[JOINT COMMITTEE PRINT]

EXPLANATION OF PROPOSED PROTOCOL TO THE INCOME TAX TREATY BETWEEN THE UNITED STATES AND BELGIUM

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

ON AUGUST 9, 1988

PREPARED BY THE STAFF

OF THE

JOINT COMMITTEE ON TAXATION

AUGUST 8, 1988

U.S. GOVERNMENT PRINTING OFFICE

-670 WASHINGTON : 1988 JCS-13-88

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, describes the proposed supplementary protocol to the income tax treaty between the United States and Belgium. The proposed protocol was signed on December 31, 1987, and was amplified by an exchange of notes signed the same day. The proposed protocol would amend the current U.S.-Belgium income tax treaty, which entered into force on October 13, 1972. A public hearing on the proposed protocol is scheduled on August 9, 1988, by the Senate Committee on Foreign Relations.

The primary reason for the negotiation of the proposed protocol was to reduce the tax at source on direct investment dividends from 15 percent to 5 percent, effective January 1, 1988. By thus reducing effective foreign tax rates, the proposed protocol will benefit many U.S. businesses that, particularly after the Tax Reform Act of 1986, have excess foreign tax credits on their foreign income.

In addition to reducing the direct investment dividend rate, the proposed protocol provides rules to prevent nonresidents of the United States and Belgium from enjoying the reduced rates of tax provided in the convention, as amended by the protocol (that is, the proposed protocol prevents a practice commonly referred to as treaty shopping).

The first part of the pamphlet is a summary of the principal provisions of the proposed protocol. The second part presents a discussion of the issues raised by the proposed protocol. This is followed by a third part containing a detailed, article-by-article explanation of the proposed protocol.

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty between the United States and Belgium* (JCS-13-88), August 8, 1988.

I. SUMMARY

Ihe proposed protocol contains the following modifications to the come tax treaty between the United States and Belgium.

(1) Dividends.—The proposed protocol would replace present Ar- ·le 10 (Dividends) of the existing treaty with a new Article 10. ıe principal change is the reduction of the maximum allowable te of tax at source on direct investment dividends. The existing eaty requires neither party to reduce its rate of tax at source on vidends below 15 percent. Under the proposed protocol, the maxi- um allowable rate would be reduced to 5 percent in cases where e beneficial owner of the payor is a company that owns at least percent of the voting stock of the payor.

(2) Anti-treaty shopping provision.—The proposed protocol would ld a provision to the treaty that generally ensures that the re- ıced rates of tax at source on dividends, interest, and royalties ould be received only by corporations whose shares are publicly aded in Belgium or the United States and corporations controlled any combination of U.S. residents, U.S. citizens, Belgium resi- nts, or the countries themselves. The existing treaty does not ntain an anti-treaty shopping provision. The proposed anti-treaty opping provision is similar to those included in recently ratified eaties, but is somewhat less strict than the anti-treaty shopping ovision of the 1981 proposed U.S. model income tax treaty (the J.S. model treaty" or the "U.S. model").

II. ISSUES

The proposed protocol raises the following specific issues.

(1) Dividends paid by pass-through entities

The primary reason for the proposed protocol is to reduce maximum allowable rate of tax at source of direct investment dends. Under the existing treaty, this rate is 15 percent; the posed protocol reduces that rate to 5 percent when the bene owner is a company that owns at least 10 percent of the v stock of the payor.

These reductions from the Internal Revenue Code withho rate of 30 percent are consistent with the U.S. model treaty consistent with one objective of the U.S. income tax treatie eliminate international double taxation by an agreed divisio income among two contracting parties. They reflect the view where, for example, the United States already imposes corpo level tax on the earnings of a U.S. corporation, a 30 percent w holding rate may represent an excessive level of source cou taxation. Moreover, the 5 percent rate reflects the view that source country tax on payments of profits to a substantial non dent corporate shareholder may properly be reduced furthe avoid double corporate-level taxation and to facilitate internati investment. However, even though the reductions will ben many U.S. multinationals by reducing their effective foreign rates, the reductions raised a concern that when the dividends paid by a U.S. company which generally does not pay any co rate level income tax they are inappropriate.

A regulated investment company (RIC) is a U.S. corporation is subject to the regular corporate income tax, but that receiv reduction for dividends paid to its shareholders if certain co tions are met (Code secs. 852(b)(2)(D) and (3)). One of those co tions is the requirement that a RIC distribute most of its inco Thus, a RIC is treated, in effect, as a conduit for federal income purposes. One purpose of this entity is to allow investors to capital to diversify investments, which they might not be able t otherwise, Dividends paid by a RIC generally are treated as source income, and thus, generally are subject to the U.S. withh ing tax of 30 percent when paid to foreign shareholders.

Because a RIC generally does not pay any corporate level income tax on the earnings it distributes and because it represe for its investors a diversification of portfolio investments, theory for reducing the maximum allowable rate of tax on source dividends in the case of dividends paid by a RIC t "direct" investor is not present. Whether the investment in RIC is above or below the threshold level for the direct inves dividend rate, the investment represents in effect an investmen the underlying portfolio investments of the RIC. Therefore, nount of stock owned in the RIC should be disregarded in determining whether the shareholder is a direct investor.

A real estate investment trust (REIT) is a corporation, trust, or ssociation that is taxable as a U.S. corporation but that, like a IC, receives conduit treatment for income that is distributed to areholders if certain conditions are satisfied (Code sec. 857(b)). ke a RIC, a REIT must distribute most of its income to qualify r conduit treatment. A REIT is organized to allow persons to dirsify ownership in primarily passive real estate investments. ften, the principal income of a REIT is rentals from real estate ldings.

Because a REIT is taxable as a U.S. corporation, a distribution of rnings is treated as a dividend, rather than income of the same pe as the underlying earnings. This is true even though the REIT nerally is not taxable at the entity level on the earnings it disibutes. Because a REIT cannot be engaged in an active trade or isiness, its distributions are U.S. source and are thus subject to .S. withholding tax of 30 percent when paid to foreign owners. hen the distributions are composed of rental income, for exame, they are not considered rental income to the recipient. Like vidends, U.S. source rental income of foreign persons generally is ibject to U.S. withholding tax at a statutory rate of 30 percent nless, in the case of rental income, the recipient elects to have it xed in the United States on a net basis at the regular income tax tes). Unlike the tax on dividends, however, the withholding tax rental income generally is not reduced in U.S. income tax treaes.

It has always been the United States' position to preserve the ght to tax income from real property to the country in which the come is derived. Thus, the United States always preserves its ght to tax real property income derived from the United States in s income tax treaties.

The issue presented under the proposed protocol and under the cisting treaty is whether dividends paid by a RIC or a REIT iould be treated differently from dividends paid by other U.S. corrations. Because those entities generally do not pay any corpote level U.S. income tax, and in the case of a REIT, because its come often is composed of a type of income over which the nited States maintains its right to tax in its treaties, reducing the .S. withholding tax rate on dividends as under the existing treaty nd the proposed protocol is inconsistent with the purposes of the ividend rate reductions and maintenance of source country jurisiction over real property income.

The committee could consider a reservation to the proposed procol to modify the reduction of the U.S. withholding tax on dividends paid by a RIC and a REIT. It is understood that the Treasury epartment considers the reductions in the proposed protocol and the existing treaty to be inappropriate with respect to distribuons from RICs and REITs. It is further understood that the Treasry Department will modify the reductions in the proposed protol and in the existing treaty when a new treaty with Belgium is egotiated. Because the Treasury Department is pursuing expediously a new treaty with Belgium and expects to complete a new eaty within the next twelve months, and because a reservation would considerably delay the benefits to be derived by U.S. m- tionationals under the proposed protocol, the committee could i- stead consider the proposed protocol with an understanding th the dividend reductions contained in the proposed protocol and i the existing treaty will be modified when the new treaty is nego- ated.

(2) Treaty shopping

The proposed protocol, like a number of U.S. income tax treati- generally limits source country withholding tax on dividends, int- est, and royalties paid to residents of the other country. Althou the proposed protocol is intended to benefit residents of Belgiu and the United States only, residents of third countries sometim attempt to use a treaty to obtain treaty benefits. This is known treaty shopping. Investors from countries that do not have tax tre- ties with the United States, or from countries that have not agre in their tax treaties with the United States to limit source countr taxation to the same extent that it is limited in another treaty m attempt to secure a lower rate of U.S. tax by, for example, lendi money to a U.S. person indirectly through a country whose trea with the United States provides for a lower rate. The third-count investor may do this by establishing a subsidiary, trust, or oth investing entity in that treaty country which then makes the loa to the U.S. person and claims the treaty reduction for the intere it receives.

The anti-treaty shopping provision of the proposed protocol d fers form the anti-treaty shopping provision of the current U. model. While the U.S. model provision is only one of several a proaches that the Treasury Department considers satisfactory prevent treaty shopping abuses, the model provision is nonethele a standard against which to compare the proposed protocol's ant treaty shopping provision. The issue, then, is whether the propose anti-treaty shopping provision effectively forestalls potential treat shopping abuses.

One provision of the anti-treaty shopping article of the propose protocol is more lenient than the comparable rule in the U.S model and other U.S. treaties. The U.S. model allows benefits to b denied if 75 percent or less of a resident company's stock is held b individual residents of the country of residence, while the propose protocol (like several newer treaties and an anti-treaty shoppin provision in the Internal Revenue Code) lowers the qualifying pe centage to 50, and broadens the class of qualifying shareholders t include residents of either treaty country (and citizens of th United States). Thus, this safe harbor is considerably easier t enter under the proposed protocol. On the other hand, counting fo this purpose shareholders who are residents of either treaty coun try would not appear to invite the type of abuse at which the prov son is aimed, since the targeted abuse is ownership by third-coun try residents attempting to obtain treaty benefits.

Another provision of the anti-treaty shopping article of the pro posed protocol, which is coupled with the ownership requirement t achieve rate reduction benefits, is the "base erosion" rule. This re quirement is met only if more than 50 percent of the gross incom of the person claiming benefits is not used directly or indirectly t

eet liabilities for interest or royalties to persons who are not resi-
ents of Belgium or the United States, citizens of the United
ates, or the countries themselves. This rule, commonly referred
as the "base erosion" rule, is necessary to prevent a corporation,
r example, from distributing most of its income through the use
deductible payments to persons not entitled to benefits under
e treaty. Because the rule is limited to payments of interest or
yalties to persons not entitled to benefits, the provision may not
broad enough to achieve its intended purpose. It is understood
at the Treasury Department is continuing to examine the scope
the base erosion rule to ensure that its breadth is adequate. It
ay be that other forms of payments, such as management fees or
mpensation arrangements, will have to be included when the
eaty is renegotiated.

Another provision of the anti-treaty shopping article differs from
e comparable rule of the U.S. model, but the effect of the change
less clear. The general test applied by the U.S. model to deny
nefits is a broad one, looking to whether the acquisition, mainte-
nce, or operation of an entity had "as a principal purpose obtain-
g benefits under" the treaty. By contrast, the proposed protocol
ntains a more precise test that allows denial of benefits only with
spect to income not derived in connection with the active conduct
a trade or business. (However, this active trade or business test
es not apply with respect to a business of making or managing
vestments, so benefits can be denied with respect to such a busi-
ss regardless of how actively it is conducted.) The practical dif-
rence between the two tests will depend upon how they are inter-
eted and applied. The principal purpose test may be applied le-
ently (so that any colorable business purpose suffices to preserve
eaty benefits), or it may be applied strictly (so that any signifi-
nt intent to obtain treaty benefits suffices to deny them). Similar-
, the trade or business test could be interpreted to require a more
tive or a less active trade or business (though the range of inter-
etation is far narrower). Thus, a narrow reading of the principal
rpose test could theoretically be stricter than a broad reading of
e active business test (i.e., would operate to deny benefits in po-
ntially abusive situations more often).

In practice, however, the opposite may be more likely. The IRS
ay find it relatively difficult to sustain a narrow reading of the
incipal purpose test. In litigation involving Code section 367, for
ample, which utilized a principal purpose test until 1985, courts
ve consistently refused to apply this test to transactions where
xpayers could claim any business purpose. Given that possibility,
may well be that the test contained in the proposed protocol will
ove stricter than that in the U.S. model treaty.

The proposed protocol also provides an exception that preserves
nefits for publicly traded companies. Under this test, a company
at is a resident of one of the countries and either (1) in whose
incipal class of shares there is substantial and regular trading on
recognized securities exchange, or (2) more than 50 percent of
hose share of each class is owned by a resident of that country in
hose principal class of shares there is also substantial and regular
ading on a recognized securities exchange, would be entitled to
e benefits of the reduced rates of tax at source on dividends, in-

terest, and royalties regardless of where its actual owners resi
The terms "substantial" and "regular" are not defined in the p
posed protocol, nor does the Treasury Department's technical
planation detail any standard for these terms. Presumably th
the terms would be defined pursuant to local law. The regulati
under Code section 897, relating to an exception from the taxat
of real property income for certain stock that is regularly trad
on an established securities market, provide a definition of "re
lar" for that purpose. Also, the Tax Reform Act of 1986 (the "19
Act") enacted a branch profits tax that allows certain treaty-p
tected residents to avoid being subject to the tax if their stock
"primarily and regularly" traded on an established securit
market. Although no regulations are prescribed to define the
ception from the branch profits tax, it may be that, for practi
reasons the definition provided when the regulations are prescrib
could be used for interpreting the substantial and regular t
under the proposed protocol.

The United States should maintain its policy of limiting trea
shopping opportunities whenever possible. In this regard, it is no
ble that the proposed protocol would add an anti-treaty shoppi
provision to the existing treaty. Although drafted to limit foresee
ble cases of abuse, the anti-treaty shopping provision of the pr
posed protocol may not prevent all potential unintended uses of t
treaty by third-country investors. For example, it is undestood th
the Treasury Department generally does not believe that Belgi
Coordination Centers, which are entitled to special tax benefi
that result in their paying little or no Belgian tax, can avail the
selves of the good business purpose exception. However, to bolst
this view, the committee may want to consider an understanding
that effect. Allowing the United States to fully tax U.S. sour
income derived by a Coordination Center in the event the oth
conditions to satisfying the anti-treaty shopping provision are n
met would be consistent with one of the primary objectives of th
existing treaty and the proposed protocol—to eliminate double ta
ation, rather than all taxation. The committee should further sati
fy itself that the anti-treaty shopping provision in its entirety is a
adequate deterrent of possible treaty-shopping abuses in the futur

(3) Implementation of the Tax Reform Act of 1986

The 1986 Act enacted several fundamental changes in the U.S
taxation of U.S. persons doing business abroad and foreign persor
doing business in the United States. The proposed protocol does nc
address any of those changes.

One of those changes was the imposition of branch level taxes o
foreign corporations earning income effectively connected with th
conduct of a U.S. trade or business. The 1986 Act provided that n
U.S. treaty shall exempt any foreign corporation from the branc
profits tax (or reduce the amount thereof) unless the foreign corpo
ration is a "qualified resident" of the treaty country or the treat
satisfies certain other criteria. (A bill passed by the House of Rep
resentatives and pending in the Senate which includes technica
corrections to the 1986 Act amends this requirement to provid
that only qualified treaty country residents are entitled to treat
waivers or reductions of the branch profits tax.) The 1986 Act als

rovided that its withholding tax on dividends paid by a foreign ırporation that derives a certain amount of its income from a U.S. usiness would not apply if the earnings distributed were subject to ıe branch profits tax.

As indicated above, the proposed protocol does not attempt to im- lement this change in U.S. tax policy. The proposed protocol does, owever, include a provision, which is substantially similar to a rovision in the existing treaty, that precludes the United States om imposing its withholding tax on dividends paid by a Belgian ımpany to Belgian residents where the Belgian company derives 5 percent or more of its income does not explicitly provide for the nposition of a branch profits tax.

The issue presented with respect to the branch profits tax (and ıe other changes in U.S. tax policy caused by the 1986 Act that re not incorporated in the proposed protocol) is whether the pro- ısed protocol should have incorporated this change. On the one and, the legislative history to the 1986 Act makes it clear that ongress refrained from overriding U.S. income tax treaties that rguably prevented the imposition of the branch profits tax to llow the Treasury Department to renegotiate existing treaties to nplement that change in U.S. tax policy. In this case, it would ave been appropriate for the proposed protocol to have included ıis change. On the other hand, the proposed protocol was done uickly to reduce direct investment dividends, but was done on the nderstanding that a new treaty, which would incorporate, among her things, the many changes brought about by the 1986 Act, ould be taken up expeditiously after ratification of the proposed rotocol. Since the Treasury Department expects to have a new eaty within twelve months, the Committee could consider the roposed protocol with an understanding, rather than reserving on ıe issue, that the U.S. tax policy changes in general, and the im- ısition of the branch profits tax, in particular, caused by the 1986 ct will be incorporated in the new treaty.

III. EXPLANATION OF PROPOSED PROTOCOL

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

Article 1. Dividends

The proposed protocol would replace the present dividend arti
with a new article whose principal change lowers the maximum
lowable rate of tax at source on direct investment dividends. T
lower rate is consistent with the rate contained in the U.S. mo
and recently ratified treaties. The other treaty provisions perta
ing to the taxation of dividends are modernized by the propo
protocol, bringing the treaty's dividend article into closer confor
ty with the U.S. model.

The existing treaty allows both the United States and Belgium
tax dividends paid by a corporation of one country to a resident
the other. The maximum allowable rate of tax at source on di
dends is 15 percent, regardless of the recipient's ownership inter
in the dividend payor, unless the shares on which the dividends a
paid are effectively connected with a permanent establishment
one of the countries. In this latter case, the dividends are taxal
as business profits (Article 7 of the treaty). The existing treaty a
precludes one country from taxing dividends paid by a corporati
of the other country to residents of the other country, unless t
shares on which the dividends are paid are effectively connect
with a permanent establishment in the first country.

Under the proposed protocol, dividends paid by a corporation
one country to a resident of the other can continue to be taxed
both the United States and Belgium. However, when the corpor
tion paying the dividends is resident in one country and the bene
cial owner of the dividends is resident in the other, the maximu
allowable rate of tax is 5 percent if the beneficial owner is a co
pany that owns directly at least 10 percent of the voting stock
the corporation paying the dividends. In other cases, the maximu
allowable rate continues to be 15 percent. These rules do not r
strict the right of a country to tax the profits out of which di
dends are paid. This difference in treatment of dividends paid
"direct" investors and to "portfolio" investors (i.e., those compar
investors not owning at least 10 percent of the payor's voting stoc
is consistent with the treatment provided by the U.S. model.

Like the U.S. model treaty, the proposed protocol defines "div
dends" as income from shares or other rights which participate i
profits and which are not debt claims. To conform with Belgiu
law, the term also includes income from "jouissance" shares o
"jouissance" rights, mining shares, or founders shares which pa
ticipate in profits and which are not debt claims. Dividends also i
clude income from other corporate rights which is subjected to th

me tax treatment by the country in which the distributing corpo- tion is resident as income from shares. Under this provision, ch country may apply its rules for determining when a payment a resident company is on a debt obligation or an equity interest. nally, at Belgium's request, the term dividends includes income— en if paid in the form of interest—which is taxable as income om capital invested by the members of a company, other than an corporated company, which is a resident of Belgium. This latter clusion in the term dividends, the inclusion of which is substan- lly similar to a provision in the existing treaty, allows Belgium exercise an anti-abuse rule in its law by treating as dividends, gardless of how remitted, income paid by an unincorporated Bel- an company with respect to capital invested by its owners. The easury Department's technical explanation gives as an example this rule interest paid on loans made to a closely held general rtnership by one or more of its partners.

Consistent with the U.S. model and the existing treaty, the pro- sed protocol's limitations on source country dividend tax will not ply under the proposed protocol if the beneficial owner of the vidend carries on business through a permanent establishment in e source country and the shareholding with respect to which the vidends are paid forms part of the assets of the permanent estab- hment. The proposed protocol also modernizes the existing treaty not applying the proposed protocol's limitations on source coun- y dividend tax if the beneficial owner of the dividend performs in e source country independent personal services from a fixed base uated in that country and the shareholding with respect to nich the dividends are paid forms part of the assets of the fixed se. In these cases, the dividends are not taxed under the provi- ons of this article, but as business profits (Article 7 of the treaty) as independent personal services (Article 14 of the treaty), re- ectively.

The proposed protocol limits the right of a country to tax divi- nds paid by a company resident in the other country to residents that other country. Generally, the country in which the compa- is not resident may only tax dividends paid by a company resi- nt in the other country to residents of that other country if the areholding with respect to which the dividends are paid forms rt of the assets of a permanent establishment or a fixed base sit- ted in the first mentioned country. However, as indicated in the chnical explanation, if the United States is the first mentioned untry, it can tax dividends paid by a Belgian company to a U.S. izen resident in Belgium; the United States reserves the right to x its citizens as if the convention had not come into effect (para- aph 1 of Article 23).

This provision, which is inconsistent with the U.S. model to the tent it precludes a country from taxing dividends paid to the ner country's residents if certain income thresholds are met by e distributing company, precludes the United States from impos- g its withholding tax on dividends paid to Belgian residents by a lgian company that derives 25 percent or more of its income from J.S. business.

As under the existing treaty, the proposed protocol allows Bel- um to tax, pursuant to its internal law, dividends paid by a company which is a resident of Belgium to a company not resident Belgium but where the shareholding forms part of the assets c permanent establishment situated in Belgium.

Article 2. Cross Reference

This article merely corrects a cross-reference in the exist treaty caused by the proposed protocol.

Article 3. Limitation on Benefits

The proposed protocol contains a provision which is intended limit the benefits of the reduced rates of tax at source on d dends, interest, and royalties to persons who are entitled to th benefits by reason of their residence in the United States or B gium. The present treaty does not contain such a provision. T new provision is somewhat less strict than the corresponding pro sion of the U.S. model treaty. It is similar to, but not identical the limitation of benefits articles included in the recently ratif U.S. income tax treaties with Barbados, Australia, and New Z land.

The treaty is intended to limit double taxation caused by t interaction of the tax systems of the United States and Belgium they apply to residents of the two countries. At times, howev residents of third countries attempt to use a treaty. Such use known as "treaty shopping," and refers to the situation where person who is not a resident of either country seeks certain ben fits under the income tax treaty between the two countries. Und certain circumstances, and without appropriate safeguards, t nonresident is able indirectly to secure these benefits by establis ing a corporation (or other entity) in one of the countries which, a resident of that country, is entitled to the benefits of the trea Additionally, it may be possible for the third country resident reduce the income base of the treaty country resident by havi the latter pay out interest, royalties, or other amounts under favo able conditions (i.e., it may be possible to reduce or eliminate t taxes of the resident company by distributing its earnings throu deductible payments or by avoiding withholding taxes on the dist butions) either through relaxed tax provisions in the resident cou try or by passing the funds through other treaty countries (esse tially, continuing to treaty shop), until the funds can be repatriat under favorable terms.

As indicated above, the proposed new anti-treaty shopping artic of the protocol is intended to limit the benefits of the reduced rat of tax at source on dividends, interest, and royalties to bona fi residents of the two countries. This would be accomplished by pr viding that a person other than an individual (such as a corpor tion, partnership or trust) is not entitled to the benefits of the r duced rates of tax at source on dividends, interest, and royalti unless it satisfies any one of an ownership and "base erosion" tes a good business purpose test, or a public company test.

Under the ownership and base erosion test two conditions mu be satisfied. First, more than 50 percent of the beneficial intere in the person (in the case of a company, more than 50 percent the number of shares of each class of shares) must be owned direc ly or indirectly by any combination of one or more individual res ents of Belgium or the United States, citizens of the United tates, or the governments of the United States or Belgium. This rovision would, for example, deny the benefits of the reduced U.S. ithholding tax rates on dividends, interest, or royalties paid to a elgium company that is controlled by individual residents of a hird country. This rule is not as strict as that contained in the [.S. model, which requires 75 percent ownership, by residents of ie person's country of residence, to preserve benefits.

Second, reduced rates of tax at source on dividends, interest, and oyalties is available only if more than 50 percent of the gross icome of the person is not used directly or indirectly to meet liabilities for interest or royalties to persons who are not residents of elgium or the United States, citizens of the United States, or the overnments of Belgium or the United States. This rule is commony referred to as the "base erosion" rule and is necessary to preent a corporation, for example, from distributing most of its icome through the use of deductible payments to persons not entiled to benefits under the treaty. Gross income for this purpose is efined to mean: in the case of the United States, gross income as efined in the Internal Revenue Code of 1986, as may be amended rom time to time, without regard to the geographic source of the icome; and in the case of Belgium, gross receipts, or in the case of manufacturer or producer of goods, gross receipts reduced by the irect costs of labor and materials attributable to the manufacture r production and paid or payable out of those receipts. This provision is substantially similar to that in the U.S. model treaty.

Under the good business purpose test, denial of reduced rates of ax at source would not occur if the resident entity's dividends, inerest, or royalties are derived in connnection with, or are incidenal to, the active conduct of a trade or business in the residence ountry. However, this exception does not apply (and benefits are herefore denied) to a business the principal activities of which are naking or managing investments in the source country. This active rade or business rule replaces a more general rule in the U.S. nodel treaty and most recent U.S. income tax treaties that preerves benefits if an entity is not used "for a principal purpose of btaining benefits" under a treaty. It is understood that a Belgian Coordination Center, which receives special tax benefits in Belium, generally cannot avail itself of the good business purpose est. This would result in, for example, a Belgian Coordination Center, which does not satisfy the ownership or base erosion tests nd which receives dividends, interest, or royalties from the United States, not being entitled to reduced rates of U.S. tax under the reaty (unless it satisfied the public company test).

Under the public company test, a company that is a resident of ne of the countries and either (1) in whose principal class of hares there is substantial and regular trading on a recognized securities exchange, or (2) more than 50 percent of whose shares of ach class is owned by a resident of that country in whose principal class of shares there is also substantial and regular trading on recognized securities exchange, would be entitled to the benefits f the reduced rates of tax at source on dividends, interest, and roylties regardless of where its actual owners reside. The term "recgnized securities exchange" means any stock exchange registered with the Securities and Exchange Commission as a national secu ties exchange for purposes of the Securities Exchange Act of 193 the NASDAQ system owned by the National Association of Secu ties Dealers, Inc., the Belgium stock exchanges, and any other sec rities exchange agreed upon by the competent authorities of th two countries.

Article 4. Entry into Force

The proposed protocol will enter into force on the fifteenth da after the date of the exchange of the instruments of ratificatio Once in force, the provisions of the proposed protocol will app retroactively to dividends, interest, and royalties credited or pa on or after January 1, 1988.

Article 5. Termination

The proposed protocol will remain in force as long as the U.S Belgium income tax treaty remains in force.

A separate termination provision provides, however, that eithe country can terminate separately the provisions of the propose protocol by giving through diplomatic channels at least six month written notice of termination to the other country at any tim after five years from the day on which the proposed protocol ente into force. In this case, the proposed protocol ceases to apply t dividends, interest, and royalties credited or paid on or after th first January 1 that follows after expiration of the six-mont period and the provisions of the treaty, as effective on Decembe 31, 1987, shall apply to those amounts.

Exchange of Notes

At the signing of the proposed protocol, notes were exchange confirming the understanding of the U.S. and Belgium delegation as to the meaning of "beneficial interest", as that term is used i the anti-treaty shopping article. As indicated above, the propose protocol would add an anti-treaty shopping article. Unless othe conditions are satisfied, the proposed protocol would preclude a person (other than an individual) from claiming reduced rates o tax at source on dividends, interest, and royalties unless more tha 50 percent of the "beneficial interest" in the person is owned di rectly or indirectly by any combination of one or more individua residents of Belgium or the United States, citizens of the Unite States, or the governments of Belgium or the United States. The Belgium and United States delegations agreed that the French an Dutch language texts of the anti-treaty shopping article would in corporate the English meaning of the term "beneficial interest." As intended, more than 50 percent of the rights to income and othe economic rights in the person claiming treaty benefits would have to be owned by qualifying persons. As an example, the notes state that in the case of a trust claiming treaty benefits, more than 50 percent of the interests held by beneficiaries of the trust must be held by qualifying persons. The identities of the legal owners of the trust would be irrelevant for this purpose, the notes stated.