JOINT COMMITTEE ON TAXATION
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TESTIMONY OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION BEFORE THE SENATE COMMITTEE ON FOREIGN RELATIONS HEARING ON THE PROPOSED TAX TREATY WITH HUNGARY AND THE PROPOSED TAX PROTOCOLS WITH LUXEMBOURG AND SWITZERLAND[1]

JUNE 7, 2011

My name is Thomas A. Barthold. I am Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the staff of the Joint Committee on Taxation today concerning the proposed income tax treaty with Hungary and the proposed tax protocols with Luxembourg and Switzerland.

Overview

As in the past, the Joint Committee staff has prepared pamphlets covering the proposed treaty and protocols. The pamphlets provide detailed descriptions of the proposed treaty and protocols, including comparisons with the United States Model Income Tax Convention of November 15, 2006 ("U.S. Model treaty"), which reflects preferred U.S. tax treaty policy, and with other recent U.S. tax treaties.[2] The pamphlets also provide detailed discussions of issues raised by the proposed treaty and protocols. We consulted with the Treasury Department and with the staff of your committee in analyzing the proposed treaty and protocols and in preparing the pamphlets.

The principal purposes of the treaty and protocols are to reduce or eliminate double taxation of income earned by residents of either country from sources within the other country

[1] This document may be cited as follows: Joint Committee on Taxation, *Testimony of the Staff of the Joint Committee on Taxation Before the Senate Committee on Foreign Relations Hearing on the Proposed Tax Treaty with Hungary and the Proposed Tax Protocols with Luxembourg and Switzerland* (JCX-35-11), June 7, 2011. This publication can also be found at http://www.jct.gov/.

[2] Joint Committee on Taxation, *Explanation of Proposed Income Tax Treaty Between the United States and Hungary* (JCX-32-11), May 20, 2011; Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Luxembourg* (JCX-30-11), May 20, 2011; Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Switzerland* (JCX-31-11), May 20, 2011.

and to prevent avoidance or evasion of the taxes of the two countries. The proposed treaty and protocols also are intended to promote close economic cooperation between the treaty countries and to eliminate possible barriers to trade and investment caused by overlapping taxing jurisdictions of the treaty countries. As in other U.S. tax treaties, these objectives principally are achieved through each country's agreement to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other country.

The proposed treaty with Hungary would replace an existing income tax treaty signed in 1979. The proposed protocol with Luxembourg would amend an existing tax treaty that was signed in 1996. The proposed protocol with Switzerland would amend an existing tax treaty and previous protocol that were both signed in 1996.

My testimony today will highlight some of the key features of the proposed treaty and protocols and certain issues that those agreements raise.

U.S. Model treaty

As a general matter, U.S. model tax treaties provide a framework for U.S. tax treaty policy and a starting point for tax treaty negotiations with our treaty partners. These models provide helpful information to taxpayers, the Congress, and foreign governments about U.S. policies on tax treaty matters. The present U.S. Model treaty incorporates important developments in U.S. income tax treaty policy that had been reflected in U.S. income tax treaties signed in the years immediately preceding the Model's publication in 2006. Treaties that the United States has negotiated since 2006 in large part follow the U.S. Model treaty. The proposed treaty and protocols that are the subject of this hearing are, accordingly, generally consistent with the provisions found in the U.S. Model treaty. There are, however, some key differences from the U.S. Model treaty that I will discuss.

Hungary: Limitation-on-benefits provisions

In general

Like the U.S. Model treaty, the proposed treaty with Hungary includes extensive limitation-on-benefits rules (Article 22). Limitation-on-benefits provisions are intended to prevent third-country residents from benefitting inappropriately from a treaty that generally grants benefits only to residents of the two treaty countries. This practice is commonly referred to as "treaty shopping." A company may engage in treaty shopping by, for example, organizing a related treaty-country resident company that has no substantial presence in the treaty country. The third-country company may arrange, among other transactions, to have the related treaty-country company remove, or strip, income from the treaty country in a manner that reduces the overall tax burden on that income. Limitation-on-benefits rules may prevent these and other transactions by requiring that an individual or a company seeking treaty benefits have significant connections to a treaty country as a condition of eligibility for benefits.

The present treaty between the United States and Hungary is one of only seven U.S. income tax treaties that do not include any limitation-on-benefits rules.[3] Two of those seven treaties, including the treaties with Hungary and Poland, include provisions providing for complete exemption from withholding on interest payments from one treaty country to the other treaty country that may present attractive opportunities for treaty shopping.[4] For example, a November 2007 report prepared by the Treasury Department at the request of the U.S. Congress suggests that the income tax treaty with Hungary has increasingly been used for treaty-shopping purposes as the United States adopted modern limitation-on-benefits provisions in its other treaties. In 2004, U.S. corporations that were at least 25-percent foreign owned made $1.2 billion in interest payments to related parties in Hungary, the seventh largest amount of interest paid to related parties in any single country.[5] With its inclusion of modern limitation-on-benefits rules, the proposed treaty represents a significant opportunity to mitigate treaty shopping. Nevertheless, the Committee may wish to inquire of the Treasury Department as to its plans to address the remaining U.S. income tax treaties that do not include limitation-on-benefits provisions.

Deviations from the U.S. Model treaty

Although the limitation-on-benefits rules in the proposed treaty are similar to the rules in other recent and proposed U.S. income tax treaties and protocols and in the U.S. Model treaty, they are not identical, and the Committee may wish to inquire about certain differences. In particular, the Committee may wish to examine the rules for publicly traded companies, derivative benefits, and certain triangular arrangements. The Committee also may wish to ask the Treasury Department about the special limitation-on-benefits rules applicable to headquarters companies.

Publicly traded companies

A company that is a resident of a treaty country is eligible for all the benefits of the proposed treaty if it satisfies a regular trading test and either a management and control test or a primary trading test. The primary trading test requires that a company's principal class of shares be primarily traded on a recognized stock exchange located in the treaty country of which the

[3] The other income tax treaties without limitation-on-benefits rules are the ones with Greece (1953), Pakistan (1959), the Philippines (1982), Poland (1976), Romania (1976), and the U.S.S.R (1976). Following the dissolution of the U.S.S.R., the income tax treaty with the U.S.S.R. applies to the countries of Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikstan, Turkmenistan, and Uzbekistan.

[4] The income tax treaty with Greece also provides for complete exemption from withholding on interest, although it contains restrictions that limit the availability of the exemption, such that a Greek company receiving interest from a U.S. company does not qualify for the exemption if it controls, directly or indirectly, more than 50 percent of the U.S. company.

[5] Department of the Treasury, *Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties* (Nov. 28, 2007). The report states that, as of 2004, it does not appear that the U.S.-Poland income tax treaty has been extensively exploited by third-country residents. Although the report also focused on Iceland to the same extent as Hungary, a 2007 Income Tax Convention with Iceland that includes a modern limitation-on-benefits provision has since taken effect.

company is a resident or, in the case of a Hungarian company, on a recognized stock exchange in another European Union ("EU") or European Free Trade Association ("EFTA") country, or in the case of a U.S. company, in another North American Free Trade Agreement country. Although the list of recognized stock exchanges in EU and EFTA countries had some differences, a similar primary trading test was included in the recent protocols with France and New Zealand. Under the U.S. Model treaty, the required trading must occur on a stock exchange in the treaty country of which the relevant company is a resident; trading on a stock exchange in another country may not be used to satisfy the test.

Derivative benefits

Like other recent treaties, the proposed treaty includes derivative benefits rules that are generally intended to allow a treaty-country company to receive treaty benefits for an item of income if the company's owners (referred to in the proposed treaty as equivalent beneficiaries) reside in a country that is in the same trading bloc as the treaty country and would have been entitled to the same benefits for the income had those owners derived the income directly. The derivative benefits rules may grant treaty benefits to a treaty-country resident company in circumstances in which the company would not qualify for treaty benefits under any of the other limitation-on-benefits provisions. The U.S. Model treaty does not include derivative benefits rules.

Triangular arrangements

The proposed treaty includes special anti-abuse rules intended to deny treaty benefits in certain circumstances in which a Hungarian resident company earns U.S.-source income attributable to a third-country permanent establishment and is subject to little or no tax in the third jurisdiction and Hungary. A rule on triangular arrangements is not included in the U.S. Model treaty, but similar anti-abuse rules are included in other recent treaties and protocols.

Headquarters companies

The proposed treaty includes special rules intended to allow treaty country benefits for a resident of a treaty country that functions as a headquarters company and that satisfies certain requirements intended to ensure that the headquarters company performs substantial supervisory and administrative functions for a group of companies: (1) that the group of companies is genuinely multinational; (2) that the headquarters company is subject to the same income tax rules in its country of residence as would apply to a company engaged in the active conduct of a trade or business in that country; and (3) that the headquarters company has independent authority in carrying out its supervisory and administrative functions. While U.S. income tax treaties in force with Austria, Australia, Belgium, the Netherlands, and Switzerland include similar rules for headquarters companies, the U.S. Model treaty does not include these rules.

Exchange of information

Tax treaties establish the scope of information that can be exchanged between treaty countries. Exchange of information provisions first appeared in the late 1930s,[6] and are now included in all double tax conventions to which the United States is a party. A broad international consensus has coalesced around the issue of bank transparency for tax purposes and strengthened in recent years, in part due to events involving one of Switzerland's largest banks, UBS AG, the global financial crisis, and the general increase in globalization. As part of their efforts to restore integrity and stability to financial institutions, the United States and other G-20 jurisdictions have made significant efforts to modernize and standardize the ways in which jurisdictions provide administrative assistance under the network of tax treaties.

Although the United States has long had bilateral income tax treaties in force with Hungary, Luxembourg, and Switzerland, the United States has engaged in relatively limited exchange of information under these tax treaties. With Luxembourg and Switzerland, the limitations stem from strict bank secrecy rules in those jurisdictions. The proposed protocols are a response to that history as well as part of the international trend in exchange of information.

The pamphlets prepared by the Joint Committee staff provide detailed overviews of the information exchange articles of the proposed treaty and the two proposed protocols. They also describe the extent to which they differ from the U.S. Model treaty. I note that since the publication of those pamphlets on May 20, 2011, additional information about the exchange of information programs of Hungary, Switzerland, and the United States has become available. On June 1, 2011, the Organization for Economic Cooperation and Development ("OECD") published reports of Phase I Peer Reviews of Hungary and Switzerland, as well as a report on its Combined Phase I and Phase II Peer Review of the United States.

Here I wish to highlight first those issues related to the effectiveness of information exchange under income tax treaties that are common to both the proposed treaty and proposed protocols under consideration today, and second, the issues specific to the proposed protocols with Luxembourg and Switzerland.

Effectiveness of U.S. information exchange agreements in general

The Joint Committee staff's pamphlets describe in detail several practical issues related to information exchange under income tax treaties. I will briefly note three issues: the usefulness of automatic exchange of information, the extent to which the United States maintains and can produce information about beneficial ownership of certain foreign-owned entities, and, finally, whether there is consensus as to the standard for determining whether a request for specific exchange of information is sufficiently specific to require response by a treaty country.[7]

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[6] Article XV of the U.S.-Sweden Double Tax Convention, signed on March 23, 1939.

[7] A third method of information exchange is spontaneous exchange, which occurs when one treaty country determines that information in its possession may be relevant to the other treaty country's tax administration and thus transmits the information to the other country.

Automatic information exchange

The extent to which automatic information exchange occurs and how it is used by the recipients is not clear. Such exchanges occur when the parties to a tax treaty typically enter into a memorandum of understanding to share on a regular basis information that is deemed to be consistently relevant to the tax administration of the other treaty country; the treaty countries are not required to specifically request this information from one another. The United States, for example, annually provides over 2.5 million items of information about U.S.-source income received by residents of treaty countries to those treaty partners. Problems identified in the use of automatic exchange of information under tax treaties have included the lack of timeliness in providing information; differences in the tax reporting periods used by treaty countries; the recipient country difficulty in translating text on forms; and the large volume of information included in such exchanges.

In publishing regulations earlier this year to expand information reporting on payments to nonresident aliens, the Secretary of Treasury noted the improvement of the United States exchange of information program as a beneficial outcome of implementing such regulations. In the preamble to those regulations, the Secretary stated that "requiring routine reporting to the IRS of all U.S. bank deposit interest paid to any nonresidential alien individual will further strengthen the United States exchange of information program consistent with adequate provisions for reciprocity, usability and confidentiality in respect of this information."[8] The regulations in question would require U.S. financial institutions to report on interest paid to any nonresident aliens, not only residents of Canada as currently required.[9] The Committee may wish to inquire about those recently proposed regulations and the extent to which expanded regulations would strengthen exchange of information under the pending protocol, as well as any additional attendant burdens that may arise as a result of these regulations.[10] The Committee may also wish to explore the usability of the information exchanged with Canada under present regulations, and its relationship to the exchange of information program with Canada.

Second, the United States has been criticized for Federal and State rules that may facilitate attempts by foreign persons to evade their home country tax laws. In the past, there have been claims that the U.S. "know-your-customer" rules for financial institutions are less strict than other countries in their requirements for the determination of beneficial owners of financial accounts. A second criticism has been that the entity formation laws of some U.S. States make it difficult for government officials to ascertain the identities of owners of entities. The OECD report on the United States exchange of information program notes that, despite an otherwise robust regulatory framework and broad powers of the Federal authorities to gather information responsive to treaty requests for exchange of information, the gaps in beneficial ownership information on certain entities remains troublesome. The specific example noted in

[8] Prop. Treas. Reg. sec. 1.6049-4, 76 Fed. Reg. 1105 (January 7, 2011).

[9] Treas. Reg. sec. 1.6049-4(b)(5).

[10] The IRS and Treasury Department have requested written and electronic comments on the proposed regulations. A public hearing at which oral comments were presented was held on May 18, 2011.

the report is that of a limited liability company owned by a single foreign person. Your committee may wish to ask about the extent to which it may be appropriate to consider policy changes to ensure that the United States is able to respond effectively to information requests from its treaty partners.

Specific exchange

A second method of exchange is known as the "specific" exchange, which occurs when one treaty country provides information to the other treaty country in response to a specific request by the latter country for information that is relevant to an ongoing investigation of a particular tax matter. One problem with specific exchange has been that some treaty countries have declined to exchange information in response to specific requests intended to identify limited classes of persons.[11] Your committee may wish to seek assurances that, under the proposed treaty with Hungary and the proposed protocols with Luxembourg and Switzerland, treaty countries are required to exchange information in response to specific requests that are comparable to John Doe summonses under domestic law.[12] As discussed below, this has been a recurring issue with exchanges with Switzerland.

To the extent that there were perceived deficiencies in the former information exchange relationship with Luxembourg and Switzerland, and to the extent that the United States may have little recent practical experience in cooperating with Hungary on tax matters, your committee may wish to seek reassurances that any obstacles to effective information exchange have been eliminated. With respect to Hungary, we note that the OECD report on Phase I of the peer review determined that many of the elements required to determine that a jurisdiction is in compliance with international standards are not in place, and cited as a factor for that determination the numerous ambiguities in Hungary's domestic laws concerning the record-keeping obligations applicable to different types of entities, the scope of confidentiality afforded business secrets, and the authority of Hungarian officials to gain access to information. All of these factors pose potential impediments to effective exchange of information.

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[11] For example, a petition to enforce a John Doe summons served by the United States on UBS, AG was filed on February 21, 2009, accompanied by an affidavit of Barry B. Shott, the U.S. competent authority for the United States-Switzerland income tax treaty. Paragraph 16 of that affidavit notes that Switzerland had traditionally taken the position that a specific request must identify the taxpayer. See *United States v. UBS AG*, Civil No. 09-20423 (S.D. Fla.). On August 19, 2009, after extensive negotiations between the Swiss and U.S. governments, the United States and UBS announced that UBS had agreed to provide information on over 4,000 U.S. persons with accounts at UBS.

[12] Under a John Doe summons, the U.S. Internal Revenue Service ("IRS") asks for information to identify unnamed "John Doe" taxpayers. The IRS may issue a John Doe summons only with judicial approval, and judicial approval is given only if there is a reasonable basis to believe that taxes have been avoided and that the information sought pertains to an ascertainable group of taxpayers and is not otherwise available.

Information exchange with Luxembourg and Switzerland

Switzerland

The exchange of information article in the 1951 U.S.-Swiss treaty was limited to "prevention of fraud or the like." Under the treaty, Switzerland applied a principle of dual criminality, requiring that the purpose for which the information was sought also be a valid purpose under local law. Because "fraud or the like" was limited to nontax crimes in Switzerland, information on civil or criminal tax cases was not available. The provision was substantially revised for the present treaty, signed in 1996, and accompanied by a contemporaneous protocol that elaborated on the terms used in the exchange of information article. That 1996 Protocol was intended to broaden the circumstances under which tax authorities could exchange information to include tax fraud or fraudulent conduct, both civil and criminal. It provided a definition at paragraph 10 of "tax fraud" to mean "fraudulent conduct that causes or is intended to cause an illegal and substantial reduction in the amount of tax paid to a contracting state." In practice, exchange apparently remained limited, leading the competent authorities to negotiate a subsequent memorandum of understanding that included numerous examples of the facts upon which a treaty country may base its suspicions of fraud to support a request to exchange information.[13]

In March 2009, the Swiss Federal Council withdrew its reservation regarding Article 26 (Exchange of Information) of the OECD Model treaty, thus apparently adopting the OECD standards on administrative assistance in tax matters.[14] It simultaneously announced key elements that it would require as conditions to be met in any new agreements. The Swiss conditions established by the Federal Council limited administrative assistance to individual cases and only in response to a specific and justified request. Although Switzerland is considered by the OECD to be a jurisdiction that has fully committed to the transparency standards of the OECD, the recently published OECD report on Phase I of its peer review of Switzerland states that the Swiss authorities' initial insistence on imposing identification requirements as a predicate for exchange of information were inconsistent with the international standards and that additional actions would be needed to permit the review process to proceed to Phase II. Those actions include bringing a significant number of its agreements into line with the standard and taking action to confirm that all new agreements are interpreted in line with the standard.

The proposed protocol, by replacing Article 26 (Exchange of Information and Administrative Assistance) of the present treaty and amending paragraph 10 of the 1996 Protocol, closely adheres to the principles announced by Switzerland. It also conforms to the

[13] "Mutual Agreement of January 23, 2003, Regarding the Administration of Article 26 (Exchange of Information) of the Swiss-U.S. Tax Convention of October 2, 1996," reprinted at paragraph 9106, *Tax Treaties*, (CCH 2005).

[14] See "Switzerland to adopt OECD standard on administrative assistance in fiscal matters," Federal Department of Finance, FDF (March 13, 2009), available at http://www.efd.admin.ch/dokumentation/medieninformationen/00467/index.html?lang=en&msg-id=25863 (last accessed March 1, 2011).

standards, if not the language, of the exchange of information provisions in the U.S. Model treaty in many respects. As a result, the proposed protocol may facilitate greater exchange of information than has occurred in the past, chiefly by eliminating the present treaty requirement that the requesting treaty country establish tax fraud or fraudulent conduct or the like as a basis for exchange of information and providing that domestic bank secrecy laws and lack of a domestic interest in the requested information are not possible grounds for refusing to provide requested information. Lack of proof of fraud, lack of a domestic interest in the information requested, and Swiss bank secrecy laws were cited by Swiss authorities in declining to exchange information. The proposed protocol attempts to ensure that subsequent changes in domestic law cannot be relied upon to prevent access to the information by including in the proposed protocol a self-executing statement that the competent authorities are empowered to obtain access to the information notwithstanding any domestic legislation to the contrary.

Nevertheless, there are several areas in which questions about the extent to which the exchange of information article in the proposed protocol may prove effective are warranted. The proposed revisions to paragraph 10 of the 1996 Protocol reflect complete adoption of the first element listed above in the Swiss negotiating position, "limitation of administrative assistance to individual cases and thus no fishing expeditions." The limitation poses issues regarding (1) the extent to which the Swiss will continue to reject requests that do not name the taxpayer as a result of the requirement that a taxpayer be "typically" identified by name, and (2) the standard of relevance to be applied to requests for information, in light of the caveat against "fishing expeditions." In addition, the appropriate interpretation of the scope of purposes for which exchanged information may be used may be unnecessarily limited by comments in the Technical Explanation. One such concern is the extent to which the agreement that information may be used for purposes beyond the purposes identified in paragraph 1 of Article 26, is consistent with the comment in the Technical Explanation that such authority will only be exercised if consistent with the Mutual Legal Assistance Agreements.

Luxembourg

The proposed protocol with Luxembourg, by replacing Article 28 (Exchange of Information and Administrative Assistance) of the 1996 treaty, is consistent with both the OECD and U.S. Model treaties. There are several areas in which questions are warranted about the extent to which the new article as revised in the proposed protocol may prove effective. These questions arise not from the language in the proposed protocol itself but from the mutual understandings reflected in diplomatic notes exchanged at the time the protocol was signed. Potential areas of concern are found in statements in the diplomatic notes concerning (1) the obligation to ensure tax authority access to information about beneficial ownership of juridical entities and financial institutions, other than publicly traded entities, to the extent that such information is of a type that is within the possession or control of someone within the territorial jurisdiction, (2) the requirement that all requests must provide the identity of the person under investigation, (3) the standard of relevance to be applied in stating a purpose for which the information is sought, and (4) the requirement that requests include a representation that all other means of obtaining the information have been attempted, except to the extent that to do so would cause disproportionate difficulties.

Article-by-article summaries

The Joint Committee staff's pamphlets provide detailed article-by-article explanations of the proposed treaty and the two proposed protocols. Below is a summary of significant features of each agreement.

Hungary

Like other U.S. tax treaties, the proposed treaty with Hungary includes rules that limit each country's right, in specified situations, to tax income derived from its territory by residents of the other country. For example, the proposed treaty contains provisions under which each country generally agrees not to tax business income derived from sources within that country by residents of the other country unless the business activities in the taxing country are substantial enough to constitute a permanent establishment (Article 7). Similarly, the proposed treaty contains certain exemptions under which residents of one country performing personal services in the other country will not be required to pay tax in the other country unless their contact with the other country exceeds specified minimums (Articles 14 and 16). The proposed treaty also provides that pensions and other similar remuneration paid to a resident of one country may be taxed only by that country and only at the time and to the extent that a pension distribution is made (Article 17).

The proposed treaty provides that dividends and certain gains derived by a resident of one country from sources within the other country generally may be taxed by both countries (Articles 10 and 13); however, the rate of tax that the source country may impose on a resident of the other country on dividends may be limited by the proposed treaty. Generally, source-country taxation of dividends is limited to 15 percent of the gross amount of the dividends paid to residents of the other treaty country. A lower rate of five percent applies if the beneficial owner of the dividends is a company that owns directly at least 10 percent of the voting stock of the dividend-paying company.

The proposed treaty provides that, subject to certain rules and exceptions, interest and most types of royalties derived by a resident of one country from sources within the other country may be taxed only by the residence country (Articles 11 and 12). Notwithstanding this general rule, the source country may impose tax on certain interest in an amount not to exceed 15 percent of the gross amount of such interest.

In situations in which the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the proposed treaty generally provides for relief from the potential double taxation through the allowance by the country of residence of a tax credit for certain foreign taxes paid to the other country (Article 23).

The proposed treaty contains the standard provision (the "saving clause") included in U.S. tax treaties pursuant to which each country retains the right to tax its residents and citizens as if the treaty had not come into effect (Article 1). In addition, the proposed treaty contains the standard provision providing that the treaty may not be applied to deny any taxpayer any benefits to which the taxpayer would be entitled under the domestic law of a country or under any other agreement between the two countries (Article 1).

The proposed treaty (Articles 19 and 20) generally provides that students, business trainees, teachers, professors, and researchers visiting the other treaty country are exempt from host country taxation on certain types of payments received.

The proposed treaty provides authority for the two countries to resolve disputes (Article 25) and exchange information (Article 26) in order to carry out the provisions of the proposed treaty.

The proposed treaty also contains a detailed limitation-on-benefits provision that reflects the anti-treaty-shopping provisions included in the United States Model Income Tax Convention of November 15, 2006 (the "U.S. Model treaty") and more recent U.S. income tax treaties. The new rules are intended to prevent the inappropriate use of the treaty by third-country residents (Article 22).

The provisions of the proposed treaty will have effect generally on or after the first day of January following the date that the proposed treaty enters into force. However, with respect to withholding taxes (principally dividends, interest and royalties), the proposed treaty has effect for amounts paid or credited on or after the first day of the second month following the date on which the proposed treaty enters into force.

Luxembourg

Article I of the proposed protocol with Luxembourg replaces Article 28 (Exchange of Information) of the present treaty with rules that conform closely to the U.S. Model treaty. The proposed rules generally provide that the two competent authorities will exchange such information as may be foreseeably relevant in carrying out the provisions of the domestic laws of the United States and Luxembourg concerning taxes imposed at a national level, to the extent the taxation under those laws is not contrary to the treaty.

Article II of the proposed protocol provides that the proposed protocol will enter into force upon the exchange of instruments of ratification, and it sets forth rules for when the provisions of the proposed protocol will take effect.

Switzerland

The proposed protocol with Switzerland amends Article 10 (Dividends) of the present treaty to expand the prohibition on source-country taxation of dividends beneficially owned by pension or other retirement arrangements resident in the other treaty country. Under the proposed protocol, the prohibition on source-country taxation also applies to dividends that are beneficially owned by an individual retirement savings plan set up in, and owned by a resident of, the other treaty country, so long as the competent authorities agree that the individual retirement savings plan generally corresponds to an individual retirement savings plan recognized in the other treaty country for tax purposes. The prohibition on source-country taxation is not available if the beneficial owner controls the company paying the dividend.

The proposed protocol changes the voluntary arbitration procedure of Article 25 (Mutual Agreement Procedure) of the present treaty to a mandatory arbitration procedure that is sometimes referred to as "last best offer" arbitration, in which each of the competent authorities

proposes one and only one figure for settlement, and the arbitrator must select one of those figures as the award. Under the proposed protocol, unless a taxpayer or other "concerned person" (in general, a person whose tax liability is affected by the arbitration determination) does not accept the arbitration determination, it is binding on the treaty countries with respect to the case. A mandatory and binding arbitration procedure is included in the U.S. treaties with Belgium, Canada, France, and Germany.

Mutual administrative assistance is modernized under the proposed protocol. The proposed protocol replaces Article 26 (Exchange of Information) of the present treaty and paragraph 10 of the 1996 Protocol with rules that conform generally to the OECD standards. The proposed rules generally provide that, in response to specific requests, the two competent authorities will exchange such information as may be relevant in carrying out the provisions of the domestic laws of the United States and Switzerland concerning taxes covered by the treaty, to the extent the taxation under those laws is not contrary to the treaty.

Article 5 of the proposed protocol provides that the proposed protocol will enter into force upon the exchange of instruments of ratification, and it sets forth rules for when the provisions of the proposed protocol will take effect.

Conclusion

These provisions and issues are all discussed in more detail in the Joint Committee staff pamphlets on the proposed treaty and protocols. I am happy to answer any questions that your committee may have at this time or in the future.