[JOINT COMMITTEE PRINT]

EXPLANATION OF PROPOSED INCOME TAX TREATY (AND PROPOSED PROTOCOL) BETWEEN THE UNITED STATES AND THE ARGENTINE REPUBLIC

PREPARED FOR THE USE OF THE

COMMITTEE ON FOREIGN RELATIONS

UNITED STATES SENATE

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INTRODUCTION

This pamphlet provides an explanation of the proposed income tax treaty and accompanying proposed protocol between the United States and the Argentine Republic ("Argentina"). The proposed treaty and protocol were signed in Buenos Aires, Argentina on May 7, 1981. No similar treaty between the two countries is in force at the present time. The proposed treaty has been scheduled for a public hearing 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 Argentina's status as a developing country, and to reflect the United Nations model for The Formulation of the Provisions of a Bilateral Tax Treaties Between a Developing Countries and a Developed Country (United Nations Guidelines). It also departs from other U.S. income tax treaties to accommodate Argentina's tax system, which applies only to income from sources in Argentina and not to income from foreign sources.

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 proposed treaty.

I. SUMMARY

In General

The principal purpose of the proposed income tax treaty between the United States and Argentina 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 countries to cooperate in preventing avoidance and evasion of their 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. The treaty does, however, differ from the usual income tax treaties in several important respects. These differences reflect Argentina's tax system, and also its status as a developing 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, 16, 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 are to be taxed at reduced rates by the country of source (Article 10). No reduced rate is provided for most interest and royalties (Articles 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 relief by the country of residence of the potential double taxation (Article 23). Where the United States is the country of residence, relief is given through a foreign tax credit. Where Argentina is the country of residence, relief is given by Argentina exempting the income from tax.

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 1); that is, the treaty will only be applied to the benefit of taxpayers.

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.

The proposed treaty contains several provisions which vary from the basis U.S. model and many U.S. income tax treaties.

(1) The definition of the United States and Argentina does not include the specific reference found in most treaties that the countries include their respective continental shelves. The specific reference is no longer in the U.S. model.

(2) The proposed treaty provides that the countries will limit their withholding tax to 20 percent of the gross amount of dividends paid to residents of the other country, with a special rule in the case of dividends paid by an Argentine company and aimed at limiting the combined level of corporate level and dividend withholding tax to 45 percent. Unlike many other U.S. treaties, there is no distinction between portfolio investors and corporate direct investors. In most treaties, the withholding tax on dividends paid to direct investors is lower than the tax imposed on dividends to portfolio investors. Furthermore, the 20 percent rate is higher than generally allowed in U.S. tax treaties which are for the most part with developed countries. In the U.S. model, the rates are limited to 5 percent for direct investors and 15 percent portfolio investors.

(3) The treaty generally does not provide a reduction in source basis withholding taxes on interest and royalties paid to residents of the other country. Generally, the U.S. position (which is rarely achieved) is that these taxes should be eliminated, and many treaties limit the taxes to 10 percent. In the case of interest paid to banks, many U.S. treaties actually achieve a zero rate of tax.

(4) The provision dealing with the definition of a permanent establishment is slightly different than many other U.S. treaties, although generally consistent with treaties with developing countries. In general, it provides for a six-month test for building and construction sites to be treated as a permanent establishment rather than the one-year period usually provided.

Issues

The proposed treaty presents the following specific issues:

(1) The proposed treaty does not specifically state that it applies to mineral related activities on the continental shelf. The implications of not specifically covering continental shelf activities is arguably unclear. It is clear that the treaty would cover activities on the U.S. continental shelf by reason of section 638 of the Code. It is not clear what the effect would be for Argentina.

(2) The treaty contains a number of developing country concessions in the permanent establishment article. This raises the issue of whether the United States should make these concessions and whether Argentina is a proper recipient of them.

(3) Whether it is appropriate to forego U.S. tax when, because of the general tax system of the treaty partner, the result will be the total elimination of the taxpayer's tax? Argentina has a territorial tax system which means that it does not tax any foreign source income. Accordingly, Argentina would not tax the business income of an Argentine resident doing business in the United States. Under the treaty, an Argentine resident in that case who is doing business in the United States but not at the level that gives rise to a permanent establishment would not pay U.S. tax and would not pay any tax to Argentina because of its territorial system. This would be true even if under the Code that person would be considered to be earning business income and in the United States would be taxed on that income by the United States if the treaty had not come into effect.

(4) Whether it is appropriate to enter into a treaty that does not limit source basis taxation on interest and royalties. This may be considered a precedent by many developing countries, notwithstanding the fact that it does to some degree reflect Argentina's unilateral giving up of all taxes on all foreign source income. Arguably the treaty reaches the right result by insuring that the United States will tax passive income at a relatively high rate and therefore investors will pay a significant overall tax. U.S. investors in Argentina get nondiscrimination protection. Furthermore, the U.S. Internal Revenue Service will be able to obtain tax information on U.S. companies doing business in Argentina.

(5) Whether it is appropriate to enter into a treaty without an anti-treaty shopping provision intended to limit abusive use of the treaty? Many recent U.S. treaties contain a provision that limits the use of the treaty to corporations controlled by persons who are residents of the treaty partner. These provisions are intended to prevent third country residents from establishing a company in a treaty partner in order to take advantage of reduced withholding rates (i.e. "treaty shopping"). While withholding rates on interest and royalties are not reduced under this treaty, and while the withholding rates on dividends is relatively high, Argentina's territorial system raises the potential for other abuses. For example, a third country national could establish an Argentine company to conduct certain types of activities in the United States. If those activities do not give rise to a permanent establishment, they would avoid U.S. tax and also would avoid Argentine taxes because Argentina does not tax foreign source income.

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"). They are also taxed 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 of a nonresident alien or foreign corporation 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 U.S. has an income tax treaty.

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).

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.

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 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. Also taxable under the legislation are dispositions by foreign investors of their interests in certain U.S. corporations and other entities whose assets include U.S. real property and associated personal property.

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 use can be either tangible property or intangible property (e.g., patents, secret processes and formulas, franchises and other like property).

Since it 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 uniterally 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 jurisdiction 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 each of the two 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, for example, 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 U.S. generally imposes a 30 percent tax and seeks to reduce this tax in some cases on some income 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 further mitigated 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 to which it applies to provide that they will be considered creditable incomes 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 Argentina as modified by the proposed protocol is presented below.

Article 1. Personal Scope

The proposed treaty applies generally to residents of the United States and to residents of Argentina, 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 also provides that it does not restrict any benefits accorded by internal law or any other agreement between the United States and Argentina.

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 Argentina 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 Argentina. 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 Residence).

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 proposed 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. See R.R. 79–152, 1979–1 C.B. 237.

Exceptions to the saving clause are provided for the benefits conferred by the articles dealing with the taxation of certain public pensions and child support payments (Article 18), relief from double taxation (Article 23), nondiscrimination (Article 24) and mutual agreement procedures (Article 25). 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 income received by government employees (Article 19), students and trainees (Article 20), and diplomatic and consular officials (Article 27) are to be granted by each country to its residents provided those residents are neither citizens of, nor have immigrant status, in that country.

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

Consequently, except for the exceptions to the saving clause set forth above, U.S. citizens and residents generally benefit under the treaty as the result of the agreement by Argentina 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 Argentina 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 Argentina tax would, as a practical matter, be the U.S. Treasury rather than the U.S. taxpayer. Similarly, except as noted above, since Argentina only taxes Argentine source income, its citizens and residents benefit under the treaty not only to the extent that the United States agrees to reduce its tax on their income or to exempt their income from tax, but also to the extent the United States foregoes taxing jurisdiction it would normally assert.

Article 2. Taxes Covered

The proposed treaty applies to taxes on income which are imposed by either country. It also applies to taxes on capital. The United States does not impose a tax on capital, while Argentina does.

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 with respect to private foundations (sections 4940 and 4948). The treaty preserves the right of the United States to apply its accumulated earnings tax and personal holding company tax.

In the case of Argentina, the treaty applies to the tax on profits, the capital gains tax, the tax on capital and the tax on net worth, including prepayments of tax made by deduction at source or otherwise. Under Article 23 (Relief From Double Taxation), only the income tax and the capital gains tax are designated as income taxes for purposes of the U.S. foreign tax credit. The tax on profits is Argentina's broad based income tax on all Argentine income other than capital gain.

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 substantial changes it makes in its tax laws.

Additionally, the nondiscrimination provisions (Article 24) of the proposed treaty apply to all taxes of every kind imposed at the national, state, or local level by the United States or Argentina and the exchange of information and administrative assistance provisions (Article 26) apply to all taxes imposed at the national level.

The proposed protocol expressly states that the treaty does not cover the Argentine tax on remittances abroad in excess of a specified percentage of capital registered in Argentina. The tax is imposed by Article 15 of the Foreign Investment Law at rates of 15, 20, or 25 percent of remittances of gross dividends and branch profits which over a 5-year period average more than 14.5 percent of registered capital. It also does not prevent Argentina from recapturing tax reductions granted to a foreign investor to the extent that the foreign investor remits profits out of Argentina which incur foreign tax. As a result, the creditability of these two taxes for U.S. foreign tax credit purposes will continue to be determined solely under the Code.

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 "Argentina" means the territory comprising the Republic of Argentina.

Most recent treaties, specifically define United States and the other country as including their respective territorial sea and in certain limited situations relating to the exporation for, and exploration of, natural resources, the seabed and subsoil of the submarine areas adjacent to the coast of the countries. The definition in the proposed treaty is intended to include the respective continental shelves.

A "person" is defined to include both an individual, partnership, company, estate, trust and any other body of persons. A "company" is defined as a corporation or other entity treated as a corporation for tax purposes. An enterprise of a country 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 proposed treaty defines international transport as any transport by a ship or aircraft, except where the transport is solely between places in one country. Accordingly, purely domestic transport is excluded.

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, all terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty.

Article 4. Resident

The benefits of the proposed treaty generally are available only to a resident of one of the countries as that term is defined in the treaty.

Under U.S. law, residence of an individual is important because a resident alien is taxed on his worldwide income, while a nonresident alien is taxed only on his passive U.S. source income and on the U.S. source and certain foreign source income that is effectively connected with a U.S. trade or business. The Code, however, does not define the term. Instead, IRS regulations state that an alien is a resident of the United States if he is actually present in the U.S. and is not a mere transient or sojourner. Whether he is a transient is determined by his intentions as to the length and nature of his stay. (See Treas. Reg. § 871-2(b).) A corporation generally is resident in the U.S. if it is organized in the U.S.

Under the treaty, a person, either an individual or an entity such as a corporation of 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, place of incorporation, or by reason of other criterion of a similar nature. 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. For example, if only half of the partners of a U.S. partnership are U.S. residents Argentina would only have to reduce its withholding tax on half of the Argentine source income paid to the partnership.

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. Consistent with most U.S. income tax treaties, citizenship alone does not establish residence. As a result, U.S. citizens residing overseas (in countries other than Argentina) are not entitled to the benefits of the treaty as U.S. residents. This result is contrary to U.S. treaty policy as expressed in the U.S. model. The U.S. position is achieved in very few treaties.

A set of rules is provided to determine residence in the case of an individual person who, under the basic treaty definition, would be considered to be a resident of both countries. 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, 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 Argentina 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 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.

An employee of a country (including a political subdivision of that government) of which he is a citizen who is taxed by that government as a resident is considered a resident of that country for purposes of the proposed treaty. Also, his spouse and minor children are considered residents of his country of citizenship if they reside with him, and are taxed as residents. Accordingly, the employee and his spouse would be entitled to treaty benefits. Under this provision, a U.S. citizen employed by the U.S. government in Argentina would be a resident of the U.S. and entitled to the benefits of the proposed treaty. Likewise, his spouse and any minor children residing with him who are taxed by the United States as U.S. residents would be treated as U.S. residents for treaty purposes.

Article 5. Definition of 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 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 exemption from, tax provided for dividends, interest, and royalties are applicable, or whether those amounts will be taxed as business profits U.S. 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 branch, an office, a factory, workshop, a mine, an oil or gas well, a quarry, or other place of extraction of natural resources and facilities used for the purchase and export of goods. It also includes any building site, construction or installation project, or an installation or drilling rig or ship used for the exploration or development of natural resources, but only if the site, project, etc., lasts for more than six months. Also, a ship used for making oceanographic surveys or for fishing is a permanent establishment, only if it remains within a country for more than 90 days in a taxable year.

The six month period for establishing a permanent establishment is shorter than the 12-month period usually provided. This broadening of the definition of permanent establishment reflects Argentina's status as a developing country, and is generally consistent with United Nations guidelines for tax treaties between developed and developing countries.

The general rule 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 storing, displaying, or delivering merchandise belonging to the resident or for the maintenance of a stock of goods belonging to the resident for storage, display, or delivery, or for processing by another person. These activities also include the maintenance of a fixed place of business for the purchase of goods or merchandise or the collection of information, for advertising or scientific research, or 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 delivery of merchandise which are excluded from the definition of permanent establishment. 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 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, livestock and equipment used in agriculture and forestry, 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). It does not include interest on loans secured by real property.

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 proposed treaty would not restrict the right of the United States to tax the gain from the sale of U.S. real estate under the provisions of the 1980 legislation or any similar but later enacted legislation. It also retains the right of the United States to impose relevant reporting or withholding requirements.

The proposed treaty does not include the U.S. model provision permitting a binding election to be taxed on a net basis. U.S. law provides for an election, and Argentina taxes on a net basis in any event.

Article 7. Business Profits

U.S. Code rules. U.S. law separates 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 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 income which is effectively connected with the conduct of a trade or business within the United States.

The taxation of income as business or investment income varies depending upon whether the income is U.S. or foreign. Generally, U.S. source periodic income, such as interest, dividends, rents, wages, and capital gains 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. All other U.S. source income is treated as effectively connected 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 U.S. 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 United States 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.

A special rule is provided for insurance under which a country can tax profits from insuring its property or residents as business profits even if the insurer does not have a permanent establishment in that country.

"Business profits" are defined to mean income derived by any person from carrying on a trade or business. The proposed treaty specifically includes income from the furnishing of the services of another. 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 profts of a permanent establishment are determined on an arm's-length basis. Thus, there is to be attributed to it 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 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 Argentina but which has its head office in the United States will, in computing the Argentina 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 Argentina 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. However, the purchase and export of goods in Argentina is not a mere purchase and there will be treated as business profits subject to Argentine tax. (See Article 5 (Permanent Establishment).)

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, film rentals are taxed under the provisions of Article 12 (Royalties), and not as business profits.

Article 8. International Transport

As a general rule, the United States would tax the U.S. source income of a foreign person from the operation of ships or aircraft to or from the United States. An exemption from U.S. tax is provided if the ship or aircraft is documented under the laws of a foreign country that grants an equivalent exemption to U.S. citizens and corporations. The United States has entered into agreements with a number of countries under which that country grants an exemption which results in the United States exempting that country's shipping. The U.S. has such an agreement with Argentina.

The proposed treaty provides that income which is derived by an enterprise of one country from the operation of ships and aircraft in international transport shall be exempt from tax by the other country.

This would confirm the existing exemption that the countries grant each other's ships and aircraft, but without the registration requirement. International transport means any transport by ship or aircraft, except where the transport is solely between places in one country (Article 3(a)(d) (General Definitions)). The exemption applies even if the ship or aircraft is not registered in either country. Thus, income of a U.S. resident from the operation of a ship flying, for example, the Liberian flag would not be subject to Argentine tax. 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 ships and aircraft in international traffic.

The exemption for shipping and air transport profits applies to profits from the rental on a full or bare boat basis of ships or aircraft which are operated in international transport by the lessee, or if the rental profits are incidental to the actual operation of ships and aircraft in international transport. (Rental on a full or bare boat basis refers to whether the ships or aircraft are leased fully equipped, manned and supplied or not.) Income from the operation in international transport of ships or aircraft also includes income derived from the use, maintenance, or rental of containers, trailers for the inland transportation of containers, and other related equipment where the equipment is used in the international transport of goods and merchandise.

Article 9. Associated Enterprises

The proposed treaty, like most other U.S. tax treaties, contains an arm's-length pricing 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 its 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 United States 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 dividends are effectively connected with that trade or business. United States source dividends are dividends paid by a United States 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), but the rate of tax is limited. In the case of the United States, the rate of tax is limited to 20 percent if the beneficial owner is a resident of Argentina. This flat rate differs from many U.S. treaties that provide two withholding rates for dividends, one for direct substantial corporate investment and one for portfolio investments. For example, in the U.S. model the U.S. withholding tax rate is limited to 5 percent in the case of dividends paid to a company resident in the other country which directly or indirectly owns at least 10 percent of the voting stock of the company making the dividend distribution.

In the case of Argentina, the tax cannot exceed 20 percent if the beneficial owner of the dividend is a resident of the United States. A further limitation is provided so that the combined withholding tax on the dividend and corporate level tax on the earnings out of which the dividends are paid cannot be more than 45 percent.

Argentina currently taxes corporations at a flat 33 percent. Accordingly, it could impose a 17.5 percent tax on dividends beneficially owned by U.S. residents. For example, if a Argentine corporation earns $100, it would pay a corporate tax of $33 leaving $67 ($100 − $33) for distribution. If the company distributed that $67, Argentina could impose a tax equal to an additional $12 ($33 + $12 = $45), making the total Argentina tax $45. Under this provision, if Argentina corporate tax rate increased to more than 45 percent, a U.S. shareholder would be entitled to a refund of anything over 45 percent.

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 dividends are effectively connected with the permanent establishment (or fixed base). Dividends from stock that is effectively connected with a permanent establishment are to be taxed as business profits (Article 7). Dividends effectively connected with a fixed base are to be taxed as income from the performance of independent personal services (Article 14).

Each country may tax dividends paid by companies of the other country but only insofar as (a) the dividends are paid to residents of the country imposing the tax, (b) the dividends are effectively connected with a permanent establishment or a fixed base in the taxing country, or (c) at least 50 percent of the paying company's gross income was attributable to a permanent establishment in the taxing country. In this last situation, however, the tax can be imposed only to the extent the dividends are paid out of the profits derived from the permanent establishment and, in addition, the rate of tax on the taxable portion is limited to the withholding rules (described above) applicable to dividends paid by companies of the taxing country. This third provision enables the United States to continue to tax dividends paid by foreign corporations doing substantial business in the U.S. The provision is, however, different than U.S. rules because the 50 percent of gross income test in the treaty is based on the total profits from which the dividends are paid, while under U.S. rules, dividends are taxable if the three-year rule is met. Also, the ratio in the treaty is based on a comparison of profits to gross income rather than gross income to gross income. Finally, the permanent establishment concept is somewhat more limited than the U.S. trade or business concept. (See discussion in Article 7. Business Profits.)

In accordance with the nondiscrimination provision (Article 24) Argentina may impose its branch profits tax on the profits of Argentine branches of U.S. companies.

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, interest may be taxed by a country only if the recipient is a resident of that country, the interest arose in that country, or the debt claim to which the interest relates is effectively connected with a permanent establishment or fixed base in that country. Unlike most U.S. income tax treaties, and in significant departure from general U.S. policy, the proposed treaty does not limit the withholding tax that the countries may impose. Accordingly, the U.S. can continue to tax interest paid to Argentine residents at 30 percent and Argentina can continue to tax Argentine source interest paid to U.S. residents at 11.25 percent of gross.

The proposed protocol does provide that if Argentina raises its tax on interest significantly above the rates on August 16, 1979, the government will consider whether the interest rules should be revised. The Argentine rate on August 16, 1979, was 11.25 percent of the gross interest paid.

A provision unique to the proposed treaty is that interest will be exempt from tax at source if paid on debts made to finance imports of capital goods for industrial use by a resident of the source country.

Also, interest paid to a country or one of its instrumentalities will be exempt at source.

The limitations on taxing jurisdiction and the limited exemption from 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 performance 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 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 Argentine rules causes double taxation.

The proposed treaty provides a source rule for interest (which is also used in Article 23 (Relief from Double Taxation) for foreign tax credit purposes. Interest will be sourced within a country if the payor is the government of that country, including political subdivisions and local authorities, or a resident of that country. Generally, this is consistent with U.S. source rules (sections 861–862) which say that interest income is sourced in the country in which the payor is resident. However, if the interest is borne by a permanent establishment (or fixed base) that the payor has in one of the countries and the indebtedness was incurred with respect to that permanent establishment (or fixed base), the interest will be sourced in that country, regardless of the residency of the payor.

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 providing 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 from property located in the United States including royalties for the use of or the right to use intangibles in the United States.

The proposed treaty contains the standard definition of royalty including both industrial and cultural royalties and know-how and also includes equipment rentals. Accordingly, royalties include payments for the use of movies.

Unlike most U.S. income tax treaties, and contrary to general United States treaty policy, the proposed treaty does not provide for reduction of source basis taxation. Instead, the proposed treaty provides that both the country of source and the country of the royalty owner's residence can tax royalties, without limit.

The proposed protocol does provide that if Argentina raises its tax on royalties significantly above the rates on August 16, 1979 the governments will consider whether the royalty rules should be revised. The Argentine rate on August 16, 1979, was 11.25 percent of the gross amount of copyright royalties, 18 percent of the gross amount of other royalties under approved contracts and 22.5 percent of film rentals. Royalties on non-approved contracts were taxed at 45 percent of gross. However, the proposed protocol obligates Argentina to tax equipment rentals net of expenses incurred in producing the rentals including depreciation and expenses of bringing the property to Argentina.

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 royalties are effectively connected with the permanent establishment or fixed base, the royalties will be taxed as business profits (Article 7) or income from the performance of independent personal services (Article 14) in the source country. However, under the saving clause, the United States can tax royalties paid to its citizens or residents even if they are effectively connected with a permanent establishment in Argentina. Also, because of its territorial system of taxation, Argentina would not tax U.S. source royalties in any event.

The proposed treaty provides special source rules for royalties. Generally, under U.S. tax rules (section 861–862) royalty income is sourced where the property or right is being used. The general rule in the proposed treaty is the same as the U.S. Code rule, that is, if the property or rights which are the subject of the royalty are used in one of the countries then the royalty is sourced in that country.

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 Inmovable Property (Real Property)).)

The proposed treaty generally provides that gains from the disposition of property is taxed only in the country of residence with a number of significant exceptions. 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.

Gains from the sale or exchange of ships, aircraft or containers operated by a resident of one country in international traffic are only taxable by the country of residence. However, gains from the disposition of other ships or aircraft, and gains from the disposition of motor vehicles may be taxed where the property is registered as well as the country of residence.

Gains from the disposition of cultural or industrial intangible property described in Article 12 (Royalties) will only be taxed in accordance with that article.

Gains from the sale of real property may be taxed in the country where the real property is located. Special rules provide for the disposition of an interest in an entity (corporation, partnership, trust or estate) the property of which consists principally of real property located in one of the countries. Gains from such a disposition may be taxed by the country in which the real property is located. For this purpose real property includes an interest in an equity holding real property, but does not include property in which the business of the entity is carried on unless that property is rental or agricultural property.

The language in the proposed treaty thus reaches a different result than the Code. Under the Code, business property is included as real estate in determining whether an entity is a U.S. real property interest subject to the real property rules while under the proposed treaty it would not be. Also, under the Code a foreign person who sells an interest in a partnership is taxed on his proportionate share of any U.S. real property owned by the partnership. Under the treaty language, however, the foreign investor would pay no U.S. tax unless the partnership's assets consisted principally of U.S. real estate. The term "principally" is not defined.

Also covered are gains from the disposition of tangible (movable) property which may be taxed where the property is located.

Neither Argentina nor the United States presently taxes nonresidents on the gain on corporate securities, with the exception of U.S. taxation of gain on U.S. real property holding companies. The proposed protocal provides that if either country introduces such a tax they will decide whether to amend the proposed treaty.

Article 14. Independent Personal Services

The income of a nonresident 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 183 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.

Independent personal services include independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists, and accountants.

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 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 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 is modified in some respects for pensions and annuities (Article 18) or to compensation as a government employee (Article 19).

Article 16. Directors' Fees

This provision modifies Article 14 (Independent personal services) and Article 15 (Dependent personal services) and provides a limitation on the amount of directors' fees that may be taxed at source. If a resident of one country receives fees as a director of a company of the other country, then the other country may tax (even if the director is not physically present in the other country in connection with his duties as a director), but, only if the total of all such payments by that company to residents of the other country exceed $12,000 or its equivalent in Argentine pesos in the taxable year. Director's fees do not include fixed or contingent payments received by the person in his capacity as an officer or employee of the company.

Article 17. Entertainers and Athletes

The proposed treaty contains a separate set of rules which govern the taxation of income earned by public entertainers (such as theater, motion picture, radio or television actors and musicians) and athletes. These rules modify the other provisions dealing with the taxation of personal services (Articles 14 and 15). Under the proposed treaty, the source country may tax an entertainer or athlete who is a resident of the other country on the income from his personal services performed in the source country during any year in which the income received exceeds $400 for each day of performance including rehearsal, or exceeds $12,000 or its equivalent in Argentine pesos for 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. (This provision applies notwithstanding Articles 7, 14, and 15). Unlike the U.S. model, the provision in this treaty applies even if there is no abuse. This is because Argentina believes it is too difficult to determine when abuse is present. 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. The provision does not apply if the income is paid to an organization that is tax exempt in its country of residence. In that case, the income is exempt in the source country.

The proposed protocol makes clear that the countries can apply their internal laws to companies that employ entertainers or athletes. Thus, for example, the United States can continue to tax income paid to foreign corporations that employ entertainers and athletes and then sell their services to U.S. promoters.

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. Likewise, social security payments and other similar public pension payments paid by either country to residents of the other country will be taxable only by the paying country. These rules apply to exempt social security payments, even if the recipient is a U.S. citizen, and, accordingly, is an exception to the saving clause. This rule does not apply in the case of pensions which are paid to residents 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 may be taxed in both the recipients' country of residence, and in the source country. The source basis taxation is limited, however, to 20 percent of the gross amount of each payment that is income under the source country's laws. 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).

The proposed treaty contains special rules for alimony and child support payments. Alimony will be exempt from tax at source, while child support payments will be exempt from tax in both countries. Alimony is covered only if taxable to the recipient by his country of residence.

Article 19. Government Service

Under the proposed treaty, compensation paid by one country, its political subdivisions or local authorities, to an individual for labor or personal services performed for the paying governmental entity is taxable only by that country. However, only the country of residence may tax the income if the services are performed there and the individual is a resident national of that country who is a national of that country or did not become a resident of that country solely for the purpose of performing the service. Thus, an individual performing services for an Argentine governmental entity ordinarily will only be taxable by Argentina. However, if he is a U.S. resident performing the services in the United States and is a U.S. citizen, or whose reasons for becoming a U.S. resident were not solely to work for that Argentine governmental agency, 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 receipient 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: Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 16 (Directors Fees), 17 (Entertainers and Athletes), and 18 (Pensions, Etc.).

Article 20. Students and Trainees

Under the proposed treaty, a resident of one country who becomes a full-time student, apprentice, or business trainee in the other country will generally be exempt from tax in the host country on payments from abroad used for maintenance, education, or training.

A full-time student, apprentice or business trainee who qualifies for the exemption from tax by the host country may also elect under the treaty to be treated for tax purposes as a resident of the host country. The election applies for the entire taxable year of the election and all subsequent taxable years during which the individual is a full-time student, apprentice, or business trainee, and it may not be revoked except with the consent of the competent authority of the host country. The purpose of the election is to permit foreign students, apprentices, and business trainees present in the United States to qualify for benefits such as the zero bracket amount (standard deduction), and for the dependency deductions (if applicable). For example, for U.S. tax purposes nonresident aliens are limited to one personal deduction and they are not permitted to claim the standard deduction or the dependency deduction. By electing to be taxed as U.S. residents, they may claim these deductions but, as a consequence, they are subject to U.S. tax on their worldwide income. This election would generally be advantageous for those foreign students, apprentices, and business trainees who do not have any substantial income from sources without the United States.

Article 21. Other Income

The other income article is a catch-all article intended to cover income not specifically covered in other articles. It covers income from third countries as well as income from the United States or Argentina. If the treatment of an item of income derived by a resident of either country is not provided for in one of the other articles of the proposed treaty then that income may be taxed by the source country. This rule applies even if the country of residence does not tax the income. The rule is subject to the saving clause.

The U.S. and OECD models generally give the sole right to tax "other income" to the country of residence.

Article 22. Taxation of Capital

Many countries impose a tax on capital in addition to a tax on income. As a general rule, capital taxes are imposed when the income from the capital would be taxed by the country imposing the capital tax. The United States does not currently impose a capital tax, however, Argentina does. Under Article 2 (Taxes Covered) the Argentine tax on capital is a covered tax. Article 22 therefore applies to the Argentine taxes on capital.

Under the proposed treaty, capital would be taxed by the country in which located if it is real property owned by a resident of either country, or if it is personal property forming part of the business property of a permanent establishment or fixed base maintained by a resident of the other country. The owner's country of residence could also tax that property. The country of residence has the exclusive right to tax ships and aircraft and related personal property operated in international traffic by a resident. Both countries may tax ships or aircraft not solely taxable by a country of residence as well as motor vehicles, shares or other corporate rights, and tangible personal property. All other capital would be taxable only in the country of residence.

Article 23. Relief from Double Taxation

One of the principal reasons for entering into an income tax treaty is to limit double taxation of income earned by a resident of one of the countries that may be taxed by the other country. The United States seeks to mitigate double taxation unilaterally by allowing U.S. taxpayers to credit the foreign income taxes that they pay 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 world-wide consolidated basis. Hence, all income taxes paid to all foreign countries are combined to offset U.S. taxes on all foreign income. Separate limitations on the foreign tax credit are provided for certain interest, DISC dividends, and oil income.

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

Unilateral efforts to limit double taxation are imperfect. Because of differences in rules as to when a person may be taxed on business income, a business may be taxed by two countries as if it were engaged in business in both countries. Also, a corporation or individual may be treated as a resident of more than one country and be taxed on a worldwide basis by both.

Part of the double tax problem was dealt with in previous articles that limited the right of a source country to tax income and that coordinated the source rules. This article provides further relief where both Argentina and the United States will still tax the same item of income. The proposed treaty provides separate rules for relief of double taxation by the United States and Argentina.

The proposed treaty contains the provision found in many U.S. income tax treaties that the United States will allow a citizen or resident a foreign tax credit for income taxes paid or accrued to Argentina. The credit is to be computed in accordance with the provisions of the subject to the limitations of U.S. law. The credit is limited to the amount of tax paid to Argentina and cannot exceed the U.S. Code foreign tax credit limitations.

The proposed treaty also allows the U.S. indirect credit (section 902) to U.S. corporate shareholders of Argentine corporations receiving dividends from those corporations if the U.S. company owns 10 percent or more of the rating stock of the Argentine corporation. The credit is allowed for Argentine income taxes paid by the Argentine corporation on the profits out of which the dividends are paid.

This article provides that Argentine income and capital gains taxes covered by the treaty (Article 2 (Taxes Covered)) are to be considered income taxes for purposes of the U.S. foreign tax credit. Accordingly, all the such Argentine taxes will be eligible for the U.S. foreign tax credit. These taxes would probably be creditable for U.S. tax purposes in the absence of the proposed treaty.

Under the proposed treaty, Argentina will exclude from tax U.S. source income received by its residents which is not Argentine source income. The source of the income is determined by the proposed treaty. This method of eliminating double tax is used by Argentina under its internal law.

The proposed treaty provides that, for purposes of a credit under the treaty, with the exception of interest, royalties and dividends, 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). Interest and royalties will be sourced in the country provided for in Article 11(6) and Article 12(6), respectively. Dividends will be sourced in a country if it is paid by a resident of that country or if Article 10(5)(c) applies to the dividend. Also, the source of income not covered in other Articles (that is, income described in Article 21 (Other Income)), is left to local law.

Article 24. Nondiscrimination

The proposed treaty contains a comprehensive nondiscrimination provision relating to all taxes of every kind imposed at the national, state, or local level. (See Article 2(4).) 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 an Argentine 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 Argentine 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. The provision is not intended to limit the right of the United States to impose its "second withholding tax" on dividends paid by Argentine corporations having a permanent establishment in the United States.

In determining the taxable income of an enterprise of either country, both countries are required (except as provided in Articles 9(1) (Associate Enterprises), 11(5) (Interest), and 12(4) 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. Similarly, for purposes of determining the taxable capital of an enterprise of one country, debts owed to residents of the other country are to be deductible under the same conditions as if they were owed to residents of the same country as the enterprise. 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 eliminate U.S. double tax, such as the dividends received exclusion provided by section 243.

Article 25. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision which authorizes both the competent authority of the United States and Argentina 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.

The provision requires the waiver of the statute of limitations of either country so as to permit the issuance of a refund or credit notwithstanding the statute of limitation. The provision, however, does not authorize the imposition of additional taxes after the statute of limitations has run. This waiver only applies if the competent authority of the country not making the adjustment is notified of the proposed adjustment within one year from the time the taxpayer receives notice.

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. They are specifically authorized to agree on the application of the nondiscrimination provisions in the case of permanent establishments and personal allowances. 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 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 Argentina.

Article 26. Exchange of Information and Administrative Assistance

This article forms the basis for cooperation between the two countries to attempt to deal with 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 statutory provisions concerning taxes to which the convention applies. The exchange of information is specifically not limited by the personal scope article and applies to all national taxes even though not covered by the treaty. 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.

The proposed treaty contains narrow limitations on the obligations of the countries to supply requested information. 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.

The proposed treaty provides that a country receiving a request will endeavor to obtain the information requested in the same way as if its own taxation was involved, notwithstanding the fact that the requested country does not, at that time, need the information. A requested country will use its subpoena or summons powers and any other powers that it has under its own laws to collect information requested by the other country, even though it itself does not need that information for its own purposes. It is intended that the requested country will use those powers even if the requesting country could not under its own laws. Thus, it is not intended that provision be strictly reciprocal. For example, once the U.S. Internal Revenue Service has referred a case to the Justice Department for possible criminal prosecution, the U.S. investigators can no longer use an administrative summons to obtain information. If, however, Argentina could still use administrative process to obtain requested information, it would be expected to do so even though the U.S. cannot. The U.S. could not, however, tell Argentina which of its procedures to use.

The requested competent authority will attempt to provide the information requested in the form requested. Specifically, the competent authority will attempt to provide dispositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts or writings) to the extent that they can be obtained under the laws and practices of the requested country in the enforcement of its own tax laws.

The countries will also collect taxes for the other country, but only to the extent necessary to insure that benefits of the treaty are not going to persons not entitled to those benefits. The provision does not require a country to collect any other taxes of the other country. The collection activities are to be carried out only in accordance with the administrative measures used by the collecting country to collect its own tax, and not in a manner contrary to its sovereignty, security, or public policy.

Article 27. Diplomatic Agents and Consular Officials

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.

Article 28. 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, D.C. The treaty will enter into force when the instruments of ratification are exchanged. The treaty will become effective for taxable years beginning on or after January 1 of the year in which the proposed treaty comes into force except that it will apply to withholding taxes on or after the first day of the second month following the day on which instruments of ratification are exchanged.

Article 29. 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 generally be effective with respect to income of taxable years beginning on or after January 1 next following the expiration of the 6-month period.

Proposed Protocol

A proposed protocol to the treaty was signed at the time the proposed treaty was signed. The proposed protocol clarifies certain points raised in the treaty. The clarifications relate to the Articles dealing with taxes covered (Article 2) and relief from double taxation (Article 23), and the articles dealing with interest (Article 11), royalties (Article 12), capital gains (Article 13), and entertainers and athletes (Article 17). The clarifications are described in the Articles affected.

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