent provided in those articles. In this regard the provisions of the proposed convention dealing with income such as dividends, interest, royalties and capital gains specifically provide that if those types of income are effectively connected with a permanent establishment they are to be treated as business profits.

The proposed convention also specifically includes rents and royalties derived from motion picture films and films or tapes for radio or television broadcasting within business profits. Under the existing convention, this type of income is dealt with under the royalty article and thus is exempt from tax unless the recipient has a permanent establishment in the source country. The effect of including these rents and royalties within business profits is the same as if they were dealt with under a royalties article which embodied the effectively connected concept in that they will be exempt from tax in the source country unless they are attributable to a permanent establishment which the recipient has in that country.

Article 8. Shipping and transport

The existing convention, like most other U.S. tax conventions, provides that income derived by a resident of one country from the operation of ships or aircraft registered in that country will be exempt from tax by the other country. The proposed convention generally continues this rule and in addition broadens the exemption provided in two respects. First, the registration requirement in the case of aircraft is liberalized. It is provided that a resident of one country will qualify for the exemption from tax by the other country if the resident's aircraft are registered in the other country, or in a third country with which the other country has an income tax treaty exempting the income, as well as where the aircraft is registered in his country of residence. Second, the proposed convention extends

the exemption to gains derived by a resident of one country from the sale or other disposition of ships or aircraft in situations where the income from the operation of the ships or aircraft is exempt from tax by the other country under the general rule. Although some of our other income tax treaties do not condition the availability of the exemption on the ships or aircraft being registered in the owner's or operator's country of residence, none of our other treaties extend the exemption to gains arising on the sale or other disposition of the ships or aircraft.

Article 9. Associated enterprises

The existing convention and most other U.S. income tax conventions contain a provision similar to section 482 of the Internal Revenue Code which allows the allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons. The proposed convention includes a provision of this nature.

Article 10. Dividends

Under the existing convention, the rate of withholding tax in the source country on dividends derived by a resident of the other country may not exceed 15 percent, if the recipient does not have a permanent establishment in the source country.[1]

In general, the principal change made by the proposed convention in the treatment of dividends is the adoption of the effectively connected concept which is embodied in the Foreign Investors Tax Act of 1966, the OECD model convention and other recent U.S. tax treaties. Accordingly, the reduced rate of tax (15 percent) on dividends will apply unless the recipient has a permanent establishment in the source country and the dividends are effectively connected with the permanent establishment. Where dividends are effectively connected with the permanent establishment, they will be taxed as business profits. In this regard, the proposed convention provides that Belgium may impose on Belgian source dividends treated as business profits its movable property prepayment (precomte mobilier), or dividend withholding tax, which under Belgian law is imposed on all dividends paid to residents or nonresidents and either satisfies the taxpayer's income tax liability with respect to the dividend or is allowed as a credit against that tax liability.

In the absence of a convention, the applicable tax rate on dividends would be 30 percent in the case of the United States and 20 percent in the case of Belgium.

The proposed convention also continues in general the rule of the existing convention that dividends paid by a corporation of one country to a person other than a resident of the other country will be exempt from tax by the other country. In addition, however, the proposed convention eliminates the rule contained in the existing convention that Belgium may tax dividends paid by a U.S. corporation

[1] Technically, under the existing convention, the rate of Belgian withholding tax imposed on dividends derived by U.S. residents from Belgian sources is 15 percent if the stock is held in registered form and is 18.2 percent if the stock is held in bearer form. In the latter case, the Belgian tax is imposed at a stated rate of 15 percent on a grossed up amount of the dividend which produces the effective rate of 18.2 percent. In 1967, Belgium eliminated from its internal law the grossed up method of computing tax on dividends. It is understood that in view of this, Belgium subsequently agreed to impose its withholding tax on dividends paid to U.S. residents at an effective rate of 15 percent in all cases.

to a citizen or resident of the United States if the dividends are collected in Belgium. Belgian law provides that dividends collected or received by an individual (resident or nonresident) within Belgium from sources outside of Belgium are subject to a 20 percent prepayment (precomte mobilier). Accordingly, under this provision of the proposed convention, Belgium will not collect this tax in the case of dividends received in Belgium by a citizen or resident of the United States from a U.S. corporation.

Article 11. Interest

The existing convention limits the rate of withholding tax in the source country on interest derived by a resident of the other country to 15 percent, if the recipient does not have a permanent establishment in the source country.

The proposed convention generally makes three changes in the treatment of interest. First, although the proposed convention continues the 15 percent rate of tax on dividends generally, it exempts from source country tax interest which arises in the following three types of situations: (1) interest on commercial credit (including commercial paper) which results in general from financing arrangements made in connection with the sale of goods, merchandise or services by a resident of one country to a resident of the other country; (2) interest on interbank transactions; and (3) interest on deposits in banks or other financial institutions. In the latter two situations, the exemption is not available if the loan is represented by a bearer instrument.

Second, the proposed convention exempts from source country tax interest received by the other State or a tax-exempt instrumentality of the other State. Third, the proposed convention adopts the effectively connected concept. Thus, the generally applicable reduced rate of tax on, or the limited exemptions for, interest will apply, unless the recipient has a permanent establishment in the source country and the interest is effectively connected with the permanent establishment. This treatment of interest generally conforms to that provided by the OECD model convention and other U.S. tax conventions. The OECD model convention does not contain a total interest exemption, but a number of other U.S. tax treaties do provide a generally applicable exemption for interest rather than a reduced rate.

In the absence of a convention, the U.S. tax rate on interest paid to a nonresident would be 30 percent and the Belgian tax rate would be 20 percent.

The proposed convention contains a definition of interest which is similar to the definition contained in the OECD model convention, except that in the case of Belgium, interest also includes prizes on lottery bonds. Additionally, the proposed convention contains a limitation on the application of the interest article, which is found in the OECD model convention and other recent U.S. income tax treaties, in situations where the payor and recipient are related, to the amount of interest which would have been agreed upon by the payor and recipient if they were not related.

The proposed convention also contains a source rule for interest which, in general, conforms to the interest source rule contained in the Internal Revenue Code. In addition, as in the case of the dividend provision, the proposed convention provides that Belgium will not

impose its prepayment tax on interest received in Belgium from U.S. sources by a U.S. citizen or resident.

Article 12. Royalties

Under the existing convention, industrial and artistic royalties derived from one country by a resident of the other country are exempt from tax in the source country, if the recipient does not have a permanent establishment in the source country. The principal change made by the proposed convention in the treatment of royalties is the adoption of the effectively connected concept. In other words, the exemption from tax on royalties will apply unless the recipient has a permanent establishment in the source country and the royalties are effectively connected with the permanent establishment. This treatment of royalties is substantially identical to that provided in the OECD model convention.

In the absence of a convention, royalties derived from the United States by a nonresident would be subject to a 30 percent tax. Royalties derived from Belgium by a nonresident generally would be subject to tax computed at a 20 percent rate on 85 percent of the gross amount of the royalty (the 15 percent not taxed being an allowance for estimated expenses).

The proposed convention contains a source rule relating to nonmineral royalties which differs from that provided under the Internal Revenue Code and our other recent income tax treaties. Under the Internal Revenue Code, the source of a royalty paid for the use of property or a property right is the country where the property or property right is used. Under Belgian law the source of a royalty generally is the country of residence of the payor of the royalty. The proposed convention, in effect, adopts the Belgian rule and accordingly provides that generally the source of a nonmineral royalty is the country of residence of the person paying the royalty.

The proposed convention differs from the existing convention and the OECD model convention in form but not in substance with respect to the treatment of film royalties. Under the existing convention, such royalties are exempt from tax in the source country pursuant to the royalties provision, if the recipient does not have a permanent establishment in the source country. The proposed convention does not include such royalties within the scope of the royalties article. Instead, as previously indicated, they are treated as business profits and accordingly are exempt from tax under the business profits article unless they are attributable to a permanent establishment which the recipient maintains in the source country.

As in the case of the interest provision, the royalty provision of the proposed convention does not apply to that part of a royalty paid to a related person which is considered excessive.

Article 13. Capital gains

The existing convention has no general provision regarding the treatment of capital gains.

The proposed convention generally provides that capital gains derived by a resident of one country will be exempt from tax by the other country unless the recipient of the gain has a permanent establishment (or fixed base) in the other country and the property

giving rise to the gain is effectively connected with the permanent establishment (or fixed base). In the case of an individual resident of one country who is not taxable under the general rule, gains derived from the other country will be exempt from tax by that country unless the individual is present in that country for 183 days or more during a taxable year. These exemptions from tax for capital gains do not apply with respect to gains derived by a resident of one country on the sale or exchange of real property located in the other country. The treatment of capital gains contained in the proposed convention conforms to the recent French income tax treaty and the proposed Finnish income tax treaty, as well as to other U.S. tax conventions (except for the fixed base concept which is derived from the OECD model convention).

In the absence of a convention, the United States imposes a 30 percent tax on capital gains derived from the United States by nonresident alien individuals who are present in this country for 183 days or more during the taxable year. Generally, Belgium does not tax nonresident individuals on capital gains arising from casual sales of nonbusiness assets.

Articles 14 and 15. Independent and dependent personal services

Under the existing convention, an individual who is a resident of one country is exempt from tax in the other country on income from personal services performed there, if (1) the individual is not present in the other country for more than 90 days during the year and the income does not exceed $3,000, or (2) he is not present in that country for more than 183 days during the year and the services are performed for a resident or corporation of his country of residence. The former exemption does not apply to the compensation of officers or directors of corporations of the source country.

The proposed convention, in general, adopts the treatment of income from independent and dependent personal services provided in the OECD model convention. This treatment also generally accords with that provided in other recent U.S. tax conventions.

Under the proposed convention, income from the performance of independent activities in one country (the source country) by a resident of the other country generally will not be taxable in the source country unless the individual either (1) is present in the source country for 183 days or more during the year, or (2) maintains a fixed base in the source country for 183 days or more during the year and the income is attributable to the fixed base. In the case of public entertainers (such as actors, athletes, etc.), however, the proposed convention, in effect, continues the rule of the existing convention. In other words, income which a public entertainer derives in the source country will be taxable by that country if he either is present in that country for more than 90 days during the year or if his income from that country for the year exceeds $3,000.

In the case of income from dependent personal services (employment income) performed in one country (the source country) by a resident of the other country, the proposed convention provides that the income will not be taxable in the source country if three requirements are met: (1) The individual is present in the source country for less than 183 days during the year; (2) the individual is an employee of a resident of, or a permanent establishment in, his country

of residence, and (3) the remuneration is not borne by a permanent establishment of the employer in the source country.

Article 16. Directors' fees

The existing convention, by excluding directors' fees from the personal service income article, allows the source country to tax directors' fees paid by a corporation of that country to a resident of the other country.

The proposed convention generally continues this treatment and provides that a director's fee paid to a resident of one country as a member of the board of directors of a corporation of the other country may be taxed by the other country if the fee is not deductible in that country by the corporation paying it, but rather is treated as a distribution of profits.

This provision of the proposed convention will generally have its principal application with respect to residents of the United States who are directors of Belgian corporations, since under the Belgian corporate income tax, no deduction is allowed to a corporation for fees paid to directors as such.

Article 17. Social security payments

The proposed convention contains a provision regarding social security payments which is similar to that found in the French treaty and the proposed treaty with Finland. It is provided that only the payor country may tax social security payments (and similar pensions) made to a resident of the other country. The existing convention and the OECD model convention do not contain a similar provision.

Article 18. Private pensions and annuities

Under the existing convention, private pensions and annuities derived by the residents of one country from the other country are exempt from tax in the other country.

The proposed convention continues this rule and includes alimony within its scope.

Article 19. Government functions

The existing convention provides that residents of one country (who are citizens of the other country) are exempt from tax in that country on compensation, including pensions and annuities, paid by the other country or a political subdivision thereof.

The proposed convention makes two modifications in this provision: First, it follows the approach of our other recent income tax treaties by limiting the application of the exemption to persons performing governmental services. Second, the proposed convention expands the availability of the exemption from source country taxation to include citizens of a third country who come to that country for the express purpose of being employed by the other country or a political subdivision thereof. This treatment is similar to that provided by the OECD model convention.

The proposed convention also contains a provision which is found in the OECD model convention and the French treaty regarding the treatment of income for personal services of a nongovernmental nature paid by a country. It is provided that income from services performed in connection with a trade or business carried on by a country or political subdivision thereof will be treated under the

proposed convention in the same manner as income from personal services performed for a private employer. Thus, this type of income will be entitled to the same benefits which would have been available if it had been paid by a nongovernmental employer.

Article 20. Teachers

The existing convention provides that a teacher who is a citizen of one country will be exempt from tax in the other country on income from teaching in the other country, if he is present in the host country for a period not exceeding two years pursuant to an agreement between the countries or between teaching institutions of the two countries.

The proposed convention follows the approach of our other recent income tax treaties and extends the exemption to research activities, as well as teaching, if the research is undertaken in the public interest and not primarily for the benefit of private persons. It also eliminates the requirement that the visiting teacher must be a citizen of the other country for the exemption to apply. Accordingly, a resident of one country will be exempt from tax in the other country on income from teaching or research for a period of two years, if he is present in the host country at the invitation of the government or an accredited educational institution for the purpose of teaching or engaging in research (in the public interest) at an accredited educational institution.

Article 21. Students and trainees

The existing convention provides a very limited exemption for students. Students or apprentices who are citizens of one country and who are present in the other country exclusively for the purpose of study or acquiring experience are exempt from tax in the host country on remittances from abroad.

The proposed convention provides a substantially more liberal exemption similar to that embodied in other recent U.S. treaties or proposed treaties. Under the proposed convention, residents of one country who become students in the other country will be completely exempt from tax in the host country on gifts from abroad used for maintenance or study and on any grant, allowance, or award received from a governmental or charitable organization. In addition, a limited exemption is provided for personal service income derived from sources within the country in which the individual is studying. This exempts from tax in the host country $2,000 per year of personal service income (such as income from a part-time job). The exemptions provided by this provision (the complete as well as the limited one) and the visiting teachers exemption may not be utilized for a period of longer than five years from the date of the individual's arrival in the host country.

In addition to the exemptions regarding students, the proposed convention follows the approach of other recent U.S. treaties and provides a limited exemption for personal service income of residents of one country who are employees of a resident of that country and who are temporarily present in the other country to study at an educational institution or to acquire technical, professional or business experience. This exemption is available for a period of 12 months and is limited to $5,000. The proposed convention also pro-

vides a $10,000 exemption for income from personal services performed in connection with training, research or study by a resident of one country who is temporarily present in the other country as a participant in a Government sponsored exchange training program.

Article 22. Income not expressly mentioned

The proposed convention provides that income of a resident of one country which is not expressly dealt with in the convention may not be taxed by the other country unless the income is from sources within the other country. This accords with the approach of other U.S. income tax treaties.

Article 23. Relief from double taxation

The usual savings clause is included in the proposed convention. This clause provides that with certain exceptions the proposed convention is not to affect the taxation by a country of its own residents and citizens. The primary exceptions include the nondiscrimination and social security payments provisions and the provisions of this article regarding relief from double taxation.

Under the existing convention, the United States allows its citizens, residents, and corporations a tax credit for Belgian income taxes. A per-country limitation is imposed on the amount of the credit.

The proposed convention continues this general method of avoiding double taxation by providing that a U.S. citizen or resident will be allowed a credit against U.S. tax for the appropriate amount of income taxes paid to Belgium. The credit allowed under this provision is subject to the provisions of United States law applicable to the year in question and is limited to the amount of United States tax attributable to income from sources within Belgium. Since this provision does not contain a specific formulation of the limitation on the credit allowed (i.e., the per country limitation which is usually found in other U.S. income tax treaties), a foreign tax credit claimed by a U.S. taxpayer under this provision of the proposed convention will be subject to the applicable limitation provided by the Internal Revenue Code.

The proposed convention also in substance follows the proposed treaties with Brazil, Finland, and Trinidad and Tobago by providing that income which is taxed by Belgium pursuant to the proposed convention will be treated for purposes of the foreign tax credit as income from sources within Belgium. Thus, a foreign tax credit will be available with respect to this income, even though under the Internal Revenue Code the income might have its source elsewhere in which case a foreign tax credit would not be available under the per country limitation, or at all if the source of the income was the United States.

As is the case under the existing convention, Belgium will employ a variety of methods to afford relief from double taxation to its residents. The general means by which Belgium will grant relief from double taxation to its residents on income taxed by the United States is the exemption method. In addition, however, Belgium will also grant deductions, credits, or reduced rates of tax.

Under the proposed convention, the basic form of relief granted by Belgium is exemption with progression. A Belgian resident who receives income which is specifically dealt with in the proposed con-

vention and which has been taxed by the United States under the proposed convention will be exempt from Belgian tax on that income, but Belgium may take the income into account in computing the rate of tax applicable to the remainder of the individual's income. This relief provision does not apply to income for which there is a specific relief provision: Generally, dividends and interest taxed by the United States at the reduced rate (and not as business profits) and income not specifically dealt with in the proposed convention. Thus, this general relief provision will be available with respect to income such as income from real property located in the United States which is owned by a Belgian resident and business profits (including effectively connected passive income) attributable to a United States permanent establishment of a Belgian resident. In this regard, the proposed convention provides a limitation on the exemption in the case of a U.S. permanent establishment of a Belgian resident which incurs a loss that is offset against Belgian income, and which also reduces the amount of the permanent establishment profits in other years that are subject to United States tax by reason of the net operating loss carryover. In this case, the exemption provided by Belgium to the profits of those other years would be reduced to the extent the profits had been reduced for United States tax purposes by reason of the net operating loss. In other words, the amount of the net operating loss deducted must be added back to the Belgian tax base.

The second Belgian relief provision of the proposed convention provides that in the case of a Belgian resident who receives U.S. source interest or royalties which have been taxed by the United States under the proposed convention (other than as business profits), Belgium will allow a lump sum foreign tax credit against the resident's tax on that income. At present this credit amounts to 15 percent of the net amount of the income. In the case of U.S. source dividend income received by an individual Belgian resident, the 15 percent lump sum credit also will be allowed.

The third Belgian relief provision deals with income received by a Belgian resident which is not expressly dealt with under the proposed convention and which has been taxed by the United States. In this case the income will be taxed at one-quarter of the normal rate in the case of corporations and at one-half the normal rate in the case of individuals. This is the rate of tax which Belgium would apply under its law if the income were taxed as foreign source earned income which had been subjected to foreign tax.

In the case of dividends received by a Belgian corporation from a U.S. corporation which are taxed by the United States at the reduced 15 percent rate under the proposed convention (i.e., the dividends are not effectively connected with a U.S. permanent establishment of the Belgian corporation), the proposed convention in effect provides that Belgium will allow an intercorporate dividends exemption to the Belgian corporation of 95 percent of the net dividend where the Belgian corporation owns less than 50 percent of the paying U.S. corporation. In other cases, the exemption will be 90 percent of the net dividend. This exemption is the same as that accorded by Belgium to dividends received by one Belgian corporation from another.

This relief provision, however, does not exempt the Belgian recipient of the dividend from the movable property prepayment (precompte mobilier)—at present 10 percent—which is generally imposed on foreign source dividends received by a Belgian corporation. An additional procedure, however, is provided by which the Belgian corporation may elect to be exempt from the prepayment on the dividends. Generally, if it so elects, the dividends will be subject to the prepayment when they are redistributed by the Belgian corporation to its shareholders. Under Belgian law dividends which are subject to the prepayment when received by a Belgian corporation are not again subjected to the prepayment when redistributed by the corporation. The proposed convention also provides that if in the future Belgium limits the availability of its intercorporate dividends exemption to situations where the recipient corporation owns at least 10 percent of the paying corporation, then the election provided by this provision would be similarly limited.

A special rule is also provided by this provision of the proposed convention in the case of a U.S. citizen who is a resident of Belgium and who receives U.S. source income which is neither exempt from Belgian tax nor subject to a reduced rate of tax. In such a case, it is provided that if the income is dividends, interest, or royalties, the amount of Belgian tax on the income is not to exceed 20 percent of the income after allowance of the 15 percent lump sum foreign tax credit. In other words, the U.S. citizen first computes the lump sum credit, and then the Belgian tax on his remaining income is limited to 20 percent of that income. In the case of other types of income received by a U.S. citizen, the proposed convention in effect provides that they will be taxed at one-half the normal Belgian rates (i.e., the rate at which they would be taxed under Belgian law if they were treated as foreign source earned income which as been subjected to foreign tax).

Finally, the proposed convention provides that if a corporation is treated for tax purposes by the United States as a U.S. corporation and by Belgium as a Belgian corporation, then relief from double taxation is to be provided in accordance with the principles discussed above.

Article 24. Nondiscrimination

Under the existing convention, a limited nondiscrimination provision is provided which prevents one country from imposing higher taxes on citizens and corporations of the other country than it imposes on its own citizens and corporations.

The proposed convention contains the more comprehensive nondiscrimination provisions which are found in our other recent treaties and which apply to taxes imposed at the state and local level as well as at the national level. It provides that one country cannot discriminate by imposing more burdensome taxes on its residents who are citizens of the other country, or on permanent establishments of residents of the other country, than it imposes on its comparable taxpayers. The proposed convention also extends the nondiscrimination provision to corporations of one country which are owned by residents of the other country.

The proposed convention further provides that the nondiscrimination provision will not prevent Belgium from taxing the business profits of a Belgian permanent establishment of a U.S. resident (which i

a U.S. corporation or unincorporated entity) at a rate which is the highest rate at which a Belgian corporation's profits may be taxed. (The allowable rate of tax on the permanent establishment is that computed before application of the Belgian surcharges.) It is further provided, however, that the rate of tax (before the surcharges) on those profits of the permanent establishment which are deemed to have been distributed shall be the rate imposed on distributed profits of a Belgian corporation (as long as Belgium taxes distributed profits of Belgium companies at a lower rate than the highest rate it imposes on retained profits). For this purpose the Belgian permanent establishment will be deemed to distribute the same percentage of its profits which the U.S. resident maintaining the permanent establisment distributes of its total profits. At the present time, a Belgian company's distributed profits are taxed at a 30 percent rate and its undistributed profits are taxed at rates ranging from 25 to 35 percent. In the absence of a treaty provision, the profits of a Belgian permanent establishment of a nonresident company are subject to a 35 percent tax (whether or not they are remitted to the nonresident company). Accordingly, the effect of this provision of the proposed convention is to allow Belgium to tax the undistributed profits of a U.S. resident's Belgian permanent establishment at the 35 percent rate. However, the portion of the permanent establishment's profits which are deemed distributed may only be taxed by Belgium at the lower 30 percent rate (or such other lower rate as Belgium may impose on distributed profits in the future).

Articles 25, 26, and 27. Administrative provisions

The existing convention contains various administrative provisions. Under the proposed convention, these provisions are modernized and expanded generally along the lines of the provisions contained in other U.S. tax treaties.

In general, the proposed convention provides—

(1) For consultation and negotiation between the two countries to resolve differences arising in the application of the proposed convention and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the terms of the proposed convention;

(2) For the exchange between the countries of legal information and of information pertinent to carrying out the provisions of the proposed convention or to preventing fraud or fiscal evasion with respect to the taxes covered by the proposed convention; and

(3) That each country is to assist the other in collecting taxes imposed by the other country to the extent necessary to insure that the benefits provided by the proposed convention are enjoyed only by persons entitled to those benefits.

The proposed convention specifically includes the definition of terms as an item on which countries are to consult and attempt to reach mutual agreement. Although most of our other income tax treaties contain a mutual agreement procedure, generally, they do not have a specific agreement provision relating to definitional matters. A similar provision, however, is included in the proposed conventions with Finland and Trinidad and Tobago.

Article 28. Miscellaneous

The proposed convention provides that its provisions are not to affect the fiscal privileges which diplomatic or consular officials enjoy under the general rules of international law or the provisions of special agreements. A similar provision is contained in the OECD model convention and in a number of our other income tax treaties.

In addition the proposed convention provides, as do most other U.S. income tax treaties, that it is not to be interpreted to deny any tax benefit available presently or in the future under the tax laws of the two countries or under any other agreement between the countries.

Article 29. Extension to territories

The proposed convention provides a method similar to that found in some of our other income tax conventions by which the convention may be extended to areas, not otherwise covered by the proposed convention, for whose international relations the United States is responsible, if the area imposes taxes substantially similar to those covered by the convention. The convention may be extended pursuant to this provision either in its entirety by a written notification given Belgium by the United States and assented to by Belgium in a written communication which notification and communication ore then to be ratified by the two countries.

Article 30. Entry into force

The proposed convention will enter into force one month following the exchange of the instruments of ratification. It will become effective for taxable years beginning on or after January 1, 1971 (or in the case of withholding taxes, with respect to payments made on or after that date).

When the proposed convention enters into effect, the various existing conventions will terminate as they apply between Belgium and the United States (the convention of October 28, 1948; the supplementary conventions of September 9, 1952, and August 22, 1957; and the protocol of May 21, 1965).

Article 31. Termination

The proposed convention will continue in force indefinitely, but either country may terminate the proposed convention at any time after 5 years from its entry into force by giving notice through diplomatic channels. In addition, it is provided that the provisions of the social security payments article may be terminated by either country at any time.

PROPOSED INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND FINLAND

(Memorandum Prepared by the Staff of the Joint Committee on Internal Revenue Taxation)

The presently applicable income tax convention between the United States and Finland, which was signed on March 3, 1952, would be replaced by the proposed convention.

Since 1952, a number of changes have been made in the tax laws of both the United States and Finland and, in addition, in recent years

there has been a trend toward the modernization and standardization of international tax relationships. This trend is reflected in the model income tax convention of the Organization for Economic Cooperation and Development (OECD) and in the U.S. income tax treaties which have been revised in recent years. These various factors are reflected in the proposed convention.

In general, the proposed convention with Finland follows the pattern embodied in our other recent income tax treaties. The change of most significance which is made by the proposed convention is the adoption of the effectively connected concept (i.e., the abandonment of the so-called force of attraction doctrine). Thus, if a resident of one country derives investment income from the other country, he will be able to enjoy the reduced rates of, or exemptions from, tax provided by the proposed convention, even if he has a permanent establishment in the other country, provided the income is not effectively connected with that permanent establishment.

The other more important features of the proposed convention are as follows:

(1) It is specifically provided that the countries may by mutual agreement establish common meanings for terms used in the convention in order to prevent double taxation. A specific provision of this nature is not contained in our other income tax treaties (other than the proposed conventions with Trinidad and Tobago and Belgium).

(2) Business profits and effectively connected income of a permanent establishment located in one country will be treated as being from sources within that country even though the income might have its source elsewhere under the Internal Revenue Code. This is designed to help insure that a U.S. taxpayer who incurs Finnish taxes on this type of income will be entitled under the foreign tax credit provisions of the proposed treaty, which place a per-country limitation on the credit, to a credit against his U.S. tax liability on that income for the Finnish taxes.

(3) Royalties on motion picture films (and on radio and television tapes), which are not covered by the existing convention, will be exempt from tax unless they are attributable to a permanent establishment in the source country.

(4) The 5 percent rate of source country witholding tax on intercorporate dividends, which is now available only where there is a 95 percent ownership interest, will be available if there is at least a 10 percent ownership interest. In the absence of a treaty, dividends would be taxed by the United States at a 30-percent rate, and by Finland at a 15-percent rate.

(5) The present exemption from source country tax for artistic royalties is extended to industrial and commercial royalties. These royalties, in the absence of a convention, would be taxed by the United States at a 30-percent rate and would be taxed by Finland at the regular corporate or individual rates.

(6) Capital gains (other than on real property) which a resident of one country derives from the other country will be exempt from source country taxation, unless they are effectively connected with a permanent establishment (or a fixed base of an individual) in the source country. In addition, nonbusiness capital gains of an individual will be

exempt from source country taxation provided the individual is not present in that country for more than 183 days during the year. In the absence of a treaty, short-term capital gains (real property held less than 10 years and other capital assets held less than 5 years) would be taxed by Finland at the regular corporate and individual tax rates. A 30-percent U.S. tax would be imposed on capital gains of nonresident individuals present in this country for 183 days or more during the year.

A detailed explanation of the proposed convention on an article-by-article basis is presented below.

Article 1. Taxes covered

The proposed convention applies to the United States Federal income tax except for the accumulated earnings tax imposed by section 531 of the Internal Revenue Code and the personal holding company tax imposed under section 541.

In the case of Finland, the proposed convention applies to the state income tax and the communal tax. These are the national and municipal income taxes imposed by Finland on individuals and corporations. The proposed convention also applies to the state capital tax imposed by Finland which is a graduated tax imposed on individuals (resident and nonresident) with respect to certain forms of property. Finally, the proposed convention applies to the sailors' tax imposed by Finland which is an income withholding tax imposed on the compensation of crewmen of Finnish ships in lieu of the national and municipal income taxes.

The proposed convention also contains the provision generally found in U.S. income tax treaties to the effect that the convention will apply to substantially similar taxes which either country may subsequently impose. In addition, the nondiscrimination provisions of the proposed convention will apply to taxes imposed at the state or local level as well as at the national level.

Article 2. General definitions

The standard definitions contained in most U.S. income tax treaties are contained in the proposed convention.

The proposed convention also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the convention. In addition, however, the proposed convention provides in a manner similar to the proposed conventions with Trinidad and Tobago and Belgium, that where a term is defined in a different manner by the two countries, the competent authorities of the countries may establish a common meaning for the term in order to prevent double taxation or to further any other purpose of the convention. Although most of our other income tax treaties contain a mutual agreement procedure, generally, they do not have a specific agreement provision relating to definitional matters.

Article 3. Fiscal domicile

Generally, only residents of the two countries are entitled to the benefits of the proposed convention. The proposed convention defines "resident of Finland" and "resident of the United States" and in addition provides a set of rules to determine residence for purposes of

the convention in the case of an individual with dual residence. This provision of the proposed convention is based on the OECD model convention's fiscal domicile article and is similar to the provision found in the French treaty and the proposed Belgian treaty.

Under the proposed convention, if both countries consider an individual to be a resident according to their general rules for determining residence, the individual will be deemed for all purposes of the convention to be a resident of the country in which he has his permanent home, his center of vital interests, or his habitual abode. If the residence of an individual cannot be determined by these tests applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement.

Article 4. General rules of taxation

The existing convention contains general rules regarding the manner in which one country may tax residents of the other country which are of limited scope.

The proposed convention contains the more comprehensive set of general rules which are found in most of our other income tax treaties. Thus, one country may tax residents of the other country only on income from sources within the taxing country. Since under the proposed convention (article 6) industrial or commercial profits attributable to a permanent establishment located in a country are treated as from sources within that country, under this provision one country may tax residents of the other country on business profits attributable to a permanent establishment located in the taxing country and on other income from sources within the taxing country.

The taxation under the proposed convention must be in accordance with the limitations contained in the proposed convention. Each country, however, may tax without regard to the proposed convention any income from sources within that country to which the convention is not expressly applicable. In addition, the proposed convention is not to be interpreted to deny any tax benefits available presently or in the future under the tax laws of the two countries or under any other agreement between the countries.

The usual savings clause is included in the proposed convention. This clause provides that with certain exceptions the proposed convention is not to affect U.S. taxation of its own citizens and residents. The primary exceptions include the foreign tax credit, the nondiscrimination provision, and the benefits relating to social security payments. The savings clause does not apply in the case of Finland since Finland bases its taxation on residence rather than citizenship.

Article 5. Relief from double taxation

Under the existing convention the United States allows its citizens, residents, and corporations a tax credit for Finnish income taxes in accordance with the foreign tax credit provisions of the Internal Revenue Code of 1939.

The proposed convention continues this method of avoiding double taxation by providing that a U.S. citizen or resident (which includes corporations) may credit against its U.S. tax the appropriate amount of income taxes paid to Finland. As is the case in other recent U.S. tax treaties, the proposed convention does not specifically refer to the

foreign tax credit provisions of the Internal Revenue Code. This makes it clear that modifications of the Code which affect the foreign tax credit will not be barred by the proposed credit article if the modifications do not contravene the general principles of the convention.

The proposed convention provides a per country limitation on the amount of the credit and, in addition, provides that the source rules contained in the proposed convention are to be applied in determining the credit. Of course, under the general rule that the proposed convention is not to deny existing tax benefits, if the source of income rules or the overall limitation on the credit provided by the Internal Revenue Code produce a more favorable credit, a U.S. taxpayer may use the Code rules.

Under the existing convention, Finland allows its residents and corporations a tax credit for income taxes paid to the United States (or its political subdivisions). A per-country limitation is imposed on the amount of the credit.

Under the proposed convention, Finland, to avoid double taxation, will employ both an exemption method and a tax credit method. First, where a resident of Finland derives income from the United States (other than dividends) which may be taxed by the United States under the convention, Finland will exempt that income from taxation. Although the proposed convention sets forth this exemption in the terms of a tax credit, it is in fact an exemption since the amount of the "credit" is the amount of Finnish tax imposed on the income in question. An exemption from Finnish tax will also be provided for intercorporate dividends paid by a U.S. corporation to a Finnish corporation as long as Finland continues to provide under its internal law an exemption for intercorporate dividends paid by one Finnish corporation to another. It is also provided that Finland may employ an exemption with progression system. Thus, a specific item of income may be taken into account by Finland in determining the rate of tax applicable to the total income of a Finnish resident taxable under Finnish law even though the item of income is exempt from Finnish tax under the proposed convention.

In the case of dividends from sources within the United States which are derived by Finnish residents, the proposed convention provides that Finland will allow a tax credit for the U.S. tax imposed on the dividends subject, however, to a per country limitation.

Article 6. Source of income

The existing convention does not contain source of income rules. Of course, source of income rules are one of the ways by which income tax treaties can eliminate double taxation, since the source of income is important in determining a country's jurisdiction to tax residents of the other country and also in determining the limitation on the foreign tax credit.

The proposed convention follows the general approach of some of our recent income tax treaties and provides source of income rules that conform in general to the source rules contained in the Internal Revenue Code. There is, however, a minor difference in the dividend and interest source rule and, in addition, the proposed convention follows the proposed treaties with Brazil, Trinidad and Tobago and Belgium by including a rule for determining the source of business profits.

Under the Internal Revenue Code, dividends or interest paid by a foreign corporation are considered to be in part from U.S. sources and, therefore, are taxable to that extent when paid to a nonresident alien individual or company, if more than 50 percent of the paying corporation's income for the previous three years was effectively connected with a U.S. business. Under the existing convention, if the foreign corporation is a Finnish corporation, dividends and interest paid by that corporation to a foreign person are exempt from U.S. income tax notwithstanding the relative amount of the corporation's U.S. business income. The proposed convention slightly expands the tax jurisdiction of the United States in the case of this type of dividend and interest income over that allowed under the existing convention. It provides that dividends and interest paid by a non-U.S. corporation will be treated as from U.S. sources if at least 80 percent of the corporation's gross income for the prior three years consisted of industrial and commercial profits attributable to a U.S. permanent establishment. Although this rule expands U.S. tax jurisdiction in the case of dividends or interest paid by a Finnish corporation, it also has the effect of limiting U.S. tax jurisdiction in the case of dividends or interest paid to a Finnish resident by a foreign corporation other than a Finnish corporation. This is because this type of income was not dealt with in the existing Finnish convention and is subject, under the proposed convention, to a source rule which is slightly more limited than that provided under the Internal Revenue Code.

The proposed convention also follows the proposed treaties with Brazil, Belgium, and Trinidad and Tobago by providing that industrial and commercial profits (including passive income so treated because it is effectively connected with a permanent establishment) will be treated as from sources within the country in which the permanent establishment is located. Although the inclusion of this source rule in the proposed convention does not produce a difference in the result which obtains under our other treaties insofar as jurisdiction to tax is concerned, it may produce a different result under the foreign tax credit article of the convention. This is because business profits attributable to a Finnish permanent establishment will be considered as from sources within Finland—even though under the Code source rules the income might have its source elsewhere—and, thus, a foreign tax credit under the per country limitation will be available to a U.S. taxpayer for Finnish taxes imposed on this income.

Article 7. Nondiscrimination

Under the existing convention, a limited nondiscrimination provision is provided which prevents one country from imposing higher taxes on citizens and corporations of the other country than it imposes on its own citizens and corporations.

The proposed convention contains the more comprehensive nondiscrimination provisions which are found in other recent U.S. income tax treaties. It provides that one country cannot discriminate by imposing more burdensome taxes on its residents who are citizens of the other country, or on permanent establishments of residents of the other country, than it imposes on its comparable taxpayers. The proposed convention also extends the nondiscrimination provision to corporations of one country which are owned by residents of the other country.

Article 8. Business profits

Under the existing convention, a resident of one country is taxable by the other country on industrial and commercial profits to the extent the profits are allocable to a permanent establishment in that other country.

The proposed convention generally continues this rule with various revisions to conform it to the treatment of business profits in other recent U.S. tax treaties and under the Internal Revenue Code. This includes the adoption of the effectively connected concept (i.e., elimination of the force of attraction idea under which all income from sources in the country where the permanent establishment is located, in effect, is considered attributable to the permanent establishment).

Under the proposed convention, business profits of a resident of one country are taxable in the other country to the extent they are attributable to a permanent establishment which the resident has in the other country. In computing the business profits that are subject to tax, all expenses wherever incurred which are reasonably connected with the business profits may be deducted.

It is further provided that the purchase of merchandise by a permanent establishment, or by the resident of which it is a permanent establishment, for the account of the resident will not of itself cause profits to be attributed to the permanent establishment.

Under the proposed convention, several types of income which are included within industrial and commercial profits are set forth. These include investment income arising from a right or property which is effectively connected with the permanent establishment. Industrial and commercial profits also include rents or royalties derived from motion picture films and films or tapes for radio or television broadcasting. The existing convention does not deal with this type of income and, thus, each country now may tax film or tape royalties derived by a resident of the other country. Under the proposed convention, these rents and royalties (by being included within business profits) will be exempt from tax in the source country unless they are attributable to a permanent establishment which the recipient has in that country.

Article 9. Permanent establishment

The existing convention contains a limited definition of the term "permanent establishment." The permanent establishment concept, of course, is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. Moreover, the permanent establishment concept is significant in determining whether the reduced rates of, or exemptions from, tax provided by the convention for dividends, interest, royalties, and capital gains are applicable.

A new definition of the term "permanent establishment" is contained in the proposed convention. This definition generally follows that contained in the OECD model convention and other recent U.S. income tax treaties. Basically, the proposed convention expands the definition to clarify the situations in which business activities carried on by a resident of one country in the other country will be considered a permanent establishment in that other country.

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Generally, any fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country will be considered a permanent establishment. This includes a seat of management, an office, a factory, and a building site or construction or assembly project which exists for more than twelve months. This general rule is modified by providing that a fixed place of business which is used for any or all of a number of specified activities will not be considered a permanent establishment. These activities include the warehousing of goods for purposes of storage, display, delivery, or processing by another person.

The proposed convention also provides that a resident of one country will be deemed to have a permanent establishment in the other country if it has an agent in that country who has and habitually exercises a general contracting authority (other than for the purchase of merchandise) in that country. This agency rule does not apply, however, if the agent is a broker, general commission agent, or any other agent of an independent status provided the agent is acting in the ordinary course of his business.

Article 10. Shipping and air transport

The proposed convention continues the rule found in the existing convention and in most other U.S. income tax treaties that income derived by a resident of one country from the operation in international traffic of ships or aircraft registered in that country will be exempt from tax by the other country.

Article 11. Related persons

Most U.S. income tax conventions, including the existing convention, contain a provision similar to section 482 of the Internal Revenue Code which allows the allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons. The proposed convention includes a provision of this nature which is somewhat broader than that found in the existing convention in that it is applicable where only one of the related persons is a resident of one of the two countries; under the existing convention, both related persons must be residents of the treaty countries.

Article 12. Dividends

The existing convention limits the rate of withholding tax in the source country on dividends derived by a resident of the other country to 15 percent generally, and to 5 percent in the case of dividends paid by a corporation in which the recipient has at least a 95 percent ownership interest (provided not more than 25 percent of the income of the paying corporation consisted of dividends and interest—i.e., it is not an investment company). These reduced rates of tax, however, do not apply if the recipient has a permanent establishment in the source country.

In general, the proposed convention makes two changes in the treatment of dividends. First, the required ownership interest which must exist for the 5 percent intercorporate rate to be available is reduced from 95 percent to 10 percent; the 15 percent rate is continued in the case of portfolio dividends. Second, the proposed convention adopts the effectively connected concept (i.e., it abandons the force of attrac-

tion idea). Accordingly, the reduced rate of tax on dividends will apply unless the recipient has a permanent establishment in the source country and, in addition, the dividends are effectively connected with the permanent establishment. This treatment of dividends generally conforms to that provided by the Foreign Investors Tax Act of 1966, the OECD model convention, and other recent U.S. income tax treaties.

As is the case under the existing convention, the limitations on Finnish tax imposed on dividends derived from sources within Finland by a United States resident apply to the combined amount of the Finnish income tax and the Finnish capital tax imposed on capital stock of a Finnish corporation owned by a U.S. resident.

In the absence of a convention, dividends paid by a Finnish corporation to a U.S. resident would be subject to a 15 percent withholding tax. A U.S. resident's capital stock in a Finnish corporation would be subject to tax at graduated rates ranging from approximately one-half of 1 percent to 2½ percent. Dividends paid by a U.S. corporation to a Finnish resident would be subject to a 30 percent withholding tax.

Article 13. Interest

Under the existing convention, interest derived by a resident of one country from sources within the other country is exempt from tax in the source country if the recipient does not have a permanent establishment in that country. In addition, an exemption from the Finnish property tax is provided for bonds, bank deposits, and trade balances of a U.S. resident.

The proposed convention continues the exemption from source country tax for interest and, in addition, adopts the effectively connected concept. Thus, the exemption from source country tax for interest will apply unless the recipient has a permanent establishment in the source country and, in addition, the interest is effectively connected with the permanent establishment. This treatment generally conforms to that provided by other recent U.S. tax treaties and the OECD model convention.

The proposed convention does not contain the exemption from Finnish property tax for bonds, bank deposits or trade balances of a U.S. resident, inasmuch as this exemption is now provided under Finnish law.

In the absence of a convention, U.S. source interest paid to a nonresident would be subject to a 30 percent U.S. tax. Interest derived from Finnish sources by a nonresident would be exempt from Finnish income tax.

A definition of interest is contained in the proposed convention which is substantially identical to that found in the OECD model convention and other recent U.S. income tax treaties. It also contains the limitation on the application of the interest article which is found in these conventions in situations where the payor and recipient are related, to the amount of interest which would have been agreed upon had they not been related.

Article 14. Royalties

Under the existing convention, artistic royalties (other than film royalties) derived by a resident of one country from sources within

the other country are exempt from tax in the source country if the recipient does not have permanent establishment in the source country.

The proposed convention makes three principal changes in the treatment of royalties. First, it extends the exemption to industrial and scientific royalties. Second, the proposed convention adopts the effectively connected concept. Accordingly, the exemption from tax for royalties will apply unless the recipient has a permanent establishment in the source country and the royalties are effectively connected with the permanent establishment. This treatment generally follows that provided in the OECD model convention. Third, as previously discussed (in connection with article 6), the proposed convention treats film royalties as business profits, thus exempting those royalties from source country taxation unless they are attributable to a permanent establishment located in the source country.

In addition, as in the case of the interest provision, the royalty provision of the proposed convention does not apply to that part of a royalty paid to a related person which is considered excessive.

In the absence of a convention, Finland generally would tax royalties derived by a U.S. resident at the regular corporate or individual tax rates. Royalties derived from the United States by Finnish residents would be subject to a 30 percent tax.

Article 15. Income from real property

The existing convention provides that income from real property (not including interest on obligations secured by the property) and natural resources royalties may be taxed in the country where the real property or natural resources are located. In addition, it provides that a resident of one country who derives real property income from the other country may elect to be taxed in the source country as if he were engaged in a trade or business in that country through a permanent establishment.

A similar provision is included in the proposed convention. The principal change made by this provision is the elimination of the net basis election provision of the existing convention, which is no longer needed since both Finland and the United States tax allow income from real property to be taxed on a net basis.

Accordingly, under the proposed convention real property income and natural resources royalties (including gains from the sale or exchange of the property or right giving rise to the royalty, but not including interest on debts secured by real property or a royalty interest) will be taxable by the country in which the property or natural resource is located.

Article 16. Capital gains

The existing convention does not deal with the treatment of capital gains. The proposed convention generally provides that capital gains derived by a resident of one country will be exempt from tax by the other country, unless the recipient of the gain has a permanent establishment in the other country and the property giving rise to the gain is effectively connected with the permanent establishment. In the case of an individual resident of one country who is not taxable under the general rule, gains derived from the other country will be exempt from tax by that country unless the individual either main-

tains a fixed base in that country and the property giving rise to the gain is effectively connected to the fixed base or the individual is present in that country for more than 183 days during a taxable year. These exemptions from tax for capital gains do not apply with respect to gains derived by a resident of one country on the sale or exchange of real property located in the other country. The treatment of capital gains contained in the proposed convention conforms to the recent French income tax treaty and the proposed Belgium income tax treaty, as well as to other U.S. tax conventions (except for the fixed base concept which is derived from the OECD model convention).

In the absence of a convention, the United States imposes a 30 percent tax on capital gains derived from the United States by nonresident alien individuals who are present in this country for 183 days or more during the taxable year. Finland taxes capital gains at the regular corporate and individual tax rates, other than gains on the sale of real property which has been held for at least 10 years and gains from the sale of other kinds of capital assets held for at least 5 years which are exempt from tax by Finland.

Article 17. Capital taxes

The existing convention does not cover capital taxes. As previously indicated (article 1), the proposed convention applies to the capital tax imposed by Finland. This provision of the proposed convention, in effect, provides that a resident of the United States will be exempt from the capital tax imposed by Finland on nonbusiness personal property (i.e., on property other than real property or property effectively connected with a Finnish permanent establishment) and on U.S. registered ships and aircraft and personal property pertaining to the operation of those ships and aircraft.

Although this provision of the proposed convention is reciprocal in form, it only will affect the taxation by Finland of U.S. residents since the United States does not impose a capital tax. In the absence of a convention, individuals who are not residents of Finland are subject to the Finnish national capital tax with respect to the net amount of various types of property located in Finland. This tax is imposed at rates ranging from approximately one-half of 1 percent to 2½ percent.

Articles 18 and 19. Independent and dependent personal services

Under the existing convention, an individual who is a resident of one country is exempt from tax in the source country on income from personal services performed there, if the individual is not present in that country for more than 183 days during the year and if either the services are performed for a resident or corporation of his country of residence or the income does not exceed $10,000.

The proposed convention provides a more liberal treatment of personal services income which generally accords with that provided in other recent U.S. tax treaties.

In the case of income from the performance of independent activities in one country (the source country) by a resident of the other country, the proposed convention eliminates the $10,000 limit on the exemption. Accordingly, this type of personal service income will be exempt from source country tax provided the person performing the services

is not present in the source country for more than 183 days during the year, regardless of the amount of the income.

In the case of income from dependent personal services (employment income) performed by a resident of one country in the other country, the proposed convention generally follows our other recent treaties and provides that the income will be exempt from source country taxation if three requirements are met: (1) the individual is not present in the source country for more than 183 days during the year; (2) the remuneration is paid by, or on behalf of, an employer who is not a resident of the source country; and (3) the remuneration is not borne by a permanent establishment of the employer in the source country.

Article 20. Teachers

Under the existing convention, teachers who are residents of one country and who are temporarily present in the other country for the purpose of teaching at an educational institution in that country are exempt from tax in that country on income derived from teaching activities for a period of two years.

The proposed convention follows the approach of other recent U.S. tax treaties and extends this exemption to income from research, other than research undertaken primarily for the benefit of private persons rather than in the public interest. Accordingly, a resident from one country will be exempt from tax in the other country on income from teaching and research for a period of two years, if he is present in the host country at the invitation of the government or an accredited educational institution for the purpose of teaching or engaging in research (in the public interest) at an accredited educational institution.

Article 21. Students and trainees

The existing convention provides a very limited exemption for students. Students or apprentices who are residents of one country and who are present in the other country exclusively for the purpose of studying or acquiring business or technical experience are exempt from tax in the host country on remittances from abroad.

The proposed convention provides a substantially more liberal exemption similar to that embodied in the 1965 Supplementary Convention with the Netherlands, the recent French treaty, and the proposed treaties with Brazil, Belgium, and Trinidad and Tobago. Under the proposed convention, residents of one country who become students in the other country will be completely exempt from tax in the host country on gifts from abroad used for maintenance or study and on any grant, allowance or award received from a governmental or charitable organization. In addition, a limited exemption is provided for personal service income derived from sources within the country in which the individual is studying. Under this provision, the host country will exempt from tax $2,000 per year of personal service income (such as income from a part-time job). These exemptions (the complete, as well as the limited one) and the visiting teachers exemption may not be utilized for a period of more than 5 years in total.

In addition to the exemption regarding students, the proposed convention follows the approach of other recent U.S. tax treaties

and provides a limited exemption for personal service income of residents of one country who are employees of a resident of that country and who are temporarily present in the other country to study at an educational institution or acquire technical, professional or business experience. This exemption is available for a period of one year and is limited to $5,000. The proposed convention also provides an exemption for income from personal services performed in connection with training, research or study by residents of one country who are temporarily present in the other country as participants in Government sponsored exchange training programs. This exemption is limited to $10,000.

Article 22. Governmental functions

The existing convention provides that residents of one country (other than citizens of that country unless the person is also a citizen of the other country) are exempt from tax in that country on compensation, including pensions, paid by the other country or a political subdivision thereof.

The proposed convention follows the approach of our other recent income tax treaties by restricting the availability of the exemption to citizens of the paying country who are performing governmental functions.

Article 23. Rules applicable to personal income articles

The proposed convention provides that reimbursed travel expenses are exempt from tax under the personal income article without regard to maximum amount of the exemption. The proposed convention also provides that only the benefits of the most favorable personal income article may be claimed by a taxpayer for a year if more than one of those articles is applicable in that year.

The proposed convention also contains a provision not found in our other income tax treaties which, in effect, exempts a resident of one country who is present in the other country as a teacher or student from tax in his country of residence on at least 30 percent of the amount of his income from personal services (which he derives as a teacher or student and which is exempt from tax in the host country under the proposed convention). This provision, although reciprocal in form, only affects Finnish taxation of Finnish students and teachers who are temporarily present in the United States. This is because the United States, under the savings clause, may tax its residents without regard to the proposed convention.

This provision, which it is understood was requested by Finland, provides that a resident of one country who is temporarily present in the other country as a teacher or student may deduct in determining his income tax in his country of residence the following amounts: (1) all traveling expenses (including meals and lodging and incidental expenses) while traveling between the two countries; and (2) all ordinary and necessary living expenses (including meals and lodging) while temporarily present in the host country. These deductible expenses are presumed in any event to be at least 30 percent of the amount of the student's or teacher's income which is exempt from tax in the host country under the visiting teachers article or the students article of the proposed convention.

Article 24. Private pensions and annuities

Under the existing convention, private pensions and annuities derived from one country by residents of the other country are exempt from tax in the source country.

The proposed convention continues this rule and includes alimony within its scope.

Article 25. Social security payments

The proposed convention provides that when social security payments or other public pensions are paid by one country to a resident of the other country, only the payor country may tax these payments. Although the existing convention and the OECD model convention do not contain a corresponding provision, the French and the proposed Belgian treaties do contain a provision of this nature.

Article 26. Diplomatic and consular officers

The proposed convention provides, as do a number of our other income tax treaties and the existing convention, that its provisions are not to affect the fiscal privileges which diplomatic and consular officials enjoy under the general rules of international law or the provisions of special agreements.

Article 27. Investment or holding companies

The proposed convention contains a provision which denies the benefits of the dividends, interest, and royalties articles to a corporation which is entitled in its country of residence to special tax benefits resulting in a substantially lower tax on those types of income than the tax generally imposed on corporate profits by that country, if 25 percent or more of the capital of the corporation is owned by corporations or individuals who are nonresidents of that country (or by U.S. citizens, in the case of a Finnish corporation). A similar provision is contained in the Luxembourg convention and in other recent proposed U.S. tax treaties.

The purpose of this provision is to prevent residents of third countries from using a corporation in one treaty country, which is preferentially taxed in that country, to obtain the tax benefits in the other treaty country which the proposed convention provides for dividends, interest, and royalties derived from that other country. This accords with the purpose of an income tax convention between two countries which is to lessen or eliminate the amount of double taxation of income derived from sources within one country by a resident of the other country.

At the present time, neither Finland nor the United States grants to investment or holding companies the type of tax benefits with respect to dividends, interest, or royalties which would make this provision of the proposed convention applicable. Thus, the provision will have effect only if Finland or the United States should subsequently enact special tax measures granting preferential tax treatment to dividends, interest and royalties received by an investment or holding company.

Articles 28–30. Administrative provisions

Various administrative provisions are contained in the existing convention. The proposed convention modernizes and expands these

provisions generally along the lines of the provisions contained in other U.S. tax treaties.

In general, the proposed convention provides—

(1) For consultation and negotiation between the two countries to resolve differences arising in the application of the proposed convention and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the terms of the proposed convention;

(2) For the exchange between the countries of legal information and of information pertinent to carrying out the provisions of the proposed convention or to preventing fraud or fiscal evasion with respect to the taxes covered by the proposed convention; and

(3) That each country is to assist the other in collecting taxes imposed by the other country to the extent necessary to insure that the benefits provided by the proposed convention are enjoyed only by persons entitled to those benefits.

Article 31. Entry into force

The proposed convention will enter into force two months following the exchange of the instruments of ratification. It will become effective generally for taxable years beginning on or after January 1 of the year following the exchange of the instruments of ratification. Reductions in U.S. withholding taxes under the proposed convention generally will apply to amounts received on or after the date the proposed convention enters into force. When the proposed convention enters into effect, the existing convention which was signed on March 3, 1952, and which entered into force on December 18, 1952, will terminate.

Article 32. Termination

The proposed convention will continue in force indefinitely but either country may terminate the proposed convention after 1973 by giving notice through diplomatic channels. In addition, it is provided that the provisions of the social security payments article may be terminated by either country at any time.

PROPOSED INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND TRINIDAD AND TOBAGO

(Memorandum Prepared by the Staff of the Joint Committee on Internal Revenue Taxation)

The existing income tax convention with Trinidad and Tobago which was signed on December 22, 1966, ceased to be effective as of the end of 1969. It was a treaty of limited scope and had been entered into pending agreement by the countries on a more comprehensive income tax convention.

The proposed convention with Trinidad and Tobago is a comprehensive convention which follows in most respects the general pattern embodied in other recent U.S. income tax treaties. The proposed convention departs from our other income tax treaties in two principal respects in order to reflect the fact that Trinidad and Tobago is a developing country, rather than a developed country. The principal

aspect of the proposed treaty which differs from the general pattern is the inclusion within the treaty of a provision which provides for the deferral of both countries' taxes which would otherwise be imposed on the transfer of technical assistance (such as patents, designs, etc., knowhow, and ancillary and subsidiary services) by a U.S. corporation to a Trinidad and Tobago corporation in return for stock of the Trinidad and Tobago corporation. This provision is designed to induce the flow of knowhow and related services to Trinidad and Tobago.

The other principal aspect of the proposed convention which differs from the general pattern is the unilateral reduction by Trinidad and Tobago of its withholding taxes on dividends and interest which flow from that country to the United States. The U.S. withholding taxes on this type of income are not reduced under the proposed convention so as not to encourage an outflow of capital to the United States from Trinidad and Tobago.

The other more important features of the proposed convention are as follows:

(1) The terms "United States" and "Trinidad and Tobago" are to include the countries' respective continental shelves, insofar as income arising from the exploration and exploitation of natural resources on the continental shelves is concerned. Accordingly, a country's jurisdiction to tax under, and the benefits provided by, the proposed convention will extend to this type of income. Our other income tax treaties (except for the proposed treaty with Belgium) do not contain a provision of this type. However, a similar provision was added to the Internal Revenue Code by the Tax Reform Act of 1969.

(2) The two countries may under the mutual agreement procedure establish common meanings for undefined terms used in the proposed convention. This provision, which will help insure the availability of the benefits provided by the proposed convention, is not contained in other recent U.S. tax treaties (other than the proposed conventions with Belgium, Finland, and the Netherlands).

(3) A source rule is provided under which business profits and effectively connected income of a permanent establishment in one country will be considered to be from sources within that country, even though the income might have its source elsewhere under the Internal Revenue Code. This is designed to help insure that a U.S. taxpayer who pays taxes to Trinidad and Tobago on this type of income will be entitled under the foreign tax credit provisions of the proposed treaty, which would place a per country limitation on the credit, to a credit for the Trinidad and Tobago taxes.

(4) The rate of Trinidad and Tobago withholding tax on intercorporate dividends (where the recipient has a 10-percent ownership interest in the paying company) is reduced from 25 percent to 10 percent. The branch profits tax imposed by Trinidad and Tobago is similarly reduced from 25 percent to 10 percent.

(5) The rate of Trinidad and Tobago withholding tax on interest is reduced from 30 percent to 15 percent in cases where the recipient is a U.S. bank or other financial institution not having a permanent establishment in Trinidad and Tobago.

(6) Artistic royalties will be exempt from source country taxation and industrial and scientific royalties will be subject to a 15 percent

rate of source country withholding taxation. In the absence of a treaty, these royalties would be taxed by both the United States and Trinidad and Tobago at a rate of 30 percent.

A detailed analysis of the proposed convention on an article-by-article basis is presented below.

Article 1. Taxes covered

The proposed convention applies to the U.S. Federal income tax with the exception of the accumulated earnings tax imposed by section 531 of the Internal Revenue Code and the personal holding company tax imposed under section 541. In the case of Trinidad and Tobago, the proposed convention applies to the corporation tax and the income tax.

The proposed convention also contains the provision generally found in U.S. income tax treaties to the effect that the convention will apply to substantially similar taxes which either country may subsequently impose. In addition, the nondiscrimination provisions will apply to taxes imposed at the State or local level as well as at the national level.

Article 2. General definitions

The standard definitions found in most of our income tax treaties are contained in the proposed convention. There is one provision, however, in the proposed convention which differs from existing treaties. This provision includes within the definition of the term "United States" the territorial sea of the United States and the continental shelf of the United States insofar as the exploration and exploitation of natural resources on the continental shelf is concerned. This expanded definition, however, is applicable for purposes of the proposed convention only to the extent that the person, property, or activity of concern is connected with the exploration and exploitation of natural resources. A similar definition of Trinidad and Tobago is contained in the proposed convention.

The definition of continental shelf areas contained in the proposed convention is similar to that contained in the proposed Belgian convention and to that provided in the Internal Revenue Code (as amended by the Tax Reform Act of 1969) except that under the Code the continental shelf definitions apply only with respect to mines, oil and gas wells, and other natural deposits. Under the proposed convention, the applicability of the definition is not expressly restricted in this manner since it applies with respect to the exploration for or exploitation of any natural resource. In practical operation, however, the applicability of the provision usually will be similarly restricted. The activity of fishing is not intended to be considered the exploration or exploitation of natural resources of the continental shelf, and thus the definition of continental shelf is not to apply with respect to this activity.

The proposed convention also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the convention. In addition, however, the proposed convention provides that where a term is defined in a different manner by the two countries or where the definition of a term cannot be readily determined under the laws of one of the countries, then the competent authorities of the two countries may establish a common meaning of the term under the mutual

agreement procedures provided by the proposed convention in order to prevent double taxation or to further any other purpose of the convention. A similar provision is contained in the proposed conventions with Belgium and Finland. While most other U.S. income tax treaties contain a mutual agreement procedure, generally they do not contain a specific provision of this nature relating to definitional matters.

Article 3. General rules of taxation

The proposed convention contains the basic general rules of taxation regarding the manner in which one country may tax residents and corporations of the other country which are found in most of our other income tax conventions. Thus, one country may tax residents of the other country only on income from sources within the taxing country. In this regard, it should be noted, however, that (as discussed in connection with article 5) the source rules contained in the proposed convention, which are to be used for purposes of this basic rule, provide that industrial or commercial profits attributable to a permanent establishment located in a country are treated as from sources within the country. The taxation under the proposed convention must be in accordance with the limitations contained in the proposed convention. Each country, however, may tax without regard to the proposed convention any income to which the convention is not expressly applicable.

The proposed convention is not to be interpreted to deny any tax benefits available presently or in the future under the tax laws of the two countries or under any other agreement between the countries.

The usual savings clause is included in the proposed convention. This clause provides that with certain exceptions the proposed convention is not to affect the taxation by a country of its own residents (and, in the case of the United States, of its own citizens). The primary exceptions include the foreign tax credit, the nondiscrimination provision, and the provision allowing tax deferral for technical assistance.

Article 4. Relief from double taxation

The previous convention with Trinadad and Tobago which terminated at the end of 1969 contained a provision regarding the allowance of a foreign tax credit by each of the countries for taxes paid to the other country. The proposed convention continues this method of avoiding double taxation. As in the case of other recent U.S. tax conventions and the previous convention with Trinidad and Tobago, the proposed convention does not specifically refer to the foreign tax credit provisions of the Internal Revenue Code or of the tax laws of Trinidad and Tobago. This makes it clear that modifications of the Code or of the tax laws of Trinidad and Tobago which affect the foreign tax credit will not be barred by the proposed convention if the modifications do not contravene the general principles of the convention.

Under the proposed convention, a citizen, resident, or corporation of the United States will be allowed to credit against its U.S. tax the amount of income tax paid to Trinidad and Tobago. Moreover, a U.S. corporation which receives a dividend from a Trinidad and

Tobago corporation in which it has at least a 10-percent ownership interest will be allowed a credit for the Trinidad and Tobago tax paid on the corporate profits out of which the dividend is paid, if the U.S. corporation includes the amount of Trinidad and Tobago tax in its gross income. The credit allowed by the United States under the proposed convention is subject to the so-called per-country limitation. Of course, if the overall limitation on the foreign tax credit which is provided by the Internal Revenue Code produces a more favorable result, a U.S. taxpayer may use that provision rather than the per-country limitation contained in the proposed convention.

The foreign tax credit allowed by the United States under this provision of the proposed convention conforms generally to the foreign tax credit allowed under the Internal Revenue Code (secs. 901–906). There is, however, one significant difference regarding the so-called deemed paid credit, i.e., the credit allowed to certain U.S. corporations for Trinidad and Tobago taxes paid on the corporate profits out of which a dividend is paid. To receive this credit under the proposed convention, the recipient U.S. corporation must include in its income the amount of Trinidad and Tobago tax for which a deemed paid credit is claimed. In other words, the dividend must be grossed up. Under the Internal Revenue Code, however, a dividend does not have to be grossed up in order for the recipient U.S. corporation to claim a deemed paid credit, if the dividend is paid by a less developed country corporation and most Trinidad and Tobago corporations will be considered less developed country corporations. Inasmuch as the computation of the deemed paid tax credit without gross-up under the Internal Revenue Code will generally produce a more favorable result than the grossed-up computation under the proposed convention, it will be to the advantage of U.S. corporations in many cases to use the Code rules in computing the deemed paid credit. Of course, in these cases U.S. corporations may continue to use the Code rules rather than those found in the proposed convention.

Under the proposed convention, Trinidad and Tobago will allow its taxpayers a credit for income taxes paid to the United States. Also, a Trinidad and Tobago corporation which receives a dividend from a U.S. corporation in which it has at least a 10-percent ownership interest will be allowed a credit for the U.S. tax paid on the corporate profits out of which the dividend is paid. In the absence of the proposed convention, this credit would be allowed under Trinidad and Tobago law only where the recipient corporation had at least a 25-percent ownership interest in the paying corporation. The credit allowed by Trinidad and Tobago under the proposed convention is subject to a per-country limitation.

Article 5. Source of income

One of the ways by which income tax treaties can eliminate double taxation is to provide rules for determining the source of income. The source of income is important in view of the general rule in treaties that one country may tax residents and corporations of the other country only on income from sources within the taxing country, and also in view of the fact that the limitation in the foreign tax credit provision is based on the source of income.

The proposed convention with Trinidad and Tobago follows the general approach of recent U.S. tax treaties and provides source of income rules that conform in general to the source rules contained in the Internal Revenue Code. There is, however, a minor difference in the dividend source rule, and, in addition, the proposed convention follows the proposed treaties with Brazil, Finland, and Belgium by including a rule for determining the source of business profits.

Under the Internal Revenue Code, dividends paid by a foreign corporation are considered to be in part from U.S. sources, and therefore are taxable to that extent by the United States when paid to a nonresident alien individual or company, if more than 50 percent of the paying corporations' income for the previous three years was effectively connected with a U.S. business. The proposed convention slightly limits the tax jurisdiction of the United States which arises by virtue of this source rule. It applies the 50 percent test with respect to industrial or commercial profits which are effectively connected with a permanent establishment in the United States of a Trinidad and Tobago corporation and limits the amount of dividends paid by such a corporation which will be treated as U.S. income under this rule to that amount of money or other property transferred from the permanent establishment in the United States to the Trinidad and Tobago corporation during the relevant period. In other words, dividends paid by a Trinidad and Tobago corporation are not to be considered U.S. source income under this rule to the extent the profits of the permanent establishment are reinvested in the United States by the permanent establishment rather than remitted to the Trinidad and Tobago corporation.

The proposed convention also contains a rule regarding the source of industrial and commercial profits including passive income which is treated as industrial and commercial profits because it is effectively connected with a permanent establishment. This rule is found in some of our recent proposed treaties, but not in other U.S. income tax treaties or under the Internal Revenue Code. Under the Code and other U.S. tax treaties, the country in which a permanent establishment is located may tax the business profits which are effectively connected with the permanent establishment regardless of the source of those profits. Insofar as jurisdiction to tax is concerned, the proposed Trinidad and Tobago treaty achieves the same result by providing that these business profits are from sources within the country where the permanent establishment is located. The practical results of the two approaches are basically the same with one exception. Since business profits attributable to a Trinidad and Tobago permanent establishment are considered to be from sources within Trinidad and Tobago—even though under the usual source rules, the income would have its source elsewhere—a foreign tax credit under the per country limitation will be available to a U.S. taxpayer for Trinidad and Tobago taxes imposed on this income.

Article 6. Nondiscrimination

The proposed convention contains the more comprehensive nondiscrimination provisions which have been embodied in other recent U.S. income tax treaties. It provides that one country cannot discriminate by imposing more burdensome taxes on its residents who are nationals of the other country, or on permanent establishments of nationals or

corporations of the other country, than it imposes on its comparable taxpayers. This provision, however, does not prevent Trinidad and Tobago from imposing its branch profits tax pursuant to the limitations contained in the proposed convention nor does it prevent the United States from imposing a comparable tax. The proposed convention also extends the nondiscrimination provision to corporations of one country which are owned by nationals or corporations of the other country.

Article 7. Tax deferral for technical assistance

The proposed convention contains a provision which is not found in other U.S. income tax treaties that is designed to induce the flow of know how and related services to less developed countries. This provision provides for the deferral of U.S. and Trinidad and Tobago income taxes in cases involving the transfer of technical assistance by a U.S. corporation to a Trinidad and Tobago corporation. A similar provision is contained in the proposed Israeli income tax convention which is pending before the Senate Foreign Relations Committee.

Under the proposed convention, a U.S. resident may elect to defer the U.S. and Trinidad and Tobago tax which would otherwise arise as a result of the receipt of stock of a Trinidad and Tobago corporation by the U.S. corporation in return for the transfer of technical assistance to the Trinidad and Tobago corporation. The taxes would be deferred until the stock is disposed of. Specifically, this provision applies where the U.S. corporation transfers to the Trinidad and Tobago corporation—

(1) a patent, invention, model, design, secret formula or process, or similar property rights; or

(2) information concerning industrial, commercial or scientific knowledge, experience, or skill.

In addition, the provision is applicable to the provision of technical, managerial, architectural, scientific, skilled or industrial, commercial or like services if they are ancil'ary and subsidiary to the transfer of the rights referred to in (1) above or the information referred to in (2) above. The "property" or services provided by the U.S. corporation must be for use in connection with a trade or business actively conducted by the recipient Trinidad and Tobago corporation in its own country. In addition, a transfer must be made in accordance with the laws of the two countries regulating foreign investments.

Under the Internal Revenue Code, a taxpayer may receive deferral of U.S. tax where he transfers property to a foreign corporation generally if two conditions are satisfied. First, the recipient foreign corporation must be at least 80 percent controlled by the U.S. corporation (sec. 351). Second, the Internal Revenue Service must give advance approval of the transaction (sec. 367). Thus, the effect of the proposed convention vis-a-vis U.S. law is to eliminate the 80 percent test, to relieve U.S. taxpayers of the requirement that they obtain an advance ruling from the Treasury Department, and also to eliminate the necessity which arises under the Internal Revenue Code of distinguishing between transfers of property and transfers of services.

The proposed convention, in addition to allowing the deferral of U.S. taxes, also provides for the deferral of the Trinidad and Tobago taxes which would arise in connection with the transaction. The pro-

vision is reciprocal in form and thus would also be applicable if a Trinidad and Tobago corporation were to transfer any of the specified property rights or services to a U.S. corporation.

Under the proposed convention, the competent authorities of each country are given authority to prescribe the necessary regulations for purposes of the tax deferral provision. In addition, the Trinidad and Tobago competent authority is given the power to prescribe standards for determining whether the services which may be transferred under this provision are ancillary and subsidiary to property rights or information which have been transferred, as is required by the proposed convention.

Article 8. Business profits

The proposed convention contains provisions regarding the taxation of business profits which generally accord with similar provisions found in other U.S. income tax treaties. The proposed convention includes the effectively connected concept which is found in the Internal Revenue Code and in our more recent income tax treaties.

Under the proposed convention, business profits of a resident of one country are taxable in the other country to the extent they are attributable to a permanent establishment which the resident has in the other country. In computing the taxable business profits, the proposed convention allows the deduction of all expenses, wherever incurred, which are reasonably connected with the business profits.

It is further provided that profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment, or by the resident of which it is a permanent establishment, for the account of that resident. The proposed convention also provides that in determining the profits attributable to a permanent establishment the same method is to be used from year to year unless there is good and sufficient reason to do otherwise.

The proposed convention sets forth examples of types of income which are considered industrial and commercial profits and in so doing follows the approach of our other recent treaties and the Internal Revenue Code by including within such profits investment income arising from a right or property which is effectively connected with the permanent establishment. The types of passive income included within industrial or commercial profits are dividends, interest, royalties, and income from real property.

Article 9. Definition of permanent establishment

One of the basic devices used in income tax treaties to avoid double taxation is the permanent establishment concept. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided by the convention for dividends, interest, and royalties are applicable.

The proposed convention follows the pattern of the OECD model convention and other recent U.S. income tax treaties by defining a permanent establishment as a fixed place of business through which a resident of one country engages in industrial or commercial activities

in the other country. This includes a seat of management, an office, a store or other sales outlet, a factory, and any building, construction or installation project which lasts for 6 months or more. This general rule is modified to provide that a fixed place of business which is used for any or all of a number of specified activities will not constitute a permanent establishment. These activities include the processing of goods belonging to the resident and the purchase of goods for the account of the resident under arrangements or conditions which are or would be made between independent persons and the storage or delivery of goods belonging to the resident (other than goods or merchandise held for sale by the resident in a store or other sales outlet).

The proposed convention also provides that a resident of one country will be deemed to have a permanent establishment in the other country if it—

(1) engages in industrial or commercial activity in the other country through an agent who has and who habitually exercises a general contracting authority (other than for the purchase of merchandise) in that country or who maintains in that country a stock of goods belonging to the resident from which he regularly fills orders or makes deliveries;

(2) maintains equipment or machinery for rental or other purposes within the other country for a period of 6 months or more; or

(3) sells in the other country goods or merchandise which either were subjected to substantial processing in that country (wherever purchased) or were purchased in that country and not subjected to substantial processing outside of that country.

The third situation described above which gives rise to a permanent establishment is not contained in other U.S. income tax treaties. A somewhat similar provision is found, however, in the proposed Belgian convention.

The proposed convention also contains the usual rule that the agency rule will not apply if the agent is a broker, general commission agent, or other agent of independent status acting in the ordinary course of its business.

Article 10. Ships and aircraft

The proposed convention adopts the approach found in most U.S. income tax treaties by providing that income which a resident of one country derives from the operation in international traffic of ships or aircraft will be exempt from tax by the other country. In the case of a resident of the United States, the ships or aircraft must be registered in the United States.

Article 11. Related persons

The proposed convention contains, as do most U.S. income tax treaties, a provision similar to section 482 of the Internal Revenue Code which allows the allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons.

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Article 12. Dividends

The prior convention with Trinidad an Tobago reduced the rate of withholding tax on dividends paid by a corporation of one country to a corporation of the other country with at least a 10 percent ownership interest in the paying corporation to 5 percent. This reduced rate was not available, however, if the recipient of the dividends had a permanent establishment in the other country (i.e., the prior treaty contained the force of attraction concept). In addition, in other cases the source country withholding tax on dividends was reduced to 25 percent. The prior convention also reduced the rate of the so-called branch profits tax imposed by Trinidad and Tobago to 5 percent.

The proposed convention differs from the prior convention in that only the Trinidad and Tobago withholding tax rates are reduced. In other words, the usual 30 percent withholding tax imposed by the United States on dividends paid by a U.S. corporation to a Trinidad and Tobago resident will continue to apply under the convention. In the case of intercorporate dividend payments, the generally applicable 25 percent Trinidad and Tobago withholding tax is reduced to 10 percent. In addition, the proposed convention abandons the force-of-attraction doctrine and, thus, the reduced rate will be applicable unless the U.S. corporate recipient of the dividend has a permanent establishment in Trinidad and Tobago and the stock giving rise to the dividend is effectively connected with the permanent establishment.

Specifically, the proposed convention provides that the Trinidad and Tobago withholding tax will be reduced to 10 percent in the case of dividends paid by a Trinidad and Tobago corporation to a U.S. corporation which has at least a 10 percent ownership interest in the paying corporation (provided that not more than 25 percent of the paying corporation's income is derived from interest and dividends other than interest and dividends from subsidiary corporations or interest from a banking, insurance, or financing business). If the recipient of the dividend has a permanent establishment in Trinidad and Tobago with which the stock giving rise to a dividend is effectively connected, then the reduced rate is not available.

The proposed convention also limits in other cases the Trinidad and Tobago withholding tax on dividends to 25 percent, which is the current Trinidad and Tobago withholding tax rate on dividends. As is true in the case of intercorporate dividends, this limitation is not applicable if the U.S. recipient of the dividend has a permanent establishment in Trinidad and Tobago with which the stock giving rise to the dividend is effectively connected.

The proposed convention further provides that dividends paid by a corporation of one country to a person other than a resident of the other country (and in the case of dividends paid by a Trinidad and Tobago corporation, to a person other than a citizen of the United States) will be exempt from tax by the other country, unless under the source rules provided by the convention the dividend is treated as being from sources within the other country. Thus, dividends paid by a Trinidad and Tobago corporation to a person other than a citizen or resident of the United States will be exempt from U.S. tax unless the dividend is treated as being from U.S. sources. As indicated in the discussion of the dividend source rules (article 5), the

source rules of the proposed convention generally follow the source rules provided under U.S. statutory law.

The proposed convention also contains a provision regarding the so-called branch profits tax imposed by Trinidad and Tobago. Under Trinidad and Tobago law, the profits of a Trinidad and Tobago permanent establishment of a foreign corporation are subject to the regular 45 percent corporate tax and, in addition, are subject to a 25 percent branch profits tax unless the profits are reinvested in Trinidad and Tobago. In other words, these profits are taxed in the same manner as if they were earned by a subsidiary corporation and then the aftertax profits were paid as a dividend to the parent corporation. The proposed convention limits to 10 percent the Trinidad and Tobago branch profits tax on remittances by a Trinidad and Tobago permanent establishment of a U.S. corporation of profits which were effectively connected with the permanent establishment. In other words, such remittances will be treated under the proposed convention in the same manner as intercorporate dividends.

Article 13. Interest

U.S. income tax treaties generally provide that interest derived from one country by a resident of the other country will either be exempt from, or subject to a reduced rate of, tax in the source country. As is true in the case of the proposed Brazilian convention, the proposed convention contains a more limited provision dealing with interest. It provides that interest received by the Government, or a wholly owned agency, of the United States or Trinidad and Tobago will be exempt from tax by the other country.

The proposed convention also reduces from 30 to 15 percent the Trinidad and Tobago tax imposed on interest derived from sources in Trinidad and Tobago by a U.S. resident which is a bank or other financial institution and which does not have a permanent establishment in Trinidad and Tobago. This reduction is unilateral, is limited to the specified type of recipient, and does not embody the effectively connected concept.

The proposed convention also contains a limitation on the application of the interest article which is similar to that found in the OECD model convention and other recent U.S. income tax treaties in situations where the payor and recipient are related. The proposed convention provides that if the interest paid to a related person is in excess of a fair and reasonable consideration for the indebtedness for which it is paid, then the interest article will apply only to that part of the interest as represents a fair and reasonable consideration.

The proposed convention also provides that the provision of Trinidad and Tobago law, which, in effect, treats interest in certain cases as a dividend distribution rather than as interest, is to apply to interest paid to a U.S. resident only to the extent the U.S. resident cannot demonstrate to the satisfaction of the Trinidad and Tobago taxing authorities that the investment giving rise to the interest (including the fact that it is in the form of indebtedness) did not have as its purpose the avoidance of Trinidad and Tobago tax. Under Trinidad and Tobago law, interest on convertible debt and interest on securities of a Trinidad and Tobago company which are held by a

nonresident parent company or brother-sister corporation are treated as dividends rather than as interest.

Article 14. Royalties

The OECD model convention and a number of U.S. income tax treaties provide an exemption from source country tax for nonmineral royalties paid to residents of the other country, provided the recipient does not have a permanent establishment in the source country (and in the case of more recent treaties, unless the property or right giving rise to the royalty is effectively connected with the permanent establishment).

The proposed convention with Trinidad and Tobago follows this general approach with respect to artistic royalties. In other words, artistic royalties derived by a resident of one country from sources in the other country will not be subject to tax in the source country unless the recipient has a permanent establishment in the source country and the property giving rise to the royalty is effectively connected with the permanent establishment.

In the case of industrial and scientific royalties, the proposed convention differs from the general treaty approach and follows the approach embodied in the proposed Brazilian treaty of providing a reduced rate of, rather than an exemption from, source country withholding tax. Under the proposed convention, industrial and scientific royalties derived from one country by a resident of the other country will be subject to a maximum 15 percent withholding tax rate in the source country, unless the recipient has a permanent establishment in the source country, and the property giving rise to the royalty is effectively connected with the permanent establishment.

In the absence of the convention, the United States and Trinidad and Tobago would impose a 30 percent withholding tax on royalties paid to a resident of the other country.

As in the case of the interest provision, the royalty provision of the proposed convention does not apply to that part of a royalty paid to a related person which is in excess of a fair and reasonable consideration.

The proposed convention does not cover royalties arising from the use of motion picture films or films or tapes for radio or television broadcasting as do a number of other U.S. income tax treaties.

Article 15. Income from real property

The proposed convention follows the approach of the Internal Revenue Code and most U.S. income tax treaties by providing that a resident of one country may elect to be taxed on a net basis in the other country, as if the resident were engaged in business in that other country, on real property income (including gains from the sale or exchange of real property) and on mineral royalties arising from sources in that other country. This provision has the effect of reducing the source country tax on this income to an amount which in most cases will be fully creditable against the tax imposed on the income by the recipient's country of residence which is usually computed on a net basis.

In the absence of this provision, Trinidad and Tobago would tax a U.S. person on the gross amount of this type of income from Trinidad and Tobago sources unless the person was engaged in business in Trinidad and Tobago.

Article 16. Investment or holding companies

The proposed convention contains a provision which denies the benefits of the dividends, interest, and royalties articles to a corporation which is entitled in its country of residence to special tax benefits resulting in a substantially lower tax on those types of income than the tax generally imposed on corporate profits by that country, if 25 percent or more of the capital of the corporation is owned by nonresidents of that country (or by U.S. citizens in the case of a Trinidad and Tobago corporation). A similar provision is contained in the Luxembourg convention and in other recent proposed U.S. tax treaties.

The purpose of this provision is to prevent residents of third countries from using a corporation in one treaty country, which is preferentially taxed in that country, to obtain the tax benefits in the other treaty country which the proposed convention provides for dividends, interest, and royalties derived from that other country. This accords with the purpose of an income tax convention between two countries which is to lessen or eliminate the amount of double taxation of income derived from sources within one country by a resident of the other country.

At the present time, neither Trinidad and Tobago nor the United States grants to investment or holding companies the type of tax benefits with respect to dividends, interest, or royalties which would make this provision of the proposed convention applicable. Thus, the provision will have effect only if Trinidad and Tobago or the United States should subsequently enact special tax measures granting preferential tax treatment to dividends, interest and royalties received by an investment or holding company.

Article 17. Income from personal services

Under the Internal Revenue Code, a nonresident alien is not taxed by the United States on income earned from services performed by him in the United States if—

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

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

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

Under Trinidad and Tobago tax law, tax is imposed on any income derived by a nonresident individual from the performance of personal services in Trinidad and Tobago.

Our income tax treaties generally follow the approach of the Internal Revenue Code but in addition extend the period a nonresident may be present in the host country (usually from 90 to 183 days) and, in effect, eliminate either the $3,000 income limitation or the foreign employer requirement by not taxing nonresidents in the host country if either requirement is satisfied.

The proposed convention adopts the general treaty approach by extending the 90-day presence requirement to 183 days. The $3,000 requirement is retained in the case of income derived from the performance of services in an independent capacity but is eliminated in

the case of employment income. On the other hand, the foreign employer requirement is retained in the case of employment income but is eliminated for income derived from the performance of services in an independent capacity.

The proposed convention also follows the proposed Brazilian and Philippine conventions by imposing an additional specific dollar limitation on the amount of personal service income which public entertainers (such as actors, athletes, etc.) may receive tax free in the source country. If the compensation of these persons exceeds $100 for each day the person is present in the source country for purposes of performing the entertainment services, the person is subject to tax. In addition, any person who receives income from providing services of public entertainers in the source country in excess of $100 for each day the entertainers are present in the source country for the purpose of performing the entertainment services may not avail himself of the exemption provided by the convention for personal services income. If a Trinidad and Tobago public entertainer, however, satisfies the requirements of the Internal Revenue Code for exemption of personal service income which includes the $3,000 per year limitation, he may avail himself of the Code exemption and thus avoid the $100 per day limitation contained in the proposed convention.

Article 18. Teaching and research

Most U.S. income tax treaties provide some exemption from source country taxation to teachers who are residents of the other country and who are temporarily present in the source country at the invitation of the Government or an educational institution. The purpose of such a provision is to facilitate the exchange of teachers between countries. The proposed convention with Trinidad and Tobago follows the approach of our more recent treaties which contain more liberal exemption provisions than did earlier treaties. It is provided that a resident of one country will be exempt from tax in the other country on income from teaching and research for two years, if he is present in the host country for purposes of teaching or engaging in research at an accredited educational institution. The exemption, however, does not apply to income from research undertaken primarily for the benefit of private persons, rather than in the public interest, or to income which arises in cases where there is an agreement between the governments of the two countries for the provision of the services of the individuals.

Article 19. Students and trainees

It is generally provided in our income tax treaties that students who are residents of one country will be exempt from tax in the other country on certain types of income if they are present in the other country for purposes of attending school. This exemption is usually limited to gifts from abroad which are used by the student for his maintenance or education.

The proposed convention contains a substantially more liberal exemption similar to that embodied in the 1965 supplementary convention with the Netherlands, the recent French treaty, and the proposed conventions with Brazil, Belgium and Finland. Under the proposed convention, residents of one country who become students in the other country will be completely exempt from tax in the host coun-

try on gifts from abroad used by the student for maintenance or study and on any grant, allowance, or award received from a governmental or charitable organization. In addition, limited exemptions are provided for personal service income derived from sources within the country in which the individual is studying. In the case of students generally, $2,000 per year of personal service income (such as income from a part-time job) is exempt from tax in the country in which the individual is a student. The limitation is increased to $5,000 per year if the individual is studying for a profession or a professional specialty. These exemptions (the complete as well as the limited ones) may not be utilized for a period of longer than five years.

In addition to the exemptions regarding students, the proposed convention follows the approach of other recent U.S. income tax treaties and provides limited exemptions for personal service income of residents of one country who are employees of a resident or corporation of that country and who are temporarily present in the other country to study at an approved educational institution or to acquire technical, professional or business experience ($5,000) and for income from personal services performed in connection with training, research or study by participants in Government-sponsored exchange training programs ($10,000).

Article 20. Governmental salaries

As is the case in our other income tax treaties, the proposed convention provides that one country will not tax wages, salaries, pensions, or annuities paid by the other country to its nationals for governmental services.

Article 21. Rules applicable to personal income articles

The proposed convention provides that reimbursed travel expenses are exempt from tax under the personal income articles without regard to the maximum amount of the exemptions. The proposed convention also provides that only the benefits of the most favorable personal income article may be claimed by a taxpayer for a year with respect to the same income, if more than one of those articles is applicable to the income in that year.

Article 22. Private pensions and annuities

The proposed convention adopts the approach of most U.S. income tax treaties which exempts private pensions and annuities paid to residents of one country from tax in the other country. The proposed convention also extends this treatment to alimony payments which are taxable to the recipient under the laws of his country of residence.

Articles 23–27. Administrative provisions

The proposed convention contains the various administrative provisions found in most U.S. income tax treaties. In general, the proposed convention provides—

(1) For consultation and negotiation between the countries to resolve differences arising in the application or interpretation of the proposed convention and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the proposed convention;

(2) For the exchange between the countries of legal information and of information relating to carrying out the provisions

of the proposed convention or to preventing fraud or fiscal evasion with respect to the taxes covered by the proposed convention; and

(3) That each country is to assist the other in collecting taxes imposed by the other country to the extent necessary to insure that the benefits provided by the proposed convention are enjoyed only by the persons entitled to those benefits.

Article 28. Effective dates

The proposed convention generally will become effective for taxable years beginning on or after January 1 of the year in which the instruments of ratification are exchanged. An exception to this general rule is provided in the case of the provision which allows tax deferral for technical assistance. This provision will be effective with respect to stock received on or after the date the proposed convention was signed (i.e., January 9, 1970).

In addition, Trinidad and Tobago unilaterally will take all necessary steps to make the reduced rates of Trinidad and Tobago withholding tax on dividends which are provided by the proposed convention effective from January 1, 1970, through December 31, 1970, rather than only from the later date when the convention enters into force.

The proposed convention will continue in effect indefinitely, but either country may terminate it after it has been in effect for five years by giving notice of termination.

Article 29. Extension of convention

The proposed convention contains a provision similar to that found in some of our other income tax treaties pursuant to which the convention may be extended to any areas of either of the two countries for whose international relations the country is responsible, if the area imposes taxes substantially similar to those covered by the convention.

The convention may be extended pursuant to this provision either in its entirety or with the necessary modifications. The extension is to be effected by a written notification of extension by the one country which is assented to by the other country in a written communication, which notification and communication are then to be ratified by each of the countries in accordance with their constitutional procedures.

PROPOSED ESTATE TAX CONVENTION BETWEEN THE UNITED STATES AND THE NETHERLANDS

(Memorandum Prepared by the Staff of the Joint Committee on Internal Revenue Taxation)

At the present time, the United States has 12 estate tax treaties, the most recent of which is the 1962 Canadian treaty.

The proposed convention, although it has the same basic purpose as our other estate tax treaties—namely, the lessening of double taxation at death and the prevention of fiscal evasion—embodies a substantially different approach to the resolution of double taxation problems. One of the principal objectives of this approach is to reduce the instances of double tax jurisdiction, and thereby minimize the burdens of death

taxation, in situations where employees of private businesses die while on a foreign assignment that is basically of a temporary nature.

Our existing estate tax conventions are based on the situs principle of taxation. These treaties set forth detailed rules for determining the situs of a decedent's property and provide that a country may tax property situated in it even though the decedent is domiciled in the other country. These existing treaties also provide that the country of domicile will allow a tax credit against its death tax with respect to the taxes imposed by the country in which the property is situated. Although these treaties have helped lessen the burdens of double taxation, in some instances the provisions give inadequate relief and, in addition, they generally do not adequately deal with the situation where both countries tax the worldwide estate of the decedent on the basis that each country considers the decedent to have been a domiciliary.

To resolve a substantial portion of these problems, the proposed convention, in general, confers primary death tax jurisdiction on the country in which the decedent was domiciled, limits situs country taxation to the decedent's real property or business assets of a permanent establishment located in that country, and provides a system of tax credits under which the country in which the decedent was not domiciled, even if he was a citizen of that country, will assert only secondary worldwide tax jurisdiction with respect to the decedent's estate if he had been domiciled for a substantial period in the other country in the sense that it will allow a credit for the taxes imposed by the country of domicile.

Generally, these basic rules of the proposed convention produce the following pattern of death taxation. A U.S. citizen who under Dutch law was domiciled in the Netherlands for less than 7 out of the 10 years prior to his death and who did not intend to indefinitely remain there will be considered domiciled only in the United States and thus will be subject to Dutch death taxes, at the lower rates which are generally applicable to nonresidents, only on his real property and business assets situated in the Netherlands. In this type of case, the United States will then allow a credit against the Federal estate tax on the property which has been taxed by the Netherlands for the Dutch death taxes imposed on that property. Moreover, in computing the amount of the Dutch death tax, the proposed convention provides for the allowance of a 50-percent marital deduction and for the exemption from tax of small estates ($30,000 or less).

Where a U.S. citizen is domiciled in the Netherlands for more than 7 out of the 10 years prior to his death, then both the United States and the Netherlands will impose their death taxes on the worldwide estate of the decedent. However, in this case the United States will relinquish its primary jurisdiction and will allow a credit against the Federal estate tax for the Dutch death tax imposed on the same property, even where that property is located in the United States.

In the case of a Dutch citizen who was present in the United States, the above results on a reciprocal basis would be obtained.

In essence, the basic approach of the proposed convention is (1) to always allow the situs country primary tax jurisdiction with respect to the property it may tax under its situs jurisdiction, (2) to give the country of citizenship primary tax jurisdiction with respect to the rest

of the decedent's worldwide estate during the first 7 years the decedent is temporarily present in the other country, and (3) then to give the country of domicile primary tax jurisdiction where the decedent was domiciled in that country for more than 7 out of the 10 years prior to his death. This approach is designed to recognize that when a decedent has been domiciled for only a temporary period in a country, his ties with that country are not sufficient to justify the assertion of primary estate tax jurisdiction by that country, on the one hand, and to recognize, on the other hand, that where a decedent who is a citizen of one country has been domiciled in the other country for a substantial period of time, generally his closest ties will be with the country of domicile rather than the country of citizenship, thus making it appropriate to confer primary estate tax jurisdiction on the country of domicile and secondary jurisdiction on the country of citizenship.

A detailed analysis of the proposed convention on an article-by-article basis is presented below.

Article 1. Estates covered

The proposed convention provides that it will apply to estates of decedents who are domiciled in, or are citizens of, one or both of the countries at the time of their death. Thus, it will apply to decedents who are U.S. citizens or domiciliaries at the time of their death and will apply to decedents who at the time of death are domiciliaries of the Netherlands, or are citizens of the Netherlands who had been living outside of the Netherlands for less than 10 years. (Although the Netherlands does not impose its death taxes on the basis of citizenship, but rather imposes them on the basis of domicile, it treats Dutch citizens who have been nonresidents of the Netherlands for less than 10 years as domiciled in the Netherlands.)

The proposed convention does not treat U.S. possessions citizens who are residents of a possession as U.S. citizens or domiciliaries. Accordingly, the proposed convention will not apply to estates of these possessions citizens-residents, unless it is applicable by reason of the person being domiciled in the Netherlands.

Since the purpose of the proposed convention is to avoid double taxation of estates and to prevent fiscal evasion of death taxes, it is provided (in article I of the protocol) that the provisions of the proposed convention are not to affect property rights under laws relating to descent, distribution, succession, inheritance, or similar matters.

Article 2. Taxes covered

The proposed convention applies to the U.S. Federal estate tax which is imposed on the worldwide estates of decedents who are U.S. citizens or residents and on the U.S. estates of nonresident aliens. In the case of the Netherlands, it applies to the Dutch succession duty, which is imposed on the worldwide estates of decedents who are residents of the Netherlands, and the Dutch transfer duty, which is imposed on certain types of assets situated in the Netherlands of decedents who were nonresidents.

As is generally true in the case of our other estate tax treaties, the proposed convention does not apply to death taxes imposed by State or local governments. In addition, the proposed convention contains a provision similar to that generally found in other U.S. estate tax

treaties which provides that the convention will apply to any death taxes either country may subsequently impose in the form of taxes on estates or inheritances, transfer duties, and taxes on gifts in contemplation of death.

Article 3. General definitions

The standard definitions generally found in most existing U.S. estate tax treaties are contained in the proposed convention. Under the proposed convention, the Netherlands is defined to mean that part of the Netherlands situated in Europe and thus does not include either the Netherlands Antilles or Surinam.

The proposed convention also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the convention. In addition, it is further provided (in article II of the protocol) that where a term is defined in a different manner by the two countries, or where the definition of a term is not readily determinable under the laws of one or both of the countries, then the competent authorities of the two countries may establish a common meaning of the term in order to prevent double taxation or to further any other purpose of the proposed convention. Although a provision of this nature is not found in our other estate tax treaties, a similar provision is contained in the proposed income tax treaties with Belgium, Finland, and Trinidad and Tobago.

Article 4. Fiscal domicile

The concept of domicile is important for death tax purposes since it is one of the principal means employed by countries to assert jurisdiction over the worldwide estates of decedents. (The other principal basis used for this purpose is citizenship.) The tests employed, however, by countries to determine the domicile (i.e., residence for death tax purposes as the term is used in the proposed convention) of a decedent often are quite different. Under the Internal Revenue Code a decedent is considered a domiciliary of the United States for purposes of the Federal estate tax, if the person was residing in the United States and had the intent to remain in the United States indefinitely (or had been residing in the United States with such an intent and had subsequently left this country without an intent to remain indefinitely at his new place of residence). Under Dutch law, on the other hand, a decedent is considered to be domiciled in the Netherlands for purposes of Dutch death taxes, if the person had an habitual abode in the Netherlands even though he did not intend to remain there indefinitely.

Our existing estate tax treaties generally merely provide that each country is to determine the domicile of a decedent in accordance with the provisions of its own law. In cases where this results in both countries considering a decedent to have been a domiciliary, then both countries usually apply their death taxes on the worldwide estate of the decedent. To provide relief from double taxation in these cases, our existing conventions, rather than attempting to resolve the double domicile problem, provide for a prorated or split foreign tax credit; i.e., each country allows a credit for a portion of the other's tax. This means of granting relief from double taxation, however, has often proved inadequate. Accordingly, as previously indicated, the proposed convention provides a series of rules to resolve double domicile

problems, so that for purposes of applying the proposed convention a decedent will be considered as domiciled in only one of the countries. That country then will have the primary death tax jurisdiction with respect to the worldwide estate of the decedent, other than with respect to real property or business assets situated in the other country. In essence, these rules of the proposed convention are based on the concept that primary death tax jurisdiction should be exercised only by the country of true domicile and not by the country of mere presence or residence or citizenship where the decedent has been domiciled in the other country for a substantial period of time prior to death and in all likelihood, has his most significant ties with that country.

In determining the domicile of a decedent under the proposed convention, each country will first determine whether it would consider the decedent to be a domiciliary under its own laws. In this regard, it is provided (in article V of the protocol) that the Netherlands will not assert its 10-year rule with regard to Dutch citizens who were living in the United States for less than 10 years prior to their death and who intended to indefinitely remain in the United States. Thus, in these cases the Netherlands will not consider a decedent to be a Dutch domiciliary, and, accordingly, the decedent will be considered under the convention to have been domiciled in the United States. Although the Netherlands would still assert its death tax with respect to the worldwide estate of the decedent on the basis of his Dutch citizenship, this would be a secondary tax jurisdiction after 7 years of domicile in the United States and thus the Netherlands would allow a tax credit for the U.S. death taxes.

If after the application of the provisions of the internal laws of each country, a decedent is considered to be domiciled in both countries, the proposed convention provides a series of rules by which an exclusive domicile for the decedent will be determined; in other words, by which the double domicile problem will be resolved. The principal rule is the 7-out-of-10-year rule. Under this rule a decedent who is a citizen of only one of the countries will be considered domiciled in the country of citizenship, if he was domiciled in the other country for less than 7 out of the 10 years prior to his death and if he was in the other country without a clear intent to indefinitely remain there for business, professional, education, training, tourism, or similar purposes (or was a spouse or a dependent of a person in that country for one of these purposes). A decedent will not be considered to have had a clear intent to indefinitely remain in the other country unless all the evidence considered together is clear and convincing to the contrary.

In essence, the 7-out-of-10 year rule gives the country of citizenship the primary death tax jurisdiction with respect to the decedent's worldwide estate (other than real property or business assets of a permanent establishment situated in the other country) during the first 7 years he is domiciled in the other country. As is subsequently discussed, after a decedent has been domiciled in the other country for more than 7 years, the country of citizenship gives up its primary jurisdiction and instead will have a secondary death tax jurisdiction. In this case, the country of citizenship may assert its death tax on

the worldwide estate of the decedent, but it generally must allow a full credit for the death tax imposed by the country of domicile.

In the case of U.S. citizens who are temporarily employed in the Netherlands or who are temporarily there for one of the other specified reasons, the effect of this provision will be to exempt their estate, other than real property or business assets situated in the Netherlands, from Dutch death taxes.

Since the Internal Revenue Code embodies a relatively restricted definition of domicile, generally most Dutch citizens temporarily present in the United States who will be considered as Dutch, rather than United States, domiciliaries under the proposed convention also would be so considered under U.S. law.

It is contemplated that the 7-out-of-10-year rule will resolve the great majority of double domicile situations. In cases where a double domicile problem still remains after application of that rule, the proposed convention further provides that a decedent will be deemed to be domiciled in the country in which he had his permanent home for at least 5 years immediately prior to death (under article III of the protocol, the decedent may only have one permanent home for this purpose), in the country with which his personal relations were closest, or in his country of citizenship. In cases where a decedent's domicile cannot be determined by these tests, applied in the order stated, and he is a citizen of both countries or of neither country, then the competent authorities of the countries are to settle the question by mutual agreement.

In this regard, it is provided (article VI of the protocol) that it is intended for all questions of double domicile to be resolved under the convention, and, accordingly, the competent authorities must resolve any double domicile questions which are presented within the time provided under the convention for filing tax refund or credit claims, which generally is from 5 to 11 years after the decedent's death. The type of cases covered by this second set of rules, in addition to dual or third country citizenship, include the situation where a citizen of one country was domiciled in the other country for more than 7 out of 10 years but did not intend to remain there indefinitely.

Article 5. Application of domestic laws

The proposed convention follows the approach of our existing estate tax treaties and provides that each country is to apply its domestic death tax laws except as otherwise provided in the proposed convention. The principal effect of this provision is that each country will apply its own laws in determining the manner in which a decedent's debts are to be allocated among the various assets of his estate.

The allocation of debts is relevant in determining the value of a decedent's property which is considered subject to death tax in a country where that country asserts a situs jurisdiction (i.e., where it taxes the property of the decedent solely on the basis that it was situated in that country). It is also relevant where a country asserts worldwide jurisdiction with respect to a decedent's estate in determining the amount of the estate which is considered situated outside of that country for purposes of determining the allowable credit for foreign death taxes. Under Dutch law, debts which relate to real property or business property are allocated solely to the property to

which they relate. On the other hand, under the Internal Revenue Code a decedent's debts are allocated on a pro rata basis to all of the assets in his estate.

Insofar as it relates to the allocation of deductions, the proposed convention modifies the above general rule in the situation where a country allocates deductions on the basis of the situs of property to insure that there is proper allocation of deductions in two situations: (1) the determination of the net amount of a decedent's estate which is taxable in a country; and (2) the amount of the foreign tax credit a country will allow for death taxes imposed by the other country. First, it, in effect, is provided that in determining the amount of deductions to be allocated to a country (which accordingly will serve to reduce the net amount of the decedent's taxable estate in that country), property which that country may not tax under the terms of the proposed convention is not to be taken into account. In the absence of this rule, property which a country could tax under its domestic law, but not under the proposed convention, could be taken into account in determining the amount of deductions to be allocated to that country and thus would result in the allocation to that country of a disproportionately large amount of the deductions. In other words, it is not proper to allocate deductions to a country on the basis of property located in that country which it is prevented from taxing. Second, it is provided that in allocating deductions for purposes of determining the amount of a foreign death tax credit one country will allow for death taxes imposed by the other country, deductions are not to be allocated to property in the country, unless a credit is allowable under the terms of the proposed convention for the taxes imposed by the other country with respect to the property.

The proposed convention also preserves the existing reporting and recordkeeping requirements with respect to estates of persons which are taxable under the domestic law of a country but are exempt from that country's tax under the proposed convention. In effect, it is provided that the reporting and recordkeeping requirements of each country, and the sanctions imposed on failures to comply with these requirements (which often are imposed with reference to the amount of underpayment of tax), are to be applied without regard to the exemptions from tax provided by the proposed convention. Either country, however, may by regulations waive any of these requirements or sanctions if they are found to be unnecessary to prevent fraud or fiscal evasion.

The proposed convention also contains a provision somewhat similar to that found in our other estate tax treaties which provides that the convention is not to have the effect of extending a country's jurisdiction to tax over that provided in its domestic law or of otherwise increasing the amount of death taxes imposed by a country (other than an increase which results from a reduction of the other country's tax under the proposed convention for which a credit is allowable).

Article 6. Immovable property

Under the proposed convention, a country may tax only that part of the estate of the decedent, who was neither a citizen nor a domi-

ciliary of that country, which consists of immovable property (basically real property) situated in that country, and business assets attributable to a permanent establishment (or fixed base) of the decedent in that country (which are dealt with in article 7).

Under the proposed convention, the determination of whether an item of property is immovable property is to be be made under the laws of the country in which the property is located. Although U.S. law does not define "immovable property," that term for U.S. purposes is to be considered to mean real property. It is further provided that immovable property does not include any security interests or ships or aircraft.

Article 7. Business property of a permanent establishment and assets pertaining to a fixed base used for the performance of professional services

The second type of property of a nonresident alien which a country may tax under the proposed convention consists of business assets of a permanent establishment of the decedent located in that country (other than ships and aircraft operated in international traffic and related movable property) and assets (other than immovable property) pertaining to a fixed base of the decedent situated in that country and used for the performance of professional services or other similar independent activities. As subsequently discussed (article 9), a country may not tax stock which a nonresident alien owns in a corporation of that country. Accordingly, the situs country jurisdiction allowed by this provision of the proposed convention is of limited significance, since a nonresident alien may carry on his business activities in the situs country through a domestic corporation, rather than a permanent establishment, and thereby not be subject to situs country death taxes on the business assets because the situs country may not impose its death tax on his stock in the domestic corporation.

The proposed convention contains a definition of the term "permanent establishment" which is similar to the modern definition found in recent U.S. income tax treaties. Generally, any fixed place of business through which a decedent engaged in a trade or business is considered a permanent establishment. For this purpose, a decedent is considered engaged in a trade or business regardless of whether the business is carried on as a sole proprietorship or through a partnership or unincorporated association. In the case of a partnership or association, however, only the decedent's interest in the business entity will be taken into account for purposes of this provision.

A fixed place of business includes an office, factory, sales outlet, and any building site or construction, or assembly project which exists for more than 12 months. This general rule is modified by providing that a fixed place of business which is used for all or a number of specified activities will not be considered a permanent establishment. These activities include the warehousing of goods for purposes of storage, display, delivery, or processing by another person.

An additional activity included within this exempt category is the maintenance of a fixed place of business (by a person other than a dealer) for the purpose of investing or trading in stocks, securities, or commodities for the decedent's own account, whether directly or through a broker or an agent. The Internal Revenue Code contains a similar jurisdictional rule for purposes of determining whether a

nonresident alien is considered engaged in business in the United States so as to be subject to U.S. income tax.

The proposed convention also provides that a decedent will be deemed to have a permanent establishment in a country if he had an agent in that country who had and habitually exercised a general contracting authority (other than for the purchase of goods or merchandise) in that country. This agency rule does not apply, however, if the agent is a broker, general commission agent, or any other agent of an independent status, provided the agent is acting in the ordinary course of his business.

Articles 8 and 9. Taxation on the basis of domicile and citizenship

Under the proposed convention, only the country of the decedent's domicile or citizenship at death may impose its death tax on the property of the decedent, except for real property, or business assets of a permanent establishment (or fixed base), situated in the other country which also may be taxed by that other country. In other words, if a decedent is neither a citizen nor a resident of a country, then that country may not impose its death tax on his property (or take that property into account in determining the rate of its tax), unless the property is real property or business assets of a permanent establishment (or fixed base) situated in that country. The principal effect of this provision is to exempt from a country's death taxes property of a nonresident alien of that country such as stocks, bonds, art objects, jewelry, and life insurance proceeds.

The exemption provided in this regard from the U.S. estate tax for stock of a U.S. corporation which is owned by a nonresident alien, who is a Dutch domiciliary or citizen, is not found in our other estate tax treaties or in the Internal Revenue Code. This exemption, however, will remove whatever impediments the existence of our estate tax imposes to investments by Dutch persons in the United States and thereby should help our balance-of-payments position. At the same time, this provision will not have the effect of totally exempting these assets from death taxation, inasmuch as the Netherlands imposes its death tax on domiciliaries at effective rates which are comparable to those in the United States, and thus property which is exempted from the U.S. estate tax under this provision will be subject to the comparable Dutch tax burden.

In the case where a decedent is domiciled in one country and is a citizen of the other country, both countries may impose their death taxes with respect to the worldwide estate of the decedent. Thus, both the United States and the Netherlands may impose their death taxes on the worldwide estates of their citizens. Where, however, the decedent is not considered domiciled under the proposed convention in his country of citizenship because he was domiciled in the other country for 7 or more of the 10 years prior to his death, the tax jurisdiction allowed that country under the proposed convention generally is a secondary jurisdiction. In other words, although that country may assert its death tax with respect to the worldwide estate of the decedent, it generally must give a credit against that tax for the death taxes imposed by the country of domicile.

Article 10. Exemptions

Under the proposed convention, the Netherlands will allow a U.S. citizen or domiciliary (who is not also a Dutch citizen or domiciliary) a marital deduction which is somewhat similar to the marital deduction allowed U.S. citizens and residents under the Internal Revenue Code. In this type of case, the Netherland's tax jurisdiction extends only to real property, or business assets of a permanent establishment (or fixed base), of the decedent which is situated in the Netherlands.

It is provided that if this property (other than community property) passes to the decedent's surviving spouse, the Netherlands will allow a deduction from the value of the decedent's estate subject to Dutch death taxes for the amount of the property passing to the spouse. The amount of the deduction, however, will be limited to 50 percent of the value of the decedent's property subject to tax in the Netherlands (determined after allowance of any applicable deductions, but before taking into account the $30,000 exemption provided by the proposed convention).

If the United States changes its estate tax laws in such a manner as to make the treatment of nonresident aliens in relation to the treatment of U.S. citizens and domiciliaries substantially less favorable than it is at the present time, the Netherlands will cease to allow this marital deduction. It is understood that the Netherlands was willing to grant this marital deduction in view of the relatively favorable treatment provided by the United States pursuant to the Foreign Investors Tax Act of 1966 to estates of nonresident aliens. Accordingly, if that treatment should become substantially less favorable, the Netherlands is not willing to continue the allowance of the marital deduction.

To relieve small estates of situs country taxation, the proposed convention provides that where a country may tax real property or business property of a nonresident alien solely by reason of the property's situs in that country, it will exempt the property from its death tax if the value of the property (after reduction by the applicable deductions and the marital deduction) does not exceed $30,000. If the value of the property does exceed $30,000, the exemption, in effect, is phased out. It is provided that the tax imposed by the situs country in this case is to be the smaller of the amount of tax determinated under its law and the proposed treaty or 50 percent of the value of the property in excess of $30,000.

In view of the 6 percent tax rate which the Netherlands imposes on property of nonresident aliens, the effect of this provision in the case of estates of U.S. citizens or domiciliaries (who are not also citizens or domiciliaries of the Netherlands) is to exempt the assets of the estate located in the Netherlands from Dutch death tax, if the taxable value of the assets is $30,000 or less, and to reduce the amount of Dutch death tax imposed on these assets where their value is between $30,000 and $34,000. This provision will not affect U.S. estate taxation of Dutch citizens or residents since the Internal Revenue Code presently allows the estates of nonresident aliens a $30,000 exemption.

Article 11. Credits

The proposed convention provides a series of rules to determine the amount of tax credits which will be allowed by each country in cases where a decedent's property is taxed by both countries. These

provisions constitute rules for determining the priority of the countries' rights to tax property of decedents in the sense that the country which grants a credit for the other country's tax, in effect, is exercising a secondary, rather than a primary, taxing jurisdiction. These credit rules, in conjunction with the limitations imposed by the proposed convention on situs country taxation and on the ability of a country to tax the worldwide estate of a decedent, constitute the approach employed by the proposed convention to avoid double taxation where both countries tax a decedent's property.

In general, the proposed convention provides for three types of credits: First, a credit against the tax of the country of domicile or citizenship for taxes imposed by the other country on property situated there; second, in the case of a citizen of both countries or a citizen of one who was domiciled in the other for 7 or more of the 10 years prior to death, the allowance by the nondomiciliary country of an additional credit for taxes imposed by the country of domicile re both countries tax the worldwide estate of a decedent; and finally, the allowance by each country of a prorated credit for a portion of the other country's tax in cases not covered by the first two credit rules. The principal case falling within the third credit rule is that of a citizen of one country who was permanently living in the other country for a period of less than 7 years. Existing U.S. estate tax treaties generally only contain a credit provision similar to the first and third types described above.

Under the proposed convention, the first credit rule provides that the country in which a decedent was domiciled, or of which he was a citizen, will allow a credit for the taxes imposed by the other country on real property and business property of a permanent establishment (or fixed base) of the decedent situated in that other country. The country of domicile or citizenship will allow this credit whether the other country imposes its tax on the basis of situs jurisdiction or imposes it on the worldwide estate of the decedent on the basis of his citizenship or domicile in that country. In many cases, this credit rule in conjunction with the 7-out-of-10-year domicile rule will serve to eliminate double taxation. This is because a citizen of one country who is temporarily in the other country for less than 7 years, on the one hand, generally, will not be considered domiciled in that other country and thus his estate will not be subject to death taxes in that country other than with respect to real property or business assets and, on the other hand, his estate will be allowed a credit by the country of citizenship for the taxes imposed by the other country on the real property or business property situated there.

In cases where both countries tax the estate of a decedent on a worldwide basis because the decedent was a citizen of both countries or a citizen of one and a domiciliary of the other for 7 or more of the 10 years prior to his death, the second credit rule of the proposed convention provides for the allowance of an additional tax credit by the country in which the decedent was not domiciled. In the case where the decedent was a citizen of only one of the countries at his death and had been domiciled for more than 7 out of the 10 years prior to his death in the other country, the country of citizenship will allow a credit for the tax imposed by the other country (i.e., the country of domicile). If the decedent was a citizen of both

countries at his death, then the country in which he was not domiciled will allow a credit for the tax imposed by the country of domicile.

Under these credit rules, the nondomiciliary country yields priority of taxation of the decedent's estate to the domiciliary country. In the first situation, the nondomiciliary country which is the country of citizenship, in effect, yields priority of taxation to the country of domicile in view of the fact that during the first 7 years of the decedent's domicile in the other country, the country of citizenship has priority of taxation (since during that period it is considered the country of domicile under the proposed convention).

The third credit rule provides that in other cases where both countries tax the worldwide estate of a decedent, they are to allow a split or prorated credit; namely, each country will allow a credit with respect to property taxed by both countries equal to that percentage of its tax on the property (or the other country's tax on the same property, if smaller) which the amount of that country's tax is of the combined tax of both countries. Generally, this credit rule will have principal application in the case of a citizen of one country who had been permanently living in the other country for less than 7 years at the time of his death.

Under the proposed convention, the total amount of credits which one country will allow under the convention and under its laws or other treaties is limited to that portion of its tax which is attributable to all property for which a credit is allowable under the convention. In determining this limitation, properties are not to be considered on an individual basis, but rather are to be aggregated. This limitation does not apply to the split credit since that credit has a built-in limitation.

As is the case under our existing estate tax treaties, the proposed convention further provides that credits allowed by a country against its tax other than pursuant to the convention are to be subtracted from the gross tax imposed by that country in order to determine the tax imposed by it which is creditable against the other country's tax or against which the other country's tax may be credited.

A credit will not be finally allowed under the proposed convention until the tax for which the credit is claimed has been paid. In addition, any credit allowed under the proposed convention is to be in lieu of credits allowed by the domestic laws of each country with respect to taxes of the other country.

Article 12. Limitation on claims for credit or refund

Under the Internal Revenue Code, a claim for credit or refund of Federal estate taxes generally must be made within 4 years and 3 months after the date of the decedent's death (or 5 years and 3 months from the date of death where the claim is based on the allowance of a credit for foreign death taxes). The proposed convention provides a period of limitation during which claims for credit or refund of taxes based on the provisions of the convention may be made, which in some cases will be somewhat longer than that allowed by the Internal Revenue Code. It is provided that a claim for credit or refund of taxes based on the provisions of the convention must be made before the expiration of the latest of (1) the period of limitations prescribed under the domestic law of the country to which the claim is made, (2) 5 years from the decedent's death, or (3) 1 year

after final determination and payment of a tax for which a credit is claimed under the convention (provided these events occur within 10 years from the decedent's death).

The proposed convention follows the approach of other U.S. estate tax treaties and provides that any refund made pursuant to the convention is to be made without interest.

Article 13 and 14. Administrative provisions

The proposed convention contains various administrative provisions which are generally found in other U.S. tax treaties. In general, the proposed convention provides—

(1) For consultation and negotiation between the countries to resolve differences arising in the interpretation or application of the proposed convention and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the proposed convention; and

(2) For the exchange between the countries of legal information and of information pertinent to carrying out the provisions of the proposed convention, or the tax laws of one of the countries insofar as its taxation is in accordance with the proposed convention, or to preventing fraud or fiscal evasion with respect to the taxes covered by the proposed convention.

Article VIII of the protocol sets forth the understanding that the Netherlands cannot disclose information obtained from banks and certain similar institutions, including insurance companies, since this information is treated as confidential under Dutch law. The Netherlands will disclose information, however, where the bank or institution is the executor or administrator of the decedent's estate.

Article 15. Diplomatic and consular officials

The proposed convention provides that its provisions are not to affect the fiscal privileges which diplomatic and consular officials and officials of international organizations enjoy under the general rules of international law or the provisions of special agreements. It is further provided that the right to tax these persons will be reserved to the country for whom they perform their functions (or the country of citizenship in the case of international officials) and that these officials are not to be considered domiciled in the country where they were employed (the receiving country). This provision is designed to prevent diplomatic and consular officials of a third country from claiming domicile in either the United States or the Netherlands so as to bring themselves within the provisions of the convention.

Article 16. Entry into force

The proposed convention will enter into force upon the date the instruments of ratification are exchanged and will apply to estates of persons dying on or after that date.

Article 17. Territorial extension

The proposed convention contains a method similar to that found in some of our other tax treaties by which the convention may be extended to Surinam or the Netherland Antilles, or to any areas not otherwise covered by the proposed convention for whose international relations the United States is responsible, if the country or area imposes taxes substantially similar to those covered by the convention.

The convention may be extended pursuant to this provision either in its entirety or with the necessary modifications. The exchange is to be effected by an exchange of notes through diplomatic channels which then must be ratified.

Article 18. Termination

The proposed convention will continue in force indefinitely but either country may terminate it as of the close of any calendar year which ends at least 5 years after the convention enters into force.

Protocol

All but one of the provisions of the protocol to the proposed convention have been discussed in connection with the provisions of the convention to which they relate. The remaining provision, article IX of the protocol, provides that if either country changes its laws with the result that there is a substantial alteration of the effects of the proposed convention, the countries are to consult together with a view to making appropriate modifications in the proposed convention, if one of the countries requests consultations.

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