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EXPLANATION OF PROPOSED INCOME TAX TREATY BETWEEN THE UNITED STATES AND THE PEOPLES' REPUBLIC OF BANGLADESH

PREPARED FOR THE USE OF THE

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INTRODUCTION

This pamphlet provides an explanation of the proposed income tax treaty between the United States and the Peoples' Republic of Bangladesh ("Bangladesh"). The proposed treaty was signed on October 6, 1980, and was amplified by an Exchange of Notes signed the same day. No similar treaty between the two countries is in force at the present time. The proposed treaty has been scheduled for a public hearing on September 24, 1981, by the Senate Committee on Foreign Relations.

The proposed treaty is similar to other recent U.S. income tax treaties, the U.S. model income tax treaty, and the model income tax treaty of the Organization of Economic Cooperation and Development (OECD). However, there are certain deviations from the model to reflect Bangladesh's status as a developing country, and the United Nation's model tax treaty between developed and developing countries.

The first part of the pamphlet is a summary of the principal provisions of the proposed tax treaty. The second part provides an overview of U.S. tax rules relating to international trade and investment and U.S. tax treaties in general. This is followed by a detailed, article-by-article explanation of the treaty.

I. SUMMARY

In General

The principal purpose of the proposed income tax treaty between the United States and Bangladesh is to reduce or eliminate double taxation of income earned by citizens and residents of either country from sources within the other country and to prevent avoidance or evasion of the income taxes of the two countries. The proposed treaty is intended to promote closer economic cooperation between the two countries and to eliminate possible barriers to trade caused by overlapping taxing jurisdictions of the two countries. It is also intended to enable the countries to cooperate in preventing avoidance and evasion of taxes.

As in other U.S. tax treaties, these objectives are principally achieved by each country agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other country. For example, the treaty contains the standard tax treaty provision that neither country will tax the business income derived from sources within that country by residents of the other unless the business activities in the taxing country are substantial enough to constitute a permanent establishment or fixed base (Articles 7 or 14). Similarly, the treaty contains the standard "commercial visitor" exemptions under which residents of one country performing personal services will not be required to file tax returns and pay tax in the other unless their contacts with the other exceed certain specified minimums (Articles 14, 15, and 17). Also, the proposed treaty provides that dividends, interest, royalties, capital gains and certain other income derived by residents of either country from sources within the other generally may be taxed by both countries (Articles 10, 11, 12, 13, and 21). Generally, however, dividends, interest, and royalties received by residents of one country from sources within the other are to be taxed at a reduced rate (Articles 10, 11, and 12), and capital gains are to be taxed on a restricted basis (Article 13).

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the treaty generally provides for the relief by the country of residence of the potential double taxation (Article 22) through a foreign tax credit.

The treaty contains the standard provision (the "saving clause") contained in U.S. tax treaties that each country retains the right to tax its citizens and residents as if the treaty had not come into effect (Article 1). In addition, it contains the standard provision that the treaty will not be applied to deny any taxpayer any benefits he would be entitled to under the domestic law of either country or under any other agreement between the two countries (Article 26); that is, the treaty will only be applied to the benefit of taxpayers.

The treaty differs from most U.S. treaties by defining a resident to include a U.S. citizen who is not a resident in the United States. This extends coverage to U.S. citizens residing outside the United States.

The treaty also contains standard nondiscrimination provisions and provides for exchanges of information and administrative cooperation between the tax authorities of the two countries to avoid double taxation and prevent fiscal evasion with respect to income taxes.

Specific Issues

The proposed treaty presents the following specific issues:

(1) The proposed treaty exempts international airline income from tax. It does not, however, exempt shipping income. The U.S. model, and most U.S. treaties, contain a source exemption for both aircraft and shipping. The issue is whether the United States wants to establish the precedent of a treaty without a shipping exemption.

(2) The treaty provides developing country type concessions in that less substantial restrictions are imposed on source basis taxation than are typically provided for in U.S. tax treaties. For example, a permanent establishment is considered to exist where a building project, etc., lasts for more than 183 days as opposed to the 12-months in the current draft U.S. model. Also, the rates of tax on investment income are somewhat higher than provided for in the U.S. model. The issue is whether these concessions to source basis taxation are appropriate for less developed countries, and if so, whether Bangladesh is an appropriate recipient.

(3) The proposed treaty also raises the issue of the expansion of our treaty network to jurisdictions with which the United States has only minimal economic contacts.

II. OVERVIEW OF UNITED STATES TAXATION OF INTERNATIONAL TRADE AND INVESTMENT AND TAX TREATIES

A. United States Tax Rules

The United States taxes U.S. citizens and residents and U.S. corporations on their worldwide income. The United States taxes nonresident alien individuals and foreign corporations on their U.S. source income which is not effectively connected with the conduct of a trade or business in the United States (sometimes referred to as "noneffectively connected income") and on their U.S. source income and certain limited classes of foreign source income which is effectively connected with the conduct of a trade or business in the United States (sometimes referred to as "effectively connected income.")

Income which is effectively connected with the conduct of a trade or business in the United States is subject to tax at the normal graduated rates on the basis of net taxable income. Deductions are allowed in computing effectively connected taxable income, but only if and to the extent they are connected with income which is effectively connected.

United States source fixed or determinable, annual or periodical income (e.g. interest, dividends, rents, salaries, wages, premiums, annuities) which is noneffectively connected income and which is received by a nonresident alien or foreign corporation is subject to tax at a rate of 30 percent of the gross amount paid. This gross tax on fixed or determinable income is often reduced or eliminated in the case of payments to residents of countries with which the United States has an income tax treaty.

Net U.S. source capital gains are also subject to the 30 percent tax but only in the case of a nonresident alien who is present in the United States for at least 183 days during the taxable year. Otherwise foreign corporations and nonresident aliens are only subject to U.S. taxation (at the graduated rates) on those capital gains that are effectively connected with the conduct of a trade or business in the United States.

Prior to June 18, 1980, noneffectively connected capital gains from the sale of U.S. real estate were subject to U.S. taxation only if received by a nonresident alien who was present in the United States for at least 183 days. However, in the Omnibus Reconciliation Act of 1980, a provision was added to the Internal Revenue Code which provided that the sale, exchange or disposition of U.S. real estate by a foreign corporation or a nonresident alien would be taxed as effectively connected income.

Certain exemptions from the gross tax are provided. Bank account interest is defined as foreign source interest and, therefore, is exempt. Exemptions are also provided for certain original issue discount and for income of a foreign government from investments in U.S. securities. Our treaties also provide for exemption from tax in certain cases.

The source of income received by nonresident aliens and foreign corporations is determined under special rules contained in the Internal Revenue Code. Under these rules interest and dividends paid by a U.S. citizen or resident or by a U.S. corporation are considered U.S. source income. However, if the U.S. corporation derives more than 80 percent of its gross income from foreign sources, then dividends and interest paid by such corporation will be foreign source rather than U.S. source. Conversely, dividends and interest paid by a foreign corporation, which has at least 50 percent of its income as effectively connected income, are U.S. source to the extent of the ratio of its effectively connected income to total income.

Rents and royalties paid for the use of property in the United States is considered U.S. source income. The property used can be either tangible property or intangible property (e.g., patents, secret processes and formulas, franchises and other like property).

The 30-percent (or lower treaty rate) tax imposed on U.S. source noneffectively connected income paid to foreign persons is collected by means of withholding (hence they are often called withholding taxes).

Since the United States taxes U.S. persons on their worldwide income, double taxation of income can arise because income earned abroad by a U.S. person will be taxed by the country in which the income is earned and also by the United States. The United States seeks to mitigate this double taxation by allowing U.S. taxpayers to credit their foreign income taxes against the U.S. tax imposed on their foreign source income. A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax on U.S. source income. Therefore, the foreign tax credit provisions contain a limitation that insures that the foreign tax credit only offset the U.S. tax on foreign source income. This limitation is computed on a worldwide consolidated basis. Hence, all income taxes paid to all foreign countries are combined to offset U.S. taxes on all foreign income.

A U.S. corporation that owns 10 percent or more of the stock of a foreign corporation may credit foreign income taxes paid or deemed paid by that corporation on earnings that are received as dividends. These deemed paid taxes are included in total foreign taxes paid for the year the dividend is received and go into the general pool of taxes to be credited.

Separate limitations on the foreign tax credit are provided for certain interest, DISC dividends, and oil income.

B. United States Tax Treaties—In General

The traditional objectives of U.S. tax treaties have been the avoidance of international double taxation and the prevention of tax avoidance and evasion. To a large extent, the treaty provisions designed to carry out these objectives supplement Code provisions having the same objectives, modifying the generally applicable statutory rules with provisions which take into account the particular tax system of the treaty country. Given the diversity of tax systems in the world, it would be virtually impossible to develop in the Code rules which unilaterally would achieve these objectives for all countries.

Notwithstanding the unilateral relief measures of the United States and our treaty partners, double taxation might arise because of differences in source rules between the United States and the other country. Likewise, if both countries consider the same deduction allocable to foreign sources, double taxation can result. Significant problems arise in the determination of whether a foreign tax qualifies for the U.S. foreign tax credit. Also, double taxation may arise in those limited situations where a corporation or individual may be treated as a resident of both countries and be taxed on a worldwide basis by both.

In addition, there may be significant problems involving "excess" taxation—situations where either country taxes income received by nonresidents at rates which exceed the rates imposed on residents. This is most likely to occur in the case of income taxed at a flat rate on a gross income basis. (Most countries, like the United States, generally tax domestic source income on a gross income basis when it is received by nonresidents who are not engaged in business in the country.) In many situations the gross income tax is imposed at a rate which exceeds the tax which would have been paid under the net income tax system applicable to residents.

Another related objective of U.S. tax treaties is the removal of barriers to trade, capital flows, and commercial travel caused by overlapping tax jurisdictions and the burdens of complying with the tax laws of a jurisdiction where the contacts with, and income derived from, that juridiction are minimal.

The objective of limiting double taxation is generally accomplished in treaties by the agreement of each country to limit, in certain specified situations, its right to tax income earned from its territory by residents of the other country. For the most part, the various rate reductions and exemptions by the source country provided in the treaties are premised on the assumption that the country of residence will tax the income in any event at levels comparable to those imposed by the source country on its residents. The treaties also provide for the elimination of double taxation by requiring the residence country to allow a credit for taxes which the source country retains the right to impose under the treaty. In some cases, the treaties may provide for exemption by the residence country of income taxed by the source country pursuant to the treaty.

Treaties first seek to eliminate double taxation by defining the term "resident" so that an individual or corporation generally will not be subject to tax as a resident by both of the contracting countries. The treaty also provides that neither country will tax business income derived from sources within it by residents of the other country unless the business activities in the taxing jurisdiction are substantial enough to constitute a branch or other permanent establishment or fixed base. The treaties contain commercial visitation exemptions under which individual residents of one country performing personal services in the other will not be required to file tax returns and pay tax in that other country unless their contacts exceed certain specified minimums, normally presence for a set number of days or earnings of over a certain fixed dollar amount.

Treaties deal with passive income such as dividends, interest, or royalties, or capital gains, from sources within one country derived by residents of the other country by either providing that they are taxed only in the country of residence or by providing that the withholding tax generally imposed on those payments is reduced. As described above, the United States generally imposes a 30 percent tax and seeks to reduce this tax, in some cases to zero, in its tax treaties.

In its treaties, the United States, as a matter of policy, retains the right to tax its citizens and residents on their worldwide income as if the treaty had not come into effect, and provides this in the treaties in the so-called "saving clause." Double taxation can therefore still arise. Double taxation can also still arise because most countries will not exempt passive income from tax at source.

This double taxation is mitigated under the treaty either by granting a credit for income taxes paid to the other country, or, in the case of some of our treaty partners, by providing that income will be exempt from tax in the country of residence. The United States provides in its treaties that it will allow a credit against U.S. tax for income taxes paid to the treaty partners, subject to the limitations of U.S. law. An important function of the treaty is to define the taxes that will be considered creditable income taxes for purposes of the treaty.

The treaties also provide for administrative cooperation between the countries. This cooperation includes a competent authority mechanism to resolve double taxation problems arising in individual cases, or more generally, by consultation between tax officials of the two governments.

Administrative cooperation also includes provision for an exchange of tax-related information to help the United States and its treaty partners administer their tax laws. The treaties generally provide for the exchange of information between the tax authorities of the two countries where such information is necessary for carrying out the provisions of the treaty or of their domestic tax laws. The obligation to exchange information under the treaties typically does not require either country to carry out measures contrary to its laws or administrative practices or to supply information not obtainable under its laws or in the normal course of its administration, or to supply information which would disclose trade secrets or other information the disclosure of which would be contrary to public policy.

The provisions generally result in an exchange of routine information, such as the names of U.S. residents receiving investment income. The IRS (and the treaty partner's tax authorities) also can request specific tax information from a treaty partner. This can include information to be used in a criminal investigation or prosecution.

III. EXPLANATION OF PROPOSED TAX TREATY

A detailed, article-by-article explanation of the proposed income tax treaty between the United States and Bangladesh is presented below.

Article 1. Personal Scope

The proposed treaty applies generally to residents of the United States and to residents of Bangladesh, with specific exceptions designated in other articles. This follows other U.S. income tax treaties, the U.S. model income tax treaty, and the OECD model income tax treaty.

The proposed treaty contains the "saving clause" contained in all U.S. income tax treaties which provides, with specified exceptions, that the treaty is not to affect the taxation by the United States of its citizens and residents or the taxation by Bangladesh of its citizens and residents. Consequently, unless otherwise specifically provided in the proposed treaty, the United States will continue to tax its citizens who are residents of Bangladesh. Residents for purposes of the treaty (and thus for purposes of the saving clause) include corporations and other entities as well as individuals (Article 4) (Fiscal Domicile).

Under section 877,[1] a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of U.S. income tax, will, in certain cases, be subject to tax for a period of ten years following the loss of citizenship. The treaty contains the standard provision found in the U.S. model, and most recent treaties, specifically retaining the right to tax former citizens. The Internal Revenue Service has taken the position that the result is the same even under treaties that do not contain this provision. Rev. Rul. 79–152, 1979–1c, B. 237.

Exceptions to the saving clause are provided for the benefits conferred by the articles dealing with social security payments, public pensions and alimony (paragraphs 1(b) and (3) of Article 18), relief from double taxation (Article 22), nondiscrimination (Article 23) and mutual agreement procedures (Article 24). Thus, the benefits of those articles will be conferred by each country on its own citizens and residents as well as the citizens and residents of the other country. In addition, the benefits conferred by the articles dealing with the taxation of income received by government employees (Article 19), teachers, students and trainees (Article 20), and diplomatic and consular officials (Article 26) are to be granted by each country to its residents provided those residents are neither citizens of, nor have immigrant status in that country.

Consequently, except for the exceptions to the saving clause set forth above, U.S. citizens and residents generally benefit under the treaty as

[1] All section references are to the Internal Revenue Code of 1954, unless otherwise cited.

the result of the agreement by Bangladesh to reduce its rate of tax on their income or exempt their income from tax rather than as the result of reductions in tax or exemptions by the United States. Even in this situation, if the tax which is foregone by Bangladesh could have otherwise been claimed in full by the U.S. taxpayers as a foreign tax credit, the real beneficiary of the reduction or elimination of the Bangladesh tax would, as a practical matter, be the U.S. Treasury rather than the U.S. taxpayer. Similarly, except as noted above, Bangladesh citizens and residents benefit under the treaty only to the extent that the United States agrees to reduce its tax on their income or to exempt their income from tax.

Article 2. Taxes Covered

The proposed treaty applies to taxes on income which are imposed by either country. In the case of the United States the proposed treaty applies to the Federal income taxes imposed under the Internal Revenue Code and to the excise taxes imposed on insurance premiums paid to foreign insurers (section 4371) but only to the extent that the relevant risk is not reinsured, directly or indirectly, with a person not entitled to relief from such tax. However, the taxes covered by the treaty do not include the U.S. accumulated earnings tax or the U.S. personal holding company tax. (The effect of covering the insurance premium excise tax is described in the discussion of Article 7) (Business Profits).

In the case of Bangladesh, the treaty applies to the income tax and the super tax. Under Article 22(1) (Relief From Double Taxation), these taxes are designated as income taxes for purposes of the U.S. foreign tax credit.

The proposed treaty also contains a provision generally found in U.S. income tax treaties to the effect that it will apply to substantially similar taxes which either country may subsequently impose. Each country is obligated under the treaty to notify the other of any changes it makes in its tax laws and of any official published material concerning the treaty, including explanations, regulations, rulings, and judicial determinations.

Additionally, the nondiscrimination provisions (Article 23) of the treaty apply to all taxes of every kind imposed at the national, state, or local level by the United States or Bangladesh.

Article 3. General Definitions

Certain of the standard definitions found in most U.S. income tax treaties are contained in the proposed treaty.

Under the proposed treaty, the term "United States" means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam or any other possession of territory of the United States. Accordingly, income from sources within those jurisdictions is not covered. The term "Bangladesh" means the Peoples' Republic of Bangladesh.

Most recent treaties specifically define the United States and the other country as including their respective territorial sea and in certain limited situations relating to the exploration for, and exploration of, natural resources, the seabed and subsoil of the submarine areas adjacent to the coast of the countries. The proposed treaty does not.

However, the definition in the proposed treaty is intended to include the respective continental shelves.

The term "national" is defined to include, in the case of Bangladesh, a national of Bangladesh, and, in the case of the United States a citizen of the United States. A "national" of either country also includes any legal entity such as a corporation, trust, estate, partnership, or association which is established under the laws of that country. A "company" is defined as a corporation or other entity treated as a corporation for tax purposes. An "enterprise of a contracting state" is defined as an enterprise carried on by a resident of that country. Although the treaty does not define the term "enterprise," it would have the same meaning that it has in other U.S. tax treaties—the trade or business activities undertaken by an individual, partnership, corporation, or other entity.

The term "person" includes an individual, a partnership, a company, an estate, a trust, and any other body of persons. The term "international traffic" means any transport by a ship or aircraft, except where the transport is solely between places in one of the countries. The "competent authority" for the United States is the Secretary of the Treasury or his delegate and for Bangladesh is the National Board of Revenue or its authorized representative.

The proposed treaty also contains the standard provision that, unless the context otherwise requires or the competent authorities of the two countries establish a common meaning (Article 24(3)), all terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty.

Article 4. Fiscal Domicile

The benefits of the proposed treaty generally are available only to a resident of one of the countries. Under the treaty, a person (either an individual or an entity such as a corporation or partnership) is considered to be a resident of a country if, under the laws of that country, the person is subject to taxation by that country because it is his country of domicile, residence, citizenship, place of management, place of incorporation, or by reason of other criterion of a similar nature. A person will not be considered to be a resident of a country if he is only taxable on his income from sources within that country. A partnership, estate, or trust will be considered to be a resident of a country only to the extent that the income it derives is subject to tax, either in its hands or in the hands of its partners or beneficiaries, as the income of a resident of the country.

This provision of the proposed treaty is generally based on the fiscal domicile article of the U.S. model and OECD model tax treaties and is similar to the provisions found in other U.S. tax treaties. However, a significant difference between the definition of resident in this treaty and the definition in other recent U.S. income tax treaties, and consequently a significant difference in the coverage of the treaty, is that a U.S. citizen is considered a U.S. resident for purposes of the treaty. As a result, U.S. citizens residing overseas (in countries other than Bangladesh) are entitled to the benefits of the treaty as U.S. residents. This result reflects U.S. treaty policy as expressed in the U.S. model, but is achieved in very few treaties.

Since Bangladesh generally taxes on the basis of residence rather than citizenship, this broadened definition of resident does not benefit citizens of Bangladesh who are not Bangladesh residents.

A set of rules is provided to determine residence in the case of a person who, under the basic treaty definition, would be considered to be a resident of both countries (e.g., a U.S. citizen who is resident in Bangladesh). In the case of a dual resident individual, the individual will be deemed for all purposes of the treaty to be a resident of the country in which he has a permanent home (where an individual dwells with his family), his center of vital interests (his closest economic and personal relations), his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests, imposed in this order, the competent authorities of the countries will settle the question by mutual agreement.

A corporation that is a dual resident of both the United States and Bangladesh because of Article 4 and which is created or organized under the laws of either country (or a political subdivision), will be treated as a resident of the country in which created or organized. The residence of a dual resident person, other than an individual or a corporation (e.g., a dual resident partnership, trust, or estate), and the mode of application of the treaty to that person will be determined by the competent authorities.

The proposed treaty also has a rule regarding income arising in one country which, under the treaty, is exempt from tax (or subject to a reduced treaty rate) in that country and which is not subject to tax in the other country until it is remitted. The proposed treaty provides that in such situations the income is only relieved from tax under the treaty to the extent that the income is remitted to the other country in the year it accrues. If the income is not remitted within that time period, the income will never be relieved from tax in the first country under the treaty, and when the income is ultimately remitted to the other country the taxpayer will have to look at Article 22 for relief from double taxation.

Article 5. Permanent Establishment

The proposed treaty contains a definition of the term "permanent establishment" which generally follows the pattern of other recent U.S. income tax treaties, the U.S. model and the OECD model.

The permanent establishment concept is one of the basic devices used in income tax treaties to avoid double taxation. Generally, an enterprise that is a resident of one country is not taxable by the other country on its business profits unless those profits are attributable to the enterprise's permanent establishment located in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemption from, tax provided for dividends, interest, and royalties are applicable, or whether those amounts will be taxed as business profits. United States taxation of business profits is discussed under Article 7 (Business Profits).

In general, a permanent establishment is a fixed place of business through which a resident of one country engages in business in the other country. A permanent establishment includes a place of management, a branch, an office, a factory, a workshop, a store or other sales outlet, a warehouse, or a mine, an oil or gas well, a quarry, or other place of extraction of natural resources. It also includes any building site, construction or installation project, or an installation or drilling rig used for the exploration or development of natural resources, but only if the site, project, etc., lasts for more than 183 days.

This general definition of a permanent establishment is modified to provide that a fixed place of business which is used solely for any or all of a number of specified activities will not constitute a permanent establishment. These activities include the use of facilities for the storage, display, or occasional delivery of merchandise belonging to the resident or for the maintenance of a stock of goods belonging to the resident for storage, display, or occasional delivery, or for processing by another person. These exempted activities also include the maintenance of a fixed place of business for the purchase of goods or merchandise or for the collection of information, or for any other preparatory or auxiliary activities for the resident.

If a resident of one country maintains an agent in the other country who has, and regularly exercises the authority to enter into contracts in that other country in the name of the resident, then the resident will be deemed to have a permanent establishment in the other country with respect to the activities which the agent undertakes on its behalf. This rule does not apply where the contracting authority is limited to those activities (described above) such as storage, display, or occasional delivery of merchandise which are excluded from the definition of permanent establishment. An agent of the enterprise will also be deemed to constitute a permanent establishment in a country if the agent habitually maintains a stock of goods in that country belonging to the enterprise from which he regularly fills or makes orders for the enterprise and additional activities were conducted in that country on behalf of the enterprise which contributed to the conclusion of the sale of the goods.

The proposed treaty contains the usual provision 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.

The determination of whether a company of one country has a permanent establishment in the other country is to be made without regard to the fact that the company may be related to a resident of the other country or to a person who engages in business in that other country. The relationship is thus not relevant; only the activities of the company being tested are relevant.

Article 6. Income from Immovable Property (Real Property)

The proposed treaty provides that income from real property (including income from agriculture or forestry) may be taxed in the country where the real property is located. For purposes of the treaty, real property will generally have the meaning provided under the laws of the country where the property is located, but will in any case include property which is accessory to real property rights, usufruct of real property, and rights to certain payments regarding natural resources. Ships, boats, and aircraft will not be considered real property.

Income from real property includes income from the direct use or renting of the property. It also includes royalties and other payments in respect of the exploitation of natural resources (e.g., oil wells).

Under Article 13 (Capital Gains), gains on the sale, exchange, or other disposition of real property may also be taxed by the country where the property is located. Also, gain from the disposition of stock in a company whose assets consist, directly or indirectly, principally of real estate may be taxed in the country in which the company's real estate is located.

Generally, gain realized by a nonresident alien or a foreign corporation from the sale of a capital asset is not subject to U.S. tax unless the gain is effectively connected with the conduct of a U.S. trade or business or, in the case of a nonresident alien, he is physically present in the United States for at least 183 days in the taxable year. However, under the Foreign Investment in Real Property Tax Act of 1980, as amended, a nonresident alien or foreign corporation is taxed by the United States on gain from the sale of a U.S. real property interest as if the gain was effectively connected with a trade or business conducted in the United States. The real estate provision of Article 13 would not in any way restrict the right of the United States to tax the gain from the sale of a U.S. real property interest under the provisions of the 1980 legislation or any similar but later enacted legislation.

Article 7. Business Profits

U.S. Code rules.—United States law taxes separately the business and investment income of a nonresident alien or foreign corporation. A nonresident alien or foreign corporation is subject to a flat 30-percent (or lower treaty rate) rate of tax on its U.S. source investment income if that income is not effectively connected with the conduct of a trade or business within the United States. The regular individual or corporate rates apply to U.S. source income and certain limited types of foreign source income which are effectively connected with the conduct of a trade or business within the United States.

Income is effectively connected with the conduct of a trade or business within the United States only if the asset generating the income is used in or held for use in the conduct of the trade or business, or if the activities of the trade or business were a material factor in the realization of the income.

Foreign source income is effectively connected income only if the foreign person has an office or other fixed place of business in the United States and the income is attributable to that place of business. Only three types of foreign source income can be effectively connected income; rents and royalties derived from the active conduct of a licensing business; dividends, interest, or gain from stock or debt derived in the active conduct of a banking, financing or similar business in the United States; and certain sales income attributable to a United States sales office.

Except in the case of a dealer, the trading in stocks, securities or commodities in the United States for one's own account does not constitute a trade or business in the United States and accordingly income from those activities is not taxed by the United States as business income. This concept includes trading through a U.S. based employee, a resident broker, commission agent, custodian or other agent or trading by a foreign person physically present in the United States.

Proposed treaty rules.—Under the proposed treaty, business profits of an enterprise of one country are taxable in the other country only to the extent they are attributable to a permanent establishment in the other country through which the enterprise carries on business. This is one of the basic limitations on a source country's right to tax income of a nonresident.

The taxation of business profits under the proposed treaty differs from U.S. rules for taxing business profits primarily in requiring more than merely being engaged in trade or business before a country can tax business profits. Under the Internal Revenue Code, all that is necessary for effectively connected business profits to be taxed is that a trade or business be carried on in the United States. Under the proposed treaty, on the other hand, some level of fixed place of business must be present.

"Business profits" are defined to mean income derived by any person from carrying on a trade or business, including the rental of tangible personal (movable) property. The amount of profits attributable to a permanent establishment must be determined by the same method each year unless there is good and sufficient reason to change the method.

The business profits of a permanent establishment are determined on an arm's-length basis. Thus, there is to be attributed to the permanent establishment the business profits which would reasonably be expected to have been derived by it if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the resident enterprise of which it is a permanent establishment. Amounts may be attributed whether they are from sources within or without the country in which the permanent establishment is located. In the exchange of notes that accompanied the signing of the proposed treaty, the United States and Bangladesh agreed that in any case where the determination of the correct amount of profits which are attributable to a permanent establishment was incapable of precise determination or presented exceptional difficulties, the amount of profits properly attributable to the permanent establishment may be determined on a reasonable basis.

In computing taxable business profits, deductions are allowed for expenses, wherever incurred, which are incurred for purposes of the permanent establishment. These deductions include a reasonable allocation of executive and general administrative expenses, interest, research and development, and other expenses which are incurred for purposes of the enterprise as a whole (or for purposes of that part of the enterprise which includes the permanent establishment). Thus, for example, a U.S. company which has a branch office in Bangladesh but which has its head office in the United States will, in computing the Bangladesh tax liability of the branch, be entitled to deduct a portion of the executive and general administrative expenses incurred in the United States by the head office, for purposes of administering the Bangladesh branch.

Business profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment for the account of the enterprise. Thus, where a permanent establishment purchases goods for its head office, the business profits attributed to the permanent establishment with respect to its other activities will not be increased by a profit element on its purchasing activities.

Where business profits include items of income which are dealt with separately in other articles of the treaty, those other articles, and not this business profits article, will govern the treatment of those items of income. Thus, for example, certain film rentals are taxed under the provisions of Article 12 (Royalties), and not as business profits.

The U.S. will not impose its excise tax (section 4371) on insurance premiums paid to foreign insurers where the premiums are receipts of a business of insurance carried on by a resident of Bangladesh (whether or not carried on through a U.S. permanent establishment) but only to the extent that the relevant risk is not reinsured, directly or indirectly, with a person not entitled to relief from this excise tax.

Article 8. Shipping and Air Transport

The proposed treaty provides that income which is derived by an enterprise of one country from the operation of aircraft in international traffic shall be exempt from tax by the other country. International traffic means any transportation by ship or aircraft, except where the transportation is solely between places in the other country (Article 3(1)(d) (General Definitions)). The exemption also applies to income from participation in a pool, a joint business or an international operating agency which is engaged in the operation of aircraft in international traffic.

The exemption for air transport profits applies to profits from the rental on a full or bare boat basis of aircraft which are operated in international traffic by the lessee, or if the rental profits are incidental to the actual operation of aircraft in international traffic. (Rental on a full or bare boat basis refers to whether the aircraft are leased fully equipped, manned and supplied or not.)

The treaty also specifically provides that each country may tax the operation of ships in international traffic in accordance with its own domestic laws. This provision is inconsistent with most other U.S. tax treaties that provide for a reciprocal exemption of income from international shipping operations as well as aircraft operations. The treaty specifically provides that the nondiscrimination provision of the treaty applies to shipping activities.

Article 9. Associated Enterprises

The proposed treaty, like most other U.S. tax treaties, contains a provision similar to section 482 of the Internal Revenue Code which recognizes the right of each country to make an allocation of income to that country in the case of transactions between related enterprises, if an allocation is necessary to reflect the conditions and arrangements which would have been made between independent enterprises. When a redetermination has been made by one country, the other country, if it agrees with the adjustment, will make an appropriate adjustment to the amount of tax paid in that country on the redetermined income. In making that adjustment due regard is to be given to other provisions of the treaty and the competent authorities of the two countries will consult with each other if necessary.

For purposes of the proposed treaty an enterprise in one country is not independent with respect to an enterprise in another country if one of the enterprises participates directly or indirectly in the management, control or capital of the other enterprise. The enterprises are also not independent if the same persons participate directly or indirectly in the management, control, or capital of both enterprises.

The provisions of the proposed treaty are not intended to limit any law in either country which permits the distribution, apportionment, or allocation of income, deductions, credits or allowances between non-independent persons when such law is necessary to prevent evasion of taxes or to reflect clearly the income of those persons. This provision makes clear that the U.S. retains the right to apply it intercompany pricing rules (section 482) and its rules relating to the allocation of deductions (sections 861, 862, and 863, and Treas. Reg. Section 1. 861–8).

Article 10. Dividends

The United States imposes a 30-percent tax on the gross amount of U.S. source dividends paid to nonresident alien individuals and foreign corporations. The 30-percent tax does not apply if the foreign recipient is engaged in a trade or business in the United States and the stock on which the dividends are paid is effectively connected with that trade or business. The treaty reduces this tax on dividend income, U.S. source dividends are dividends paid by a U.S. corporation, and dividends paid by a foreign corporation if at least 50 percent of the gross income of the corporation, in the prior three year period, was effectively connected with a U.S. trade or business of that foreign corporation.

Under the proposed treaty, each country may tax dividends paid by its companies to shareholders resident in the other country (i.e., they may impose a dividend withholding tax on shareholders resident in the other country). However, the rate of tax may not exceed 25 percent if the beneficial owner is a resident of the other country. The tax rate is limited to 15 percent in the case of dividends paid to a company which directly or indirectly owns at least 10 percent of the voting stock of the company making the dividend distribution.

The proposed treaty defines dividends as income from shares or other rights which participate in profits and which are not debt claims. Dividends also include income from other corporate rights which are taxed by the country in which the distributing corporation is resident in the same manner as income from shares.

The reduced rates of tax on dividends will apply unless the recipient has a permanent establishment (or fixed base in the case of an individual performing independent personal services) in the source country and the stock on which the dividends are paid is effectively connected with the permanent establishment (or fixed base). Dividends on stock that is effectively connected with a permanent establishment are to be taxed as business profits (Article 7). If the stock is effectively connected with a fixed base the dividends are to be taxed as income from the performance of independent personal services (Article 14).

Article 11. Interest

The U.S. imposes a 30-percent tax on U.S. source interest paid to foreign persons under the same rules that are applicable to dividends. U.S. source interest generally is interest on debt obligations of U.S. persons, but not interest on deposits in banks. U.S. source interest also includes interest paid by a foreign corporation if at least 50 percent of the gross income of the foreign corporation, in the prior three year period was effectively connected with a U.S. trade or business of that corporation.

Under the proposed treaty the withholding tax is reduced to 15 percent generally and there is an exemption for interest payments to exempt governmental organizations of the other country.

The reduction in the withholding tax will not apply if the recipient has a permanent establishment or fixed base in the source country and the interest is effectively connected with the permanent establishment or fixed base. In that event, the interest will be taxed as business profits (Article 7) or income from the performane of independent personal services (Article 14).

The proposed treaty defines interest as income from debt claims of every kind, whether or not secured and whether or not carrying a right to participate in profits. In particular, it includes income from government securities and from bonds or debentures, including premiums or prizes attaching to bonds or debentures. It is understood that this provision permits the United States to apply its rules for distinguishing between debt and equity (section 385) with the competent authorities settling disputes if conflicts between U.S. and Bangladesh rules cause double taxation.

The proposed treaty also addresses the issue of non-arm's-length interest charges between related parties (or parties having an otherwise special relationship) by holding that the amount of interest for purposes of the treaty will be the amount of arm's-length interest. The amount of interest in excess of the arm's length interest will be taxable according to the laws of each country, taking into account the other provisions of this treaty (e.g., excess interest paid to a parent corporation may be treated as a dividend under local law and thus entitled to the benefits of Article 10 of this treaty).

Article 12. Royalties

Under the same system that applies to dividends and interest, the U.S. imposes a 30-percent tax on all U.S. source royalties paid to foreign persons. Royalties are from U.S. sources if they are for the use of property located in the United States including royalties for the use of or the right to use intangibles in the United States.

Royalties from sources within one country that are paid to a resident of the other country may be taxed by both countries. The proposed treaty provides for reduction of source basis taxation, but differs from the U.S. and OECD models by providing separate rules for taxation at source of copyright royalties. Copyright royalties are subject to a 10 percent tax by the country of source while all other royalties are taxed at 15 percent of the gross royalty.

Copyright royalties are payments for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematographic films or films or tapes used for radio or television broadcasting. Other royalties are payments for the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience. Finally, gains from the alienation of these properties or rights will be considered to be copyright or other royalties, as the case may be, to the extent that the payment of the sale price is contingent on the productivity, use or disposition of the property. The term "royalties" does not include any payments in consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources.

The reduced withholding tax rate does not apply where the recipient is an enterprise with a permanent establishment in the source country or an individual performing personal services in an independent capacity through a fixed base in the source country, and the property giving rise to the royalties is effectively connected with the permanent establishment or fixed base. In that event the royalties will be taxed as business profits (Article 7) or income from the performance of independent personal services (Article 14).

The proposed treaty provides that in the case of royalty payments between related parties or persons otherwise having a special relationship, only that portion of the payment that represents an arm's-length royalty will be treated as a royalty under the treaty. Payments in excess of the arm's-length amount will be taxable according to the law of each country with due regard being given for the other provisions of the treaty. Thus, for example, any excess amount might be treated as a dividend subject to the taxing limitations of Article 10.

Article 13. Capital Gains

Under the Code, capital gains derived from U.S. sources by foreign investors are generally exempt from U.S. tax. Gain from the disposition of U.S. real estate, or a U.S. real property interest are taxed by the United States. (See discussion under Article 6 (Income From Immovable Property (Real Property)).) The proposed treaty generally provides that capital gains derived by a resident of one country will be exempt from tax by the source country.

The treaty exemption does not apply in two situations, and in those situations the gains may be taxed by both countries (with relief from double taxation provided pursuant to Article 24). First, gains from the sale or exchange of real property or stock of a company whose assets consist principally of real property located in one of the countries may be taxed in the country where the property is located (see discussion for Article 6). Second, gains from the sale or exchange of movable property which forms a part of the business property of a permanent establishment or a fixed base (including gains on the disposition of the permanent establishment or the fixed base itself) may be taxed in the country where the permanent establishment or fixed base is located. The second exception does not apply to gains from the sale or exchange of ships, aircraft or containers operated by an enterprise of the other country in international traffic; such gains are only taxable by the country of residence.

Gains from the disposition of copyright or other royalty property described in Article 12 (Royalties) will only be taxed in accordance with that article.

Article 14. Independent Personal Services

The income of a non-resident alien from the performance of personal services in the United States is not taxed if the individual is not in the United States for at least 90 days, the compensation does not exceed $3,000, and the services are performed as an employee of a foreign person not engaged in a trade or business in the United States or they are performed for a foreign permanent establishment of a U.S. person. The United States taxes the income of a nonresident alien at regular rates if the income is effectively connected with the conduct of a trade or business in the United States by the individual. (See discussion of U.S. taxation of business profits under Article 7 (Business Profits).) The performance of personal services within the United States can be a trade or business within the United States (sec. 864(b)).

The proposed treaty limits the right of a country to tax income from the performance of personal services by a resident of the other country. Under the proposed treaty, income from the performance of independent personal services are treated separately from income from the performance of dependent personal services.

Income from the performance of independent personal services (i.e., services performed as an independent contractor, not as an employee) in one country by a resident of the other country is exempt from tax in the country where the services are performed, unless (1) the person performing the personal service is present in the country where the services are performed for 90 or more days during the taxable year, or (2) the individual has a fixed base regularly available to him in that country for the purpose of performing the services. In the second situation, the source country can only tax that portion of the individual's income which is attributable to the fixed base. The 90-day threshold period for asserting jurisdiction to tax is shorter than that in the U.S. model (which is 183 days), and recognizes Bangladesh's status as a developing country.

Article 15. Dependent Personal Services

Under the proposed treaty, income from services performed as an employee in one country (the source country) by a resident of the other country may be taxable in the source country unless three requirements are met: (1) the individual is present in the source country for less than 183 days during the taxable year; (2) his employer is not a resident of the source country; and (3) the compensation is not borne by a permanent establishment or fixed base of the employer in the source country.

Compensation derived by an employee aboard a ship or aircraft operated by a resident of one country in international traffic is exempt from tax by the other country, provided that the compensation is in respect of employment as a member of the regular complement of the ship or aircraft.

This article does not apply to pensions and other payments described in Article 18 (Pensions, Etc) or to compensation as a government employee (Article 19).

The proposed treaty also provides that director's fees paid by a resident of one country to an individual shareholder who is resident in the other country may be subject to a 25 percent withholding tax to the extent that the fee exceeds the fee that would have been paid to a nonshareholder director.

Article 16. Investment or Holding Companies

The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Bangladesh as they apply to residents of the two countries. At times, however, residents of third countries attempt to use treaties by treaty shopping. Treaty shopping refers to the situation where a person who is not a resident of either treaty conutry seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, the nonresident is able to secure these benefits by establishing a corporation (or other entity) in one of the countries which, as a resident of that country, is entitled to the benefits under the treaty. Additionally, it may be possible for the third-country resident to repatriate funds to that third country from the entity under favorable conditions (i.e., it may be possible to reduce or eliminate taxes on the repatriation) either through relaxed tax provisions in the distributing country or by passing the funds through other treaty countries (essentially, continuing to treaty shop) until the funds can be repatriated under favorable terms.

The proposed treaty contains a provision which denies the benefits of the dividends, interest, and royalties articles to a corporation that 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. The provision only applies if 25 percent or more of the capital of the corporation is owned by nonresidents of that country. It is intended to have broad application. Accordingly, the term "capital" should be construed broadly. It would include, for example, common and preferred stock and convertible debt. It would also apply if nonresidents had effective control over the capital of the company. A similar provision is contained in several recent U.S. tax treaties.

If this holding company provision applies, the source country can impose its full statutory tax on dividends, income, or royalties paid to the company. Thus, the United States could tax that income at the 30-percent statutory rate.

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 which the proposed treaty provides for dividends, interest, and royalties derived from the other country. At the present time, neither Bangladesh nor the United States grants to investment or holding companies the type of tax benefits with respect to dividends, interest, and royalties which would make this provision of the proposed treaty applicable. Thus, the provision will have effect only if Bangladesh 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.

For purposes of this article, the dividend, interest, and royalty source rules of Article 24 (Relief from Double Taxation) shall apply.

Article 17. Artists and Athletes

The proposed treaty contains a separate set of rules which apply to income earned by public entertainers (such as theater, motion picture, radio or television artists and musicians) and athletes. The proposed article modifies the other provisions dealing with the taxation of personal services (Article 14 and 15). Under this Article, one country may tax an entertainer or athlete who is a resident of the other country on the income from his personal services performed in that country during any year in which the income exceeds $100 (or its equivalent in Bangladesh taka) per day or the aggregate income exceeds $3,000 (or its equivalent in Bangladesh taka) during the taxable year. As in the case of the other provisions dealing with personal services income, this provision does not bar the country of residence or citizenship from also taxing that income (subject to a foreign tax credit).

In addition, the proposed treaty provides that where income in respect of personal services performed by an entertainer or athlete is paid not to the entertainer or athlete but rather to another person or entity, that income will be taxable by the country in which the services are performed in any situation where the entertainer or athlete shares directly or indirectly in the profits of the person or entity receiving the income. (This provision applies notwithstanding Articles 7, 14, and 15.) For this purpose, participation in the profits of the recipient of the income includes the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions, or other distributions. The provision does not apply if it is established that neither the entertainer or athlete, nor related persons, participate directly or indirectly in the profits of the person or entity receiving the income in any manner. This provision prevents highly paid performers and athletes from avoiding tax in the country in which they perform by routing the compensation for their services through a third person such as a personal holding company or trust located in a country that would not tax the income.

Article 18. Pensions, Etc.

Under the proposed treaty, private pensions (and other similar compensation for past services) beneficially derived by residents of either country are subject to tax only in the recipient's country of residence. Social security payments (and other public pensions) paid by one country to residents of the other country or to U.S. citizens may only be taxed by the paying country. These rules do not apply in the case of pensions which are paid to resident nationals of one country attributable to services performed by the individual for government entities of the other (Article 19(2) (Governmental Service)).

The proposed treaty also provides that annuities will only be taxed in the recipients' country of residence. Annuities are 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).

Alimony paid by a resident of one country to a resident of the other country is subject to tax only in the recipient's country of residence. "Alimony" is defined as periodic payments made pursuant to a written separation agreement, or a decree of divorce, separate maintenance or compulsory support, which are taxable in the recipient's country of residence.

Periodic payments for the support of a minor child which are made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support and which are paid by a resident of one country to a resident of the other country are exempt from tax in both countries.

Article 19. Government Service

Under the proposed treaty, compensation paid by one country, its political subdivisions or local authorities, to an individual for personal services performed for the paying governmental entity is taxable only by that country. However, if the services are performed in the other country and the individual is a resident and national of that country, the compensation is only taxable by the country where the services are performed. Thus, an individual performing services for a Bangladesh governmental entity ordinarily will only be taxable by Bangladesh. However, if he performs the services in the United States and is a U.S. citizen and U.S. resident he will be taxable only by the United States.

Pensions paid for services performed for a governmental entity of either country will generally only be taxable by that country. However, if the recipient is a resident national of the other country, the pension will only be taxable by that other country.

The governmental services rules do not apply in situations where the compensation or pensions are paid in connection with any business carried on by any governmental entity of either country. In such situations, the provisions applicable to the private sector apply: Article 14 (Independent Personal Services), 15 (Dependent Personal Services), 17 (Artists and Athletes), and 18 (Pensions, Etc.).

Article 20. Teachers, Students, and Trainees

The proposed treaty provides that if a teacher or professor, who is a resident of one country and is temporarily present in the other country, teaches or engages in research in that other country, he will be exempt from tax by the host country on income from teaching or engaging in research for a period not exceeding two years. The exemption only applies if the individual comes to the other country primarily for the purpose of teaching or research at a university, college, school, or other recognized educational institution.

Under the proposed treaty, an individual who is a resident of one treaty country and who becomes temporarily present in the other country, for the primary purpose of (i) studying at a university or other recognized educational institution in that country, (ii) securing training as a business or technical apprentice, or (iii) studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious charitable, or educational organization, is eligible for the student exemption. Persons eligible for the student exemption will be exempt from tax in the host country on remittances from abroad used for maintenance, education, or training and on any grant, allowance or award described in (ii). In addition, a $4,500 (or its equivalent in Bangladesh taka) annual exemption from tax by the host country is provided for personal service income (such as income from a part-time job) derived from sources within the country in which the individual is studying. However, in the case of the business or technical apprentice described in (ii) above, this exemption may not be utilized for a period of more than 2 years from the date of the person's first arrival in the host country.

Article 21. Other Income

Items of income not otherwise dealt with in the proposed treaty which are derived by residents of either country shall be taxable only by the country of residence. However, if the income arises in the other country it may be taxed in that other country.

Article 22. Relief from Double Taxation

Under the proposed treaty, each country agrees to allow a foreign tax credit for the appropriate amount of income taxes paid to the other country. The credit allowed for U.S. tax purposes is in accordance with the provisions and subject to the limitations of U.S. law applicable to the year in question.

The proposed treaty also provides that a deemed-paid foreign tax credit will be made available to a U.S. corporation with respect to dividends from a Bangladesh corporation in which it has at least a 10-percent ownership interest. In this case, a credit will be allowed for the Bangladesh tax paid by the Bangladesh corporation on the earnings out of which the dividend is paid. A deemed-paid foreign tax credit satisfying the treaty requirements is presently provided under the Internal Revenue Code. Similarly, the proposed treaty provides that Bangladesh is to provide a deemed-paid foreign tax credit for U.S. tax attributable to dividends received by Bangladesh corporations from U.S. corporations in which they are 10-percent shareholders.

This article provides that all Bangladesh taxes covered by the treaty (Article 2. Taxes Covered) are to be considered to be income taxes for purposes of the U.S. foreign tax credit. Accordingly, all the Bangladesh taxes covered by the treaty will be eligible for the U.S. foreign tax credit.

For purposes of the foreign tax credit under the treaty, the proposed treaty provides rules for determining the source of income. Dividends are deemed to be sourced in one of the countries if the paying company is a resident of that country. Interest paid by a government authority or resident of a treaty country generally is sourced in that country. However, if the payor of the interest has a permanent establishment (Article 5) or a fixed base (Article 14) in one of the treaty countries in connection with which the indebtedness on which the interest is paid was incurred and the interest is borne by the permanent establishment or fixed base then the interest will be sourced in the country in which the permanent establishment or fixed base is located. Royalties are sourced in a treaty country to the extent the royalties are with respect to the use of, or the right to use, rights or property within that country.

The proposed treaty provides that, except for interest, royalties and dividends, and except for income described in Article 21(2) (Other Income), income received by a resident of one country will be considered to be from sources in the other country if that other country may tax that income in accordance with the provisions of the treaty (other than merely pursuant to the saving clause).

Article 23. Nondiscrimination

The proposed treaty contains a comprehensive nondiscrimination provision relating to all taxes of every kind imposed at the national, state, or local level. It is similar to provisions which have been embodied in other recent U.S. income tax treaties.

Under this provision, neither country can discriminate by imposing more burdensome taxes (or other requirements connected with taxes) on nationals of the other country than it imposes on its own nationals who are in the same circumstances. For this purpose, nationals taxable on their worldwide income are not to be considered to be in the same circumstances as nationals who are not. Thus, for example, the United States would not be required to tax a U.S. citizen and a Bangladesh citizen, neither of whom are residents of the United States, in the same way because the U.S. citizen is taxed by the United States on his worldwide income while the Bangladesh citizen is not. This provision does not, however, require either country to grant to residents of the other country the personal allowances, reliefs, or deductions for taxation purposes on account of personal status or family responsibilities which it grants to its own residents.

Similarly, neither country may tax a permanent establishment of an enterprise of the other country less favorably than it taxes its own enterprises carrying on the same activities. In determining the taxable income of an enterprise of either country, both countries are required (except as provided in Articles 9(1) (Associated Enterprises), 11(5) (Interest), and 12(5) (Royalties)) to allow the enterprise to deduct interest, royalties, and other disbursements paid by the enterprise to residents of the other country under the same conditions that they allow deductions for such amounts paid to residents of the same country as the enterprise. However, this provision does not affect the requirement under Bangladesh law that there must be a deduction of tax at source from interest, royalties and other disbursements as a condition for taking the deduction in Bangladesh. The nondiscrimination provision also applies to corporations of one country which are owned by residents of the other country.

The provision is not intended to override the right of the United States to tax foreign corporations on their dispositions of a U.S. real property interest because the effect of the provisions imposing the tax is not discriminatory, nor is it intended to permit foreign corporations to claim the benefit of U.S. provisions intended to elimiinate U.S. double tax, such as the dividends received exclusion provided by section 243.

Article 24. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision which authorizes both the competent authority of the United States and Bangladesh to consult together to attempt to alleviate individual cases of double taxation or cases of taxation not in accordance with the proposed treaty.

Under the proposed article a resident or citizen of one country who considers that the action of the countries or either of them will cause him to pay a tax not in accordance with the treaty may present his case to the competent authority of the country of which he is a resident or citizen. The competent authority then makes a determination as to whether or not the claim has merit. If it is determined that the claim does have merit, and if the competent authority cannot unilaterally solve the problem, that competent authority endeavors to come to an agreement with the competent authority of the other country to limit the taxation which is not in accordance with the provisions of the treaty.

A second provision directs the competent authorities to resolve any difficulties or doubts arising as to the application of the convention. Specifically, they are authorized to agree as to the attribution of profits to a resident of one country and its permanent establishment in another country, the allocation of income deductions or credits and the readjustment of taxes, the determination as to source of income, the characterization of items of income, and to the common meaning of terms. Under this authority, the Internal Revenue Service from time to time issues rulings defining terms in a treaty. The proposed treaty contains a provision, not found in most treaties, that permits the competent authorities to agree to increase dollar amounts reflected in the treaty to reflect monetary or economic developments. The proposed treaty also provides that the respective competent authorities may consult together for the elimination of double taxation in cases not provided for in the treaty.

The treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of the mutual agreement provision. It also authorizes them to meet together for an oral exchange of opinions. These provisions make clear that it is not necessary to go through normal diplomatic channels in order to discuss problems arising in the application of the treaty and also removes any doubt as to restrictions that might otherwise arise by reason of the confidentiality rules of the United States or Bangladesh.

Finally, the provision provides for the waiver of the statute of limitations of either country so as to permit the issuance of a refund or credit not withstanding the statute of limitation. The provision, however, does not authorize the imposition of additional taxes after the statute of limitations has run.

Article 25. Exchange of Information and Administrative Assistance

This article forms the basis for cooperation between the two countries to attempt to deal wtih avoidance or evasion of their respective taxes and to enable them to obtain information so that they can properly administer the treaty. The proposed treaty provides for the exchange of information which is necessary to carry out the provisions of the proposed treaty or for the prevention of fraud or for the administration of the domestic laws of either country concerning taxes to which the convention applies. The exchange of information is specifically not limited by the personal scope article. Thus. information can be exchanged with respect to persons not covered by the proposed treaty such as persons not resident in either country.

The information exchanged may relate to tax compliance generally and not merely to avoidance or evasion of tax.

Information exchanged is to be treated as secret in the same manner as information obtained under the domestic laws of the receiving country, except that it may be disclosed to persons involved in the assessment or collection, or litigation concerning, the taxes to which the treaty applies. The information may be used for such purposes only. Accordingly, it is not clear that Congress, in the exercise of its oversight responsibilities, could obtain the information. However, a country is not required to carry out administrative measures contrary to its law or administrative practice, to supply particulars not obtainable under its laws or in the normal course of administration, or to supply information that would disclose a trade secret or the disclosure of which would be contrary to public policy.

Article 26. Effect of Convention on Diplomatic Agents and Consular Officials, Domestic Laws, and Other Treaties

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the taxation privileges of diplomatic agents or consular officials under the general rules of international law or the provisions of special agreements.

The proposed treaty also provides that it does not restrict any benefits accorded under the domestic law of either country or under any other agreement between the United States and Bangladesh.

Article 27. Entry into Force

The proposed treaty is subject to ratification in accordance with the applicable procedures of each country and the instruments of ratification will be exchanged as soon as possible in Washington. The treaty will enter into force when the instruments of ratification are exchanged. The treaty will become effective in respect of taxes withheld at source, to amounts paid or credited on or after the first day of the second month following the month the instruments of ratification are exchanged. With respect to other taxes the treaty will be effective for taxable years in the United States and for income years in Bangladesh beginning on or after January 1 of the year following the year in which the proposed treaty comes into force.

Article 28. Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 months' prior notice through diplomatic channels. If terminated, the termination will be effective with respect to taxes withheld at source, to amounts paid or credited on or after January 1 of the year following the expiration of the 6-month period. With respect to other taxes the treaty will terminate for taxable years in the United States and for income years in Bangladesh which begin on or after January 1 of the year following the expiration of the 6-month period.

Exchange of Notes

At the signing of the convention notes were exchanged dealing with two issues.

First, the United States recognized that Bangladesh emphasized the importance of provisions in a treaty that will create incentives to promote investment in Bangladesh. The United States indicated that it could not accept these provisions but assured Bangladesh that if circumstances changed the United States would reopen discussions with a view toward adopting provisions to promote investment in Bangladesh. This provision is similar to that adopted with respect to other developing countries and reflects the desire of developing countries to have the United States adopt a "tax sparing" credit. Many developing countries provide tax holidays to residents of other countries who invest in the developing country. Generally, they will forego tax on the profits from that business for a period of time. The U.S. would tax repatriations of the income of that business, in the view of some conflicting with the investment policy of the host country. Many developed countries solve this problem by giving a credit against their income tax imposed on the dividend distributions from the developing country corporation in an amount equal to the developed country tax imposed on the dividends. The U.S. has refused to do this.

Second, the United States and Bangladesh agreed that in any case where the determination of the correct amount of profits which are attributable to a permanent establishment was incapable of precise determination or presented exceptional difficulties, the amount of profits properly attributable to the permanent establishment may be determined on a reasonable basis. This understanding amplifies the rules in Article 7 (Business Profits).

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