COMPARISON OF THE UNITED STATES MODEL INCOME TAX CONVENTION OF SEPTEMBER 20, 1996 WITH THE UNITED STATES MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

May 8, 2007
JCX-27-07

CONTENTS

INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, compares the Model Income Tax Convention of September 20, 1996 with the Model Income Tax Convention of November 15, 2006. Part I of the pamphlet provides a side-by-side summary of certain differences on an article-by-article basis. Part II provides a fuller explanation of the differences with respect to articles that were significantly modified in November 2006.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Comparison of the United States Model Income Tax Convention of September 20, 1996 with the United States Model Income Tax Convention of November 15, 2006* (JCX-27-07), May 8, 2007. References to "the Code" are to the U.S. Internal Revenue Code of 1986, as amended. This document is available on line at www.house.gov/jct.

I. COMPARISON OF THE UNITED STATES MODEL INCOME TAX CONVENTION OF SEPTEMBER 20, 1996 WITH THE UNITED STATES MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
1. General Scope Sets forth general rules relating to applicability of certain articles and other agreements.	The Convention generally does not restrict benefits accorded under other agreements between the Contracting States (also referred to herein as "treaty countries"). The 1996 Model provides that nondiscrimination provisions of the Convention generally govern taxation measures of the Contracting States. In the event that other agreements providing national treatment or most-favored-nation obligations also include nondiscrimination provisions, those of the Convention generally override those in the other agreements. An exception to this override is provided for the nondiscrimination provisions under the General Agreement on Tariffs and Trade ("GATT"). For purposes of the saving clause (which provides that the Convention does not affect the taxation by a Contracting State of its citizens and residents), a citizen includes a former citizen or long-term resident whose loss of this status was to avoid tax, but only for 10 years.	The Convention generally does not restrict benefits accorded under other agreements to which the Contracting States are parties. Thus, as modified, the Convention generally does not restrict benefits under multilateral agreements (as well as bilateral ones). Unlike the 1996 Model, the provision does not generally override all nondiscrimination provisions in other agreements, but rather, overrides only the nondiscrimination provision of Article XVII of the General Agreement on Trade in Services ("GATS"). The reference to GATT in the 1996 Model is deleted in the 2006 Model. The saving clause is modified to permit the United States to tax a former citizen or former long-term resident under section 877 of the Code (i.e., for 10 years following the loss of such status). The provision no longer includes the requirement of a purpose to avoid tax.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
	Exceptions to the saving clause did not include a reference to paragraph 1(b) of the Article relating to Pensions, Social Security, Annuities, Alimony, and Child Support. The rule relating to income, profit or gain derived through a fiscally transparent entity was in Article 4. This rule provides that items derived through a fiscally transparent entity are treated as derived by a resident of a Contracting State to the extent that that the items are so treated under that Contracting State's tax law.	Exceptions to the saving clause are modified by including a reference to new paragraph 1(b) of the Article relating to Pensions, Social Security, Annuities, Alimony, and Child Support (Article 17). This preserves the rule that pensions arising in one Contracting State that are exempt from tax in that State are also exempt from tax in the pensioner's State of residence. The rule relating to income, profit or gain derived through a fiscally transparent entity is moved from Article 4 to Article 1.
2. Taxes Covered Describes the specific U.S. taxes and taxes of the other treaty country.	The article lists the specific taxes covered for both of the Contracting States.	To move closer to the Model Tax Convention of the Organisation for Economic Co-operation and Development ("OECD"), the article broadens the scope of taxes covered to include taxes on income imposed on behalf of the Contracting State irrespective of the manner in which they are levied. Consequently, the article may cover certain additional taxes on income that are not substantially similar to the enumerated taxes. Taxes on income include all taxes imposed on total income, or on elements of income, including taxes on gains from the alienation of property.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
	The article lists specified U.S taxes to which the Convention applies: Federal income taxes imposed by the Internal Revenue Code (but excluding social security taxes), and the Federal excise taxes imposed with respect to private foundations. The Technical Explanation ("Technical Explanation") to the United States Model Income Tax Convention of September 20, 1996 additionally excludes Federal unemployment taxes. The competent authorities of the Contracting States are required to notify each other of significant changes in their taxation laws or of other laws that affect their obligations under the Convention. The competent authorities are also obligated to notify each other of any official published materials concerning the application of the Convention, including explanations, regulations, rulings or judicial decisions.	The article lists specified U.S taxes to which the Convention applies: Federal income taxes imposed by the Internal Revenue Code (but excluding social security taxes and unemployment taxes), and the Federal excise taxes imposed with respect to private foundations. The competent authorities are no longer obligated to notify each other of any official published materials concerning the application of the Convention.
3. General Definitions Sets forth certain definitions generally applicable to the convention.	No definition is provided for the term "enterprise." No definition is provided for the term "business."	The term "enterprise" applies to the carrying on of any business. The term "business" includes the performance of professional services and of other activities of an independent character.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
	Defines “qualified governmental entity.” This definition includes governmental noncommercial entities and governmental pension funds and is relevant to Article 4 (Residence), Article 10 (Dividends) (zero rate), and Article 22 (Limitation on Benefits).	No longer defines “qualified governmental entity.” As a consequence, activities (other than those of pension funds) of the United States or its political subdivisions (e.g., States) could be subject to tax on dividends in the other treaty country. (Activities of a foreign country in the United States remain covered by Code sec. 892.) Defines “pension fund,” relevant to Article 4 (Resident), Article 10 (Dividends), Article 22 (Limitation of Benefits), and new Article 18 (Pension Funds). A “pension fund” is any person established in a treaty country that is generally exempt from income tax in that country and is operated principally either (a) to administer or provide pension or retirement benefits, or (b) to earn income for the benefit of one or more persons described in (a).

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
4. Resident Provides rules for determining whether a person is a resident of a Contracting State for purposes of the Model Convention. Under those rules, residence is determined by looking first to a person's liability to tax as a resident under the respective taxation laws of the Contracting States. Tie-breaker rules are provided to address situations in which a person is a resident of both Contracting States on the basis of this first rule.	Paragraph 1(c) provides that a "qualified governmental entity," which includes the government of a Contracting State, or of a political subdivision of local authority thereof, and an entity wholly owned by such a government, is to be treated as a resident of the Contracting State in which it is established. Paragraph 1(d) provides that when an item of income, profit, or gain is derived through an entity that is fiscally transparent under the laws of either Contracting State, it shall be considered to be derived by a resident of a State to the extent that the item is treated for tax purposes in that State as the income, profit, or gain of a resident. Paragraph 3 provides that if a company is a resident of both Contracting States under the provisions of paragraph 1, but is created under the laws of one of the Contracting States, it shall be treated as a resident of that State. The Model Convention does not address other situations in which a company may be a dual resident under paragraph 1.	Paragraph 1 provides, in part, that a Contracting State, or any political subdivision or local authority thereof, is a resident of that State. This change reflects the elimination of "qualified governmental entity" as a defined term in the Model Convention. The residence treatment of items of income, profit, or gain derived through fiscally transparent entities is found in paragraph 6 of Article 1 of the Model Convention. Paragraph 4 provides that if a company is a resident of both Contracting States under the provisions of paragraph 1, but is created or organized under the laws of only one of the Contracting States, it shall be treated as a resident of that State; in all other cases, the competent authorities shall attempt to determine the mode of application of the Model Convention to that company. If the competent authorities cannot agree, the company will not be treated as a resident of either Contracting State for purposes of applying the Model Convention.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
5. Permanent Establishment Defines the term "permanent establishment," a concept that is significant for several Articles of the Model Income Tax Convention. The existence of a permanent establishment in a treaty country is necessary for the taxation by that country of the business profits of a resident of the other treaty country. The concept is also relevant in determining the taxation of dividends, interest, and royalties (as well as the taxation of gains and other income) by the source country.	Paragraph 4 expressly provides that certain activities will not, by themselves, create a permanent establishment; among these are the maintenance or use of facilities, goods or merchandise for certain purposes (subparagraphs (a) through (e)), as well as the maintenance of a fixed place of business solely for any combination of the activities described in subparagraphs (a) through (e) (paragraph 4(f)).	No significant change. A clarifying proviso is added to paragraph 4(f), to make explicit that the maintenance of a fixed place of business solely for any combination of the activities listed in paragraphs 4(a) through (4)(e) is excluded from permanent establishment treatment only if the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary nature.
6. Income from Real Property Provides rules for the taxation of income from real property derived by residents of one treaty country from real property situated in the other treaty country. Permits these residents to elect net-basis taxation of this real property income.	The term used to describe the property to which the article applies is "real property (immovable property)." The definition of "real property (immovable property)" is the same as the definition under the law of the treaty country in which the property in question is located.	The term used to describe the property to which the article applies is "real property." The definition of "real property" is expanded to include additional categories of property regardless of the law of the treaty country in which the property is located. These categories of property include, among others, property accessory to real property (including livestock and equipment used in agriculture and forestry) and rights to variable or fixed payments as consideration for the working of, or the right to

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
	The general rules of the article apply to income from real property of an enterprise and to income from real property used for the performance of independent personal services.	work, mineral deposits, sources, and other natural resources. "Real property" does not include ships and aircraft. The reference to income from real property used for the performance of independent personal services is deleted (in conformity with the deletion of the independent personal services article from the 2006 Model Convention).
7. Business Profits Provides rules for the taxation by a treaty country of the profits of an enterprise carried on by a resident of the other treaty country. In general, the profits of an enterprise of a treaty country are not taxable by the other treaty country unless the enterprise carries on business in the other treaty country through a permanent establishment.	Paragraph 2 provides, *inter alia*, that profits to be attributed to a permanent establishment include "only the profits derived from the assets or activities of the permanent establishment." Paragraph 3 provides that in determining the business profits of a permanent establishment, deductions are allowed for expenses incurred for the purposes of the permanent establishment, including a reasonable allocation of certain listed categories of expenses, whether incurred in the treaty country in which the permanent establishment is located or elsewhere.	Paragraph 2 is modified to expressly include profits derived from "risks assumed" by the permanent establishment (as well as profits derived from assets used and activities performed) among profits attributed to the permanent establishment. The specific list of categories of expenses is replaced with a reference to "executive and general administrative expenses." In addition, the Model treaty contains explanatory language for inclusion in a protocol or notes, providing that the OECD Transfer Pricing Guidelines shall apply by analogy in determining the profits attributable to a permanent establishment.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
	Paragraph 7 defines “business profits” to mean income from any trade or business, including income derived by an enterprise from the performance of personal services, and from the rental of tangible personal property. Under the 1996 Model Convention, income from the provision of independent personal services is addressed by Article 14 (Independent Personal Services).	The paragraph defining “business profits” has been stricken, as the concept is now addressed by the definition of “business” contained in Article 3, paragraph 1(e). The Model treaty eliminates old Article 14; instead, because these activities now fall within the meaning of the term “business,” such income is now governed by Article 7 (Business Profits).
8. Shipping and Air Transport Sets forth special rules for taxation of the operation of ships, aircraft, and ancillary equipment used in international traffic.		Contains minor changes in language, but substantially identical to the 1996 Model Convention.
9. Associated Enterprises Incorporates in the Model Convention the arm’s-length principle reflected in U.S. domestic transfer pricing provisions. It provides that when related enterprises engage in non-arm’s-length transactions, the Contracting States may make appropriate adjustments to the taxable income and tax liability of those entities to reflect what their income and tax would have been had the transactions been at arm’s-length.		No significant changes.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
10. Dividends		
Provides rules for the taxation of dividends paid by a resident of one treaty country to a resident of the other treaty country. Sets forth special rules for dividends paid by U.S. regulated investment companies and U.S. real estate investment trusts.	The general rules of Article 10 apply to dividends paid by a resident of one treaty country to a resident of the other treaty country.	The general rules of Article 10 apply to dividends paid by "a company that is a resident" of one treaty country to a resident of the other treaty country. This change conforms the Model Convention language with that of the OECD Model treaty.
	There are no special rules for dividends beneficially owned by a pension fund. A pension fund is included in the definition of a "qualified governmental entity." Dividends received by a qualified governmental entity are taxed according to the rules described immediately below.	Under an exception from the general rules of Article 10, dividends paid by a company that is a resident of one treaty country may not be taxed by that country if the beneficial owner of the dividends is a pension fund that is a resident of the other treaty country and the pension fund does not derive the dividends from carrying on a trade or business either directly or through an associated enterprise.
	Notwithstanding the general allowance of either 5-percent or 15-percent source-country taxation of dividends, dividends may not be taxed by the source country if the dividends are beneficially owned by a resident of the other treaty country and that resident is a qualified governmental entity and does not control the person paying the dividends.	As a conforming change to its general elimination of the concept of a qualified governmental entity, the 2006 Model Convention eliminates the special rule for dividends beneficially owned by qualified governmental entities.
	The reduced five-percent source-country tax rate for dividends beneficially owned by 10-percent corporate shareholders is not available for dividends paid by a U.S. regulated investment company ("RIC") or real estate	The 2006 Model Convention clarifies that the reduced 15-percent source-country tax rate applies to dividends paid by a RIC. The special rule described above for dividends beneficially owned by pension funds also applies to

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
	investment trust ("REIT"). Dividends paid by a REIT also are not eligible for the reduced 15-percent source-country tax rate unless the dividends are beneficially owned by an individual who has a less-than-10-percent interest in the REIT.	dividends paid by a RIC. For dividends paid by a REIT, the 15-percent source-country tax rate and the special rule for pension funds apply only if the dividends (i) are beneficially owned by an individual or a pension fund, in either case holding an interest in the REIT of 10 percent or less; (ii) are paid with respect to publicly-traded stock and are beneficially owned by a person who holds no more than a five-percent interest in any class of the REIT's stock; or (iii) are paid by a diversified REIT and are beneficially owned by a person holding a 10-percent-or smaller interest in the REIT.
	An exclusion from the general source-country taxing limitations applies to dividends attributable to a permanent establishment situated in the source country or to a fixed base in the source country from which independent personal services are performed.	The exclusion from the general source-country taxing limitations applies to dividends with respect to shares that are effectively connected with (rather than attributable to) a source-country permanent establishment. The use of "effectively connected with" rather than "attributable to" conforms to language in the OECD Model treaty. In conformity with the elimination of the independent personal services article, the reference to a fixed base is deleted.
	The provision permitting a source country to impose a branch profits tax on certain income of a resident of the other treaty country applies to income of a corporation.	The provision permitting a branch profits tax applies to income of a company (rather than a corporation). The use of "company" conforms to the OECD Model treaty language.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
11. Interest Provides rules for the taxation of interest paid by a resident of one treaty country to a resident of the other treaty country. Generally, interest arising in one treaty country and beneficially owned by a resident of the other treaty country is taxed only in the country of residence, subject to certain exceptions.	In the case of certain “contingent interest” arising in a Contracting State, such interest may be taxed in that State according to the laws of that State; however, if the beneficial owner is a resident of the other Contracting State, the gross amount of the interest may be taxed at a rate not to exceed the rate prescribed for the taxation of dividends under Article 10, paragraph 2(b).	This formulation is retained with regard to interest arising in the other Contracting State and paid to U.S. residents. With regard to the converse, a separate provision now expressly provides that interest arising in the United States that is contingent interest of a type that does not qualify as portfolio interest under United States law may still be taxed at a rate not exceeding the treaty rate. In both cases, the Model treaty drops the specific cross-reference to Article 10, paragraph 2(b), but it is intended that the same maximum rate of tax shall apply to such contingent interest as applies to dividends under that provision.
	The treaty provides an exception to the general rule of residence taxation. The exception allows source-country taxation of interest where the beneficial owner of the interest, resident of a Contracting State, carries on business through a permanent establishment situated in the other Contracting State, and “the interest is attributable to” such permanent establishment.	This exception now applies where “the debt-claim in respect of which the interest is paid is effectively connected” with the permanent establishment. The use of “effectively connected with” rather than “attributable to” conforms with language in the OECD Model treaty. Separately, in a non-substantive clarification, the exception now expressly applies to the special rules for contingent interest as well as to the general rule of Paragraph 1.
	A similar exception to the general rule of residence taxation applies where the beneficial owner of the interest performs independent personal services from a fixed base situated in	The exception for independent personal services is eliminated to conform to the elimination of old Article 14 (and the expansion of “business profits” to include such income).

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
	the other Contracting State, and the interest is attributable to such fixed base.	
12. Royalties Sets forth rules for taxation of cross-border royalties.	"Royalties" are defined as any consideration for the use of, or the right to use, any copyright of literary, artistic, scientific or other work (including computer software, cinematographic films, audio or video tapes or disks, and other means of image or sound reproduction), any patent, trademark, design or model, plan, secret formula, or process, <u>or other like right or property</u>, or for information concerning industrial, commercial or scientific experience; and gain derived from the alienation of any property described above, provided that such gain is contingent on the productivity, use, or disposition of the property. The business profits article applies when royalty income is "attributable to" a permanent establishment.	"Royalties" are defined as payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, scientific or other work (including cinematographic films), any patent, trademark, design or model, plan, secret formula, or process, or for information concerning industrial, commercial or scientific experience; and gain derived from the alienation of any property described above, provided that such gain is contingent on the productivity, use, or disposition of the property. The definition has been narrowed by the elimination of "or other like right or property." The business profits article applies when the right or property with respect to which royalties are paid is "effectively connected with" a permanent establishment. The use of "effectively connected with" rather than "attributable to" conforms to language in the OECD Model treaty.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
13. Gains		
Provides rules for the taxation of gains from the sale of real property situated in one treaty country by a resident of the other treaty country. Also sets forth rules governing the taxation of gains from the sale of ships, aircraft, containers, and movable property that is part of a permanent establishment. Prohibits source-country taxation of gains from sales of all property not otherwise specifically addressed.	The definition of "real property situated in the other Contracting State" applies for purposes of the Model Convention.	The definition of "real property situated in the other Contracting State" applies for purposes of this Article 13. As a result, the definition does not apply for purposes of Article 6 (Income from Real Property).
	For real property situated in the territory of the United States's treaty partner, the term "real property situated in the other Contracting State" includes an "equivalent interest in real property" to a United States real property interest.	For real property situated in the territory of the United States's treaty partner, the term "real property situated in the other Contracting State" includes (i) shares and rights to acquire shares, other than shares in which there is regular trading on a stock exchange, deriving most or all their value directly or indirectly from real property otherwise subject to this Article 13, and (ii) an interest in a partnership or trust to the extent the assets of the partnership or trust consist of real property or of shares described in (i) above.
	The article permits source country taxation of gains from the alienation of personal property that are attributable to (i) a permanent establishment that an enterprise resident in the other country has in the source country, or (ii) a fixed base in the source country that is available to a resident of the other country for the purpose of performing independent personal services.	The article permits source country taxation of gains from the alienation of movable property forming part of the business property of a permanent establishment that an enterprise resident in the other country has in the source country. In conformity with the Model Convention's elimination of the independent personal services article, the article deletes the 1996 Model Convention's reference to a fixed base available for performing independent personal services.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
	Gains derived by an enterprise of a treaty country from the alienation of ships, aircraft, or containers operated or used in international traffic or from the alienation of personal property pertaining to the operation or use of such ships, aircraft, or containers are taxable only in that country.	The article provides a separate rule for gains from the alienation of containers. That rule permits only residence country taxation of gains derived from the alienation of containers (including trailers, barges, and related equipment for the transport of containers) used for the transport of goods or merchandise, unless those containers are used for transport solely between places within the source country.
14. Income From Employment Provides rules for the taxation of employment income derived by a resident of one treaty country from services performed in the other treaty country.	Article 14 (Independent Personal Services) addresses income derived by an individual who is a resident of a Contracting State in respect of the performance of personal services of an independent character. Article 15 (Dependent Personal Services) addresses salaries, wages, and other remuneration derived by a resident of a Contracting State, and provides that such amounts shall be taxable only in that State unless the employment is exercised in the other Contracting State (in which case such remuneration may be taxed in that other State).	The 2006 Model Convention eliminates old Article 14; instead, because these activities now fall within the meaning of the term "business," such income is now governed by Article 7 (Business Profits). Article 14 (Income from Employment) is substantially identical to Article 15 (Dependent Personal Services) of the 1996 Model Convention.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
15. Directors' Fees Provides that a Contracting State may tax the fees and other compensation paid by a company that is a resident of that State for services performed in that State by a resident of the other Contracting State in his capacity as a director of the company.		No significant changes.
16. Entertainers and Sportsmen Provides that income derived by a resident of a Contracting State as an entertainer or as a sportsman, from his personal activities as such exercised in the other Contracting State, may generally be taxed in that other State even if the income would otherwise be exempt from tax in that other State under other articles of the Model Convention. This rule does not apply if the income does not exceed $20,000 in the taxable year of payment. A special rule addresses cases in which income in respect of the performer's activities does not accrue directly to the performer himself but to another person.	Paragraph 2 provides that when income accrues to a person other than the performer, that other person may be taxed in the Contracting State in which the services are performed even if the income would otherwise be exempt from tax in that State under other articles of the Model Convention, unless it is established that neither the performer nor persons related to the performer participate directly or indirectly in the profits of that other person in any manner.	Paragraph 2 provides that when income accrues to a person other than the performer, that other person may be taxed in the Contracting State in which the services are performed even if the income would otherwise be exempt from tax in that State under other articles of the Model Convention, unless the contract pursuant to which the personal activities are performed allows that other person to designate the individual who is to perform the personal activities.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
17. Pensions, Social Security, Annuities, Alimony, and Child Support Sets forth the taxation rules for cross-border payments of pension distributions, social security, annuities, alimony, and child support.	A general rule of exclusive residence-based taxation of pensions applies, except to the extent that the other treaty country had taxed amounts prior to distribution. The treaty country in which the individual is resident is not permitted to tax distributions to the extent attributable to such taxed amounts. "Annuities" is defined as a stated sum paid periodically at stated times 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 definition does not specifically include periodic payments for life. If alimony is paid by a resident of one treaty country to a resident of other treaty country, and is deductible by the payor in the country of the payor's residence, the recipient may be taxed only by the country of the recipient's residence.	A general rule of exclusive residence-based taxation of pensions applies, except that the residence state must exempt any amounts that the source state would have exempted if the recipient were a resident of the source state. "Annuities" is defined as a stated sum paid periodically at stated times during a specified number of years, or for life, under an obligation to make the payments in return for adequate and full consideration (other than services rendered). The definition specifically includes periodic payments for life. If alimony is paid by a resident of one treaty country to a resident of other treaty country, the recipient may be taxed only by the country of the recipient's residence, regardless of deductibility by the payor in the country of the payor's residence.
18. Pension Funds Sets forth the taxation rules applicable to pension funds, contributions and benefits accruals.		New article that carries over and modifies a portion of Article 17 of the 1996 Model Convention. See the separate discussion in Part II.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
19. Government Service Generally provides that remuneration paid to an individual in respect of services rendered to a Contracting State shall be taxable only in that State. In the case of remuneration other than pensions, however, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who is either a national of that State or did not become a resident of that State solely for purposes of rendering the services. In the case of pensions, such remuneration shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.	The Technical Explanation states that if an individual receives remuneration paid from the public funds of a Contracting State in respect of services rendered to that State for the discharge of functions that are not of a governmental nature, then the rules of Articles 14-17 of the Model Convention, and not the rules of Article 19, will apply.	Paragraph 3 more clearly provides that remuneration an individual receives in connection with a business carried on by a Contracting State is subject to the rules of Articles 14-17 of the Model Convention, and not the rules of Article 19.
20. Students and Trainees Sets forth special rules for taxation of certain income of students and trainees.	Payments received by students, apprentices or business trainees visiting the Contracting State, who are residents of the other Contracting State, are tax exempt in the host country if the purpose of their visit is to engage in full time education at an accredited educational institution or for full time training. The payments must arise outside of the host country and must be used for education, maintenance and training. In the case of business trainees, the exemption from income tax in the host country applies only for a period of one year from the time the visitor first arrives in the host country for training.	See separate discussion in Part II.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
21. Other Income Sets forth rules for taxation of income other than income dealt with in other articles.		Substantially identical to 1996 Model Convention.
22. Limitation on Benefits Provides rules intended to prevent inappropriate treaty shopping. Treaty shopping refers to planning by third-country residents to qualify for treaty benefits intended to be available only to residents of the two treaty countries.		See separate discussion in Part II.
23. Relief From Double Taxation Describes the manner in which each treaty country undertakes to relieve double taxation.		The 2006 Model Convention adds a new "re-sourcing" rule: gross income derived by a resident of the United States that, under the treaty, may be taxed in the other Contracting State, shall be deemed to be income from sources in the other Contracting State. This rule is intended to ensure that a U.S. resident can obtain an appropriate amount of U.S. foreign tax credit for taxes paid to the other treaty country when the treaty permits the other treaty country to tax such income. The article is otherwise substantially unchanged from the 1996 Model Convention.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
24. Non-Discrimination Provides that nationals and residents of a Contracting State may not be subject, directly or indirectly, to discriminatory taxation in the other Contracting State.	Paragraph 1 provides that a national of one Contracting State may not be subject to taxation or connected requirements in the other Contracting State that are more burdensome than the taxes and connected requirements imposed upon a national of that other State in the same circumstances. The Technical Explanation states that U.S. nationals who are subject to tax on a worldwide basis are not in the same circumstances as nationals of the other Contracting State who are not residents of the United States.	Paragraph 1 provides that a national of one Contracting State may not be subject to taxation or connected requirements in the other Contracting State that are more burdensome than the taxes and connected requirements imposed upon a national of that other State in the same circumstances. Paragraph 1 more clearly states that U.S. nationals who are subject to tax on a worldwide basis are not in the same circumstances as nationals of the other Contracting State who are not residents of the United States.
25. Mutual Agreement Procedure Sets forth procedures for dispute resolution with respect to issues arising under the treaty.		Substantially identical to the 1996 Model Convention; one minor addition made to the nonexclusive list of potential areas for competent authority settlement: "the timing of particular items of income."

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
26. Exchange of Information and Administrative Assistance Provides for the exchange of information between treaty countries to carry out the terms of the treaty or the tax laws of the treaty countries.	Provides that the competent authorities of the treaty countries will exchange such information as is relevant to carry out the provisions of the proposed treaty, or the domestic laws of the two countries. This exchange of information generally is not restricted by Article 1 (General Scope) or Article 2 (Taxes Covered). Any information exchanged under the treaty is treated as secret in the same manner as information obtained under the domestic laws of the country receiving the information. Exchanged information may be disclosed in public court proceedings or in judicial decisions.	No significant change to the 1996 Model Convention.
27. Members of Diplomatic Missions and Consular Posts Confirms that any fiscal privileges to which members of diplomatic missions or consular posts are entitled under general provisions of international law or under special agreements will apply notwithstanding any provisions to the contrary in the Model Convention.		No significant changes.

ARTICLE (2006 MODEL CONVENTION)	1996 MODEL CONVENTION	2006 MODEL CONVENTION
28. Entry Into Force Sets forth the dates and taxable periods for which a treaty will be in effect.	Provides that a treaty will enter into force on the later of the dates on which the respective treaty countries have notified each other in writing that the applicable procedures in their respective countries have been followed. With respect to withholding taxes, the article provides that a treaty will have effect for amounts paid or credited on or after the first day of the second month following the date on which the treaty enters into force. With respect to other taxes, the article provides that a treaty will have effect for taxable periods beginning on or after the first day of the January in the year following the date of entry into force of the treaty.	Substantially identical to 1996 Model Convention, except the 2006 Model Convention clarifies that the Exchange of Information provisions (Article 26) have effect from the date of entry into force without regard to the taxable period to which the matter relates.
29. Termination Establishes procedures for terminating a treaty.	Provides that a treaty will remain in force indefinitely, but that either of the treaty countries may terminate the treaty by giving notice to the other country through diplomatic channels. In the event of termination, the treaty will cease to have effect with respect to withholding taxes for amount paid or credited after the expiration of six months from the date notice of termination was given. With respect to other taxes, a treaty will cease to have effect for any taxable period on or after the expiration of six months from the date notice of termination was given.	No significant change to the 1996 Model Convention.

II. DETAILED DESCRIPTION OF CERTAIN ARTICLES

Article 18. Pension Funds

Article 18 of the 2006 Model treaty is new. It incorporates paragraph 6 of Article 18 of the 1996 Model treaty with certain modifications, and adds certain new rules. In general, paragraph 6 of Article 18 of the 1996 Model treaty addresses situations in which an individual who is a participant in a pension plan that is established and legally recognized in a treaty country performs services in the other treaty country (i.e., the "host country"), regardless of the country in which such individual is resident.

Under paragraph 6(b) of Article 18 of 1996 Model treaty, income earned by a pension plan established in a treaty country is not taxable in the host country until it is distributed from the plan. Paragraph 1 of Article 18 of the 2006 Model treaty modifies the focus of this rule from host country to residence country (in many cases, the host and residence countries will be one and the same). Under the 2006 Model treaty, if an individual resident of one treaty country is a member or beneficiary of, or a participant in, a pension fund that is resident in the other treaty country, income of the pension fund is not taxable to the individual in either country until it is distributed, subject to the rules of paragraph 1 of Article 17, relating to pension payments. Similarly, under the 1996 Model treaty, the individual may make a tax-free rollover distribution from the pension plan into a plan established in the host country. Under the 2006 Model treaty, the rollover is tax free only if made to another pension fund in the country in which the initial pension fund is resident. In other words, the 2006 Model treaty does not require tax-free treatment for a rollover from a pension fund in a treaty country to a pension fund in the country in which the individual is resident.

The rules of paragraph 6(a) of Article 18 of the 1996 Model treaty, relating to tax treatment in the host treaty country of contributions and accrued benefits with respect to a pension plan that is resident in the other treaty country, remain substantially the same under paragraph 2 of Article 18 of the 2006 Model treaty. Contributions paid by or on behalf of the individual to the pension fund during the time that the individual performs such services in the host country are deductible or excludible from the individual's tax base in the host country. Any accrued benefits or employer contributions are also excluded from the employee's taxable income and such contributions are deductible from the employer's income in the host state. These benefits are limited to the relief that would be allowed by the host country to residents of that country for contributions to, and benefits accrued under, a pension plan established in that country.

Both Model treaties apply certain limitations on the application of the benefits described in the immediately preceding paragraph. For those benefits to apply, some contributions by or on behalf of the individual must have been made to the pension fund (or to another similar pension fund for which the first-mentioned pension fund was substituted) before the individual performed the services in the host country. Under paragraph 3 of Article 18 of the 2006 Model treaty, it is sufficient if such contributions were made by or on behalf of the individual's employer. Under both Model treaties the competent authority of the host country must have agreed that the pension plan (or fund) generally corresponds to a pension plan (or fund) established in that country. In practice, the competent authorities (or the IRS unilaterally) have periodically added newly legislated arrangements to the list of agreed pension plans.

In addition to the above-described changes, paragraph 4 of Article 18 of the 2006 Model treaty provides a new set of rules for pension fund contributions and benefits with respect to U.S. citizens who are residents of the treaty country in which the pension fund is resident. These rules apply where such U.S. citizen exercises employment in such residence country, the income from such employment is taxable there, the contribution is borne by an employer who is either resident in such country or by a permanent establishment in such country, and the individual is a member or beneficiary of, or participant in, such pension plan. Under the new rules, contributions attributable to the employment paid by or on behalf of the individual during the employment period to the pension fund are deductible or excludible in computing the individual's U.S. tax. Further, accrued pension benefits and contributions attributable to the employment made by the U.S. citizen's employer during that period are not treated as income taxable to the individual in the United States. Benefits obtained under these rules are counted when determining such individual's eligibility for benefits under a generally corresponding U.S.-based pension plan.

The relief available under the rules of paragraph 4 are limited to the lesser of the amount of relief allowed for contributions and benefits under a pension fund established in the treaty country and the amount of relief that the United States would allow to its residents for contributions and benefits under a generally corresponding pension plan established in the United States. In addition, paragraph 4 applies only when the U.S. competent authority has agreed that the pension plan generally corresponds to an employer pension plan established in the United States. It is intended that notes or pronouncements specify these agreements. Paragraph 4 of Article 18 is excepted from the saving clause of paragraph 4 of Article 1.

The rules of paragraph 4, in part, qualify the provisions of paragraph 2 of Article 18 of the 2006 Model treaty, discussed above, in situations in which the individual is a U.S. citizen and is a resident of the host country.

Article 20. Students and Trainees

Under Article 20, paragraph 1 of the 2006 Model treaty, students and business trainees who are visiting a Contracting State and who immediately prior to visiting that Contracting State were resident in the other Contracting State will be exempt from income tax in the host country on certain payments received if the purpose of their visit is to engage in full-time education or full-time training. The exempt payments are limited to those payments the individual may receive for his or her maintenance, education or training as long as such payments are from sources outside the host country. In the case of business trainees, the exemption from income tax in the host country applies only for a period of one year from the time the visitor first arrives in the host country for training.

Paragraph 1 is almost identical to Article 20 of the 1996 Model Treaty, except under the 1996 Model the tax exemption applied to "students, apprentices and business trainees." Also, under the 1996 Model, students were entitled to the exemption only if they engaged in full-time education at an accredited educational institution. The 2006 Model deleted the term "apprentice," and the exemption now applies specifically to students and business trainees only.

The term "apprentice" was not defined in the 1996 Model treaty or in its Technical Explanation. Under the 2006 Model, the exemption for students is no longer limited to full-time education at an accredited educational institution. So long as the students and business trainees are engaged in full-time education or full-time training, they may qualify for the exemption.

Paragraph 2 of Article 20 of the 2006 Model provides an additional exemption for remuneration from personal services performed in the host country to the extent of $9,000 or its equivalent in the currency of the other Contracting State annually. The $9,000 limit will be adjusted every five years to take into account changes in the U.S. personal exemption and standard deduction. The 1996 Model did not permit an exemption for personal services income.

Paragraph 3 of Article 20 of the 2006 Model defines a business trainee as a person who is in a Contracting State temporarily for the purpose of securing training necessary to qualify the individual to practice a profession or professional specialty. A business trainee can also be a person who is employed, or under contract with, a resident of the other Contracting State for the primary purpose of acquiring technical, professional, or business experience from a person other than the employer or a person related to the employer. Under this definition, so long as the training is received from someone other than the employer or someone related to the employer, an employee can receive tax-free payments for maintenance, education, and training from the individual's employer that resides outside the host country. In other words, the exemption for business trainees is qualified on receiving the training from someone other than the employer, but the payments subject to the exemption may be received from the employer. The 1996 Model did not define the term business trainee.

With respect to business trainees, both the 1996 Model and the 2006 Model limit the exemption for payments received for the maintenance, education and training to a period of one year or less. The one-year limit also now applies to the new exemption for $9,000 in personal service income.

Article 22. Limitation on Benefits

In general

Article 22 of the 2006 Model Convention includes significant changes to the limitation on benefits rules of the 1996 Model Convention. These changes generally are intended to make it more difficult under the new Convention than under the 1996 Convention for third country residents to use treaty shopping to benefit inappropriately from a treaty between two countries.

The limitation on benefits rules of both the 1996 Model Convention and the 2006 Model Convention include three provisions under which a resident of a treaty country may qualify for treaty benefits. First, a treaty-country resident may qualify for all treaty benefits if it has any one of several listed attributes. For example, a resident of a treaty country may qualify for all treaty benefits if it is a company that satisfies certain public trading requirements. Second, a treaty-country resident that does not have one of the listed attributes may qualify for treaty benefits for income items that are derived from the other treaty country and that are related to a trade or business carried on in the residence country. Third, a treaty-country resident that would not be eligible for treaty benefits under the preceding two provisions may qualify for treaty benefits at the discretion of the competent authority of the other treaty country. These three provisions are described in more detail below, and significant differences between the 1996 and 2006 Model Conventions are noted.

Rules for eligibility for all treaty benefits

Under both the 1996 and the 2006 Model Convention, a treaty-country resident may qualify for treaty benefits if it has one of the following attributes: it is (1) an individual; (2) a government (as further described below); (3) a company that satisfies public-trading or ownership tests described below; (4) a pension fund or other tax-exempt organization (if, in the case of a pension fund, more than 50 percent of the fund's beneficiaries, members, or participants are individuals resident in either treaty country); or (5) a person other than an individual that satisfies ownership and base-erosion requirements described below.

Government eligibility

The 2006 Model Convention's limitation on benefits rule allowing treaty benefits to governments differs from the rule in the 1996 Model Convention. The 1996 Model Convention grants treaty benefits to a qualified governmental entity. The 2006 Model Convention eliminates the concept of a qualified governmental entity and grants treaty benefits instead to a treaty country government and to a political subdivision or local authority of that government. This grant of treaty benefits to governments and political subdivisions may be narrower than the 1996 rule because the definition of qualified governmental entity in the 1996 Model Convention included certain quasi-governmental entities.

Tax-exempt organization eligibility

The 1996 and 2006 Model Conventions use slightly different terms for describing tax-exempt organizations other than pension funds. The 1996 Convention refers (in Article 4, Residence) to an entity established and maintained in a treaty country "exclusively for a religious, charitable, educational, scientific, or other similar purpose." The 2006 Convention (also in Article 4) refers to an organization established and maintained in a treaty country "exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes." This change reflects that the U.S. internal law definition of educational organizations includes organizations that serve artistic or cultural purposes.

Company eligibility

A company that is a resident of a treaty country may be eligible for treaty benefits if it either satisfies a public-trading test or is a direct or indirect subsidiary of a company or companies that satisfy the public-trading test. The public-trading and subsidiary requirements differ in the 1996 and the 2006 Model Conventions. Under the 1996 Convention's public-trading test, all the shares of a company in the class or classes of shares representing more than 50 percent of the company's voting power and value must be traded on a recognized stock exchange. The public-trading test in the 2006 Convention is more restrictive. This more restrictive test requires that the principal class of a company's shares, and any disproportionate class of shares, be regularly traded on one or more recognized exchanges and either (1) that the principal class of shares is primarily traded on one or more recognized exchanges located in the treaty country of which the company is a resident, or (2) that the company's primary place of management and control is in the company's country of residence. The 2006 Model Convention defines the term "principal class of shares" as the ordinary or common shares of the company if that class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the voting power and value of a company, the term "principal class of shares" means the classes that in the aggregate represent the majority of the company's voting power and value. The term "disproportionate class of shares" means, for the shares of a company resident in a treaty country, any class of shares that entitles the shareholder to disproportionately higher participation in the earnings generated in the other treaty country by particular assets or activities of the company. A company's primary place of management and control is treated as being in the company's country of residence only if executive officers and senior management employees exercise day-to-day responsibility for more of the company's (and its subsidiaries') strategic, financial, and operational policy decision-making in that country than in any other country and the staff of those executive officers and senior management employees conduct more of the day-to-day activities necessary for preparing and making those decisions in that country than in any other country.

A company that does not satisfy the public-trading test may qualify for treaty benefits if it is a direct or an indirect subsidiary of a company or companies that do satisfy that test. Under the subsidiary rules of the 1996 Model Convention, at least 50 percent of each class of shares in a company must be owned directly or indirectly by companies entitled to treaty benefits under the public-trading test described in the preceding paragraph. Indirect ownership may be used to satisfy this rule only if each intermediate owner is entitled to all treaty benefits. The 2006 Model Convention changes these subsidiary rules in several ways. First, 50 percent is specifically defined as at least 50 percent of the aggregate vote and value of a company's shares and at least 50 percent of any disproportionate class of the company's shares. Second, the 50-percent-or-more ownership must be concentrated in five or fewer companies entitled to benefits under the public-trading test described previously. Third, the 2006 Model Convention provides that a subsidiary may satisfy the 50-percent-or-more ownership rule through indirect ownership only if each intermediate owner is a resident of either treaty country, but it does not require that each intermediate owner be entitled to treaty benefits.

Ownership and base-erosion test

A legal entity that is a resident of a treaty country may qualify for treaty benefits if it satisfies a two-part ownership and base-erosion test. Under the 1996 Model Convention's ownership prong of the test, on at least half the days of the taxable year, persons who qualify for all treaty benefits under the rules described previously (for qualification as an individual, a government, a company, or a pension fund or other tax-exempt organization) must own, directly or indirectly (through a chain of ownership in which each person is entitled to all treaty benefits) at least 50 percent of each class of shares or other beneficial interests in the entity for which treaty benefits eligibility is being tested. The 2006 Model Convention changes this ownership rule in several ways. First, 50 percent is specifically defined as at least 50 percent of the aggregate voting power and value of the entity (and at least 50 percent of any disproportionate class of the entity's shares). Second, the ownership test cannot be satisfied through ownership by an entity that qualifies for treaty benefits because it is a subsidiary of a company or companies that satisfy the public-trading test described previously. Third, in the case of indirect ownership, the 2006 Model Convention provides that each intermediate owner must be a resident of the country of residence of the entity for which eligibility for treaty benefits is being tested but does not require that each intermediate owner be entitled to treaty benefits.

Under the base-erosion prong of the two-part test in the 1996 Model Convention, an entity may not pay or accrue, directly or indirectly, to non-treaty-country residents deductible payments (as determined for income tax purposes in that entity's country of residence) totaling 50 percent or more of the entity's gross income for the taxable year. A payment made to someone other than a treaty-country resident does not count toward the less-than-50-percent deductible payment limitation if the payment is attributable to a permanent establishment in either treaty country. The 2006 Model Convention changes these base erosion rules in several ways. First, under the new base-erosion prong, deductible payments to a resident of a treaty country count toward the less-than-50-percent deductible payment limitation if the resident to which the payments are made does not qualify for treaty benefits under any one of certain of the limitation on benefits rules. Second, arm's length payments in the ordinary course of business for services or tangible property do not count toward the less-than-50-percent limitation. Third, the 2006 Model Convention clarifies that to determine whether the base erosion test is satisfied, an entity's gross income is determined under the laws of the entity's country of residence. Fourth, the exception for payments attributable to a permanent establishment in either treaty country is eliminated.

Eligibility for treaty benefits for particular items of income

Under both the 1996 Model Convention and the 2006 Model Convention, a resident of a treaty country may be eligible for treaty benefits for a specific income item derived from the other treaty country. Under the 1996 Model Convention, a resident of a treaty country not otherwise eligible for treaty benefits is entitled to benefits with respect to an item of income derived from the other treaty country if the resident is engaged in the active conduct of a trade or business in its country of residence; the income item is connected with or incidental to the trade or business; and the trade or business is substantial in relation to the activity in the source country generating the income. The 1996 Model Convention provides an objective test for whether a trade or business is substantial in relation to the activity in the source country that generates the income. The Convention also describes the circumstances in which income is derived in connection with or is incidental to a trade or business. And the Convention provides that the business of making or managing investments is not considered an active trade or business unless the activity is banking, insurance, or securities activity conducted by a bank, an insurance company, or a registered securities dealer.

The income item eligibility rule in the 2006 Model Convention generally is similar to the rule in the 1996 Model Convention, but the details of the rules differ. The 2006 Model Convention provides that a resident of a treaty country is entitled to treaty benefits with respect to an item of income derived from the other treaty country, regardless of whether the resident otherwise qualifies for treaty benefits, if the resident is engaged in the active conduct of a trade or business in its country of residence and the income derived from the other treaty country is derived in connection with or is incidental to that trade or business. The substantial activity requirement is stated differently in the 2006 Convention than in the 1996 Convention. Under the

2006 Convention, if a resident of a treaty country derives an item of income from a trade or business activity that it conducts in the other treaty country, or derives an income item arising in that other country from a related person, the income item eligibility rule is considered satisfied for that income item only if the trade or business activity carried on by the resident in its country of residence is substantial in relation to the trade or business activity carried on by the resident or the related person in the other country. Unlike the 1996 Model Convention, the 2006 Model Convention provides no objective test for whether a trade or business activity is substantial; instead it provides that the determination is made based on all the facts and circumstances.

Unlike the 1996 Model Convention, the 2006 Model Convention does not describe circumstances in which an item of income is considered to be derived in connection with or is incidental to a trade or business. The 2006 Convention, however, provides a new rule for determining when activities conducted by one person are treated as conducted by another person. Activities of one person are attributed to another person if the persons are connected to one another. A person is considered to be connected to another person if one person owns at least 50 percent of the beneficial interest in the other person or if a third person owns at least 50 percent of the beneficial interest in each person. In the case of a company, the 50-percent requirement means at least 50 percent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company. The 2006 Model Convention also provides that in all cases a person is connected with another person if based on all relevant facts and circumstances one has control of the other or both are under the common control of the same person or persons.

The 2006 Model Convention's exception from income item eligibility for income derived from certain financial activity differs from the 1996 Model Convention's exception. Instead of denying active trade or business status for the business of making or managing investments whenever that business is conducted by a person other than a bank, an insurance company, or a registered securities dealer, the 2006 Model Convention precludes from active trade or business status only the business of making or managing investments for one's own account (other than when that business is part of banking, insurance, or securities activities conducted by a bank, an insurance company, or a registered securities dealer, in which case active trade or business status is not automatically denied).

<u>Grant of treaty benefits by a competent authority</u>

Under both the 1996 and 2006 Model Conventions, a resident of a treaty country not otherwise eligible for treaty benefits may be eligible for benefits based on a determination by the competent authority of the relevant treaty country. The 1996 Convention provides that a resident of a treaty country not otherwise entitled to benefits may be granted benefits of the Convention if the competent authority of the country from which benefits are claimed so determines. The 2006 Model Convention adds details to this rule. First, the Convention clarifies that the competent authority that may grant benefits to a resident of a treaty country is the competent authority of the other treaty country. Second, the 2006 provision provides that a competent authority may grant general treaty benefits or may grant benefits for a specific item of income. Third, the 2006 Model Convention provides that a competent authority may grant benefits only if it determines that the establishment, acquisition, or maintenance of the resident for which treaty benefits are sought, and the conduct of that resident's operations, did not have as one of its principal purposes the obtaining of benefits under the Convention.