

## PROPOSED INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND BELGIUM

(Memorandum Prepared by the Staff of the Joint Committee on Internal Revenue Taxation)

The existing income tax convention between the United States and Belgium was signed on October 28, 1948. This convention was modified by supplementary conventions of September 9, 1952, and August 22, 1957, and by a protocol of May 21, 1965. These conventions and protocol will be replaced by the proposed convention.

The revision of the existing Belgian income tax treaty is desirable for a number of reasons. Over the years various changes have been made in the internal tax laws of the two countries, especially by the United States in the Foreign Investors Tax Act of 1966 which significantly changed our tax laws relating to treatment of foreign persons. There also has been a trend in recent years toward modernizing and standardizing international tax relationships. This is seen in the model income tax convention of the Organization for Economic Cooperation and Development (OECD) and in the revisions in recent years of other U.S. income tax treaties.

The proposed convention with Belgium, in general, follows the approach of other U.S. income tax treaties. The most significant change made by the proposed convention is the adoption of the "effectively connected concept" in place of the so-called "source of attraction doctrine." Accordingly, a resident of one country who derives investment income from the other country will be entitled to the reduced rates of, or exemptions from, tax provided by the proposed convention even though he has a permanent establishment in the source country as long as the income is not effectively connected with the permanent establishment. This change follows the approach embodied in the Foreign Investors Tax Act of 1966 and other recent U.S. tax treaties.

The other more important features of the proposed convention are the following:

(1) The United States and Belgium are defined to include their respective continental shelves insofar as income arising from the exploration and exploitation of natural resources on the continental shelf is concerned. The effect of this provision is to extend a country's jurisdiction to tax under, and the benefits provided by, the proposed convention to income arising in connection with natural resources activities on the country's continental shelf. Although a definition of this type is not found in our other income tax treaties (other than the proposed treaty with Trinidad and Tobago), a similar provision was added to the Internal Revenue Code by the Tax Reform Act of 1969.

(2) Specific provision is made for the two countries to mutually agree on common meanings for undefined terms which are used in the

proposed convention. This provision, which will help insure the availability of the benefits provided by the proposed convention, is not contained in other recent U.S. income tax treaties (other than the proposed conventions with Trinidad and Tobago and Finland).

(3) The reciprocal exemption for income from shipping and air transportation is extended to gains arising on the sale of the ships or aircraft.

(4) Dividends paid by a U.S. corporation to a U.S. citizen or resident, which at present are subject to a 20 percent Belgian tax if they are collected in Belgium, will be exempted from Belgian tax even though collected in Belgium.

(5) Although the generally applicable 15 percent rate of source country withholding tax on interest is continued, the proposed convention further provides for an exemption from source country tax where the interest is received by the government of the other country, is interest on commercial credit arising from sales transactions between residents of the two countries, or is interest on bank deposits or interbank loans.

(6) A rule for determining the source of nonmineral royalty income is provided which differs from that contained in the Internal Revenue Code and our other income tax treaties. Under the proposed convention, this type of royalty will be considered from sources within the country of residence of the payor. The normal rule is that the income has its source in the country in which the property right giving rise to the royalty is used.

(7) An exemption from source country tax is provided for capital gains (other than on real property) which are not effectively connected with a source country permanent establishment (or fixed base). In addition, nonbusiness capital gains of an individual who is not present in the source country for 183 days or more during the year will be exempt from tax by that country.

(8) The limitation on the foreign tax credit provided under the proposed convention by the United States for Belgian income taxes is not formulated in terms of a specific type of limitation. Our other income tax treaties normally impose a per-country limitation on the foreign tax credit. Thus, a U.S. taxpayer claiming the foreign tax credit under the proposed convention will be subject to the limitation applicable to that year under the Internal Revenue Code (at present the per-country limitation or the overall limitation).

(9) Business profits (and other income) which Belgium may tax under the proposed convention are treated as from sources within Belgium, even though under the Internal Revenue Code source rules the income might be treated as from sources outside Belgium. This will help insure that a U.S. taxpayer who incurs Belgian taxes under the terms of the proposed convention will be entitled to a foreign tax credit for those taxes where the per-country limitation on the credit is utilized.

A detailed explanation of the proposed convention on an article by article basis is presented below.

#### *Article 1. Personal scope*

The proposed convention provides that it is generally applicable to persons who are residents of either the United States or Belgium, or of both countries. This provision, which is based on the OECD model

convention, is not found in other U.S. income tax treaties. It does not, however, result in any substantive difference since the specific provisions of our other income tax treaties generally are limited in application to residents of the two treaty countries.

*Article 2. Taxes covered*

The proposed convention applies to the U.S. Federal income tax. In the case of Belgium, it applies to the various Belgian income taxes, including prepayments of these taxes and surcharges on these taxes.

The proposed convention also contains the provision generally found in U.S. income tax treaties to the effect that the convention will apply to substantially similar taxes which either country may subsequently impose.

In addition, it is provided that the countries are to inform each other of amendments of their tax laws or the adoption of any substantially similar taxes, and of applicable interpretations of the proposed convention. Other recent U.S. income tax treaties contain a similar provision for the exchange of legal information.

*Article 3. General definitions*

The standard definitions found in most of our income tax treaties are contained in the proposed convention.

In addition, the proposed convention contains a provision which is not found in the existing convention or other U.S. tax treaties (except for the proposed treaty with Trinidad and Tobago) which includes within the definition of the term "United States" the territorial sea of the United States and the continental shelf of the United States insofar as the exploration and exploitation of natural resources on the continental shelf is concerned. This expanded definition, however, is applicable for purposes of the proposed convention only to the extent that the person, property, or activity of concern is connected with the exploration and exploitation of natural resources. A similar definition of Belgium is contained in the proposed convention. The definition of continental shelf areas contained in the proposed convention is similar to that contained in the proposed convention with Trinidad and Tobago and to that provided in the Internal Revenue Code (as amended by the Tax Reform Act of 1969) except that under the Code the continental shelf definitions apply only with respect to mines, oil and gas wells, and other natural deposits. Under the proposed convention, the applicability of the definition is not expressly restricted in this manner since it applies with respect to the exploration for or exploitation of any natural resource. In practical operation, however, the applicability of the provision usually will be considered the exploration or exploitation of natural resources of the continental shelf, and thus the definition of continental shelf is not to apply with respect to this activity.

The proposed convention also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the convention. It is further provided, however, that under the mutual agreement procedure of the proposed convention (Article 25) the competent authorities may establish a common meaning for an undefined term. This provision is similar to those contained in the proposed conventions with Trinidad and Tobago and Finland. Although most of our other income tax treaties contain a mutual agreement procedure,

generally, they do not have a specific agreement provision relating to definitional matters.

*Article 4. Fiscal domicile*

The benefits of the proposed convention generally are available only to residents of the two countries. The proposed convention defines "resident of Belgium" and "resident of the United States," and in addition provides a set of rules to determine residence for purposes of the convention in the case of an individual with dual residence. This provision of the proposed convention is based on the fiscal domicile article of the OECD model convention and is similar to the provision found in the French treaty and the proposed Finnish treaty.

Under the proposed convention, an individual whom both countries consider to be a resident according to their general rules for determining residence will be deemed for all purposes of the convention to be a resident of the country in which he has his permanent home, his center of vital interests, his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement.

*Article 5. Permanent establishment*

The existing convention contains a limited definition of the term "permanent establishment." The permanent establishment concept, of course, is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. Moreover, the permanent establishment concept is significant in determining whether the reduced rates of, or exemptions from, tax provided by the convention for dividends, interest, royalties, and capital gains are applicable.

A new definition of the term "permanent establishment" is contained in the proposed convention. This definition generally follows that contained in the OECD model convention and other recent U.S. income tax treaties. Basically, the proposed convention expands the definition to clarify the situations in which business activities carried on by a resident of one country in the other country will be considered a permanent establishment in that other country.

Generally, any fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country will be considered a permanent establishment. This includes a seat of management, an office, a factory, and a building site or construction or installation project which exists for more than twelve months. This general rule is modified by providing that a fixed place of business which is used for any or all of a number of specified activities will not be considered a permanent establishment. These activities include the purchase of goods and the warehousing of goods for purposes of storage, display, delivery, or processing by another person.

Under the proposed convention, it is further provided that, notwithstanding the specifically exempted activities, a resident of one country will be deemed to have a permanent establishment in the other country if it has a fixed place of business in that country and sells goods or merchandise for use or disposition in that country which

either were subjected to processing in that country by another person (wherever purchased) or were purchased in that country and not subjected to processing outside of that country. This provision, although not contained in other U.S. income tax treaties, is similar to a provision contained in the proposed Trinidad and Tobago convention.

The proposed convention also provides that a resident of one country will be deemed to have a permanent establishment in the other country if it has an agent in that country who has and habitually exercises a general contracting authority (other than for the purchase of merchandise). This agency rule does not apply, however, if the agent is a broker, general commission agent, or any other agent of an independent status, provided the agent is acting in the ordinary course of his business.

The proposed convention further provides that this independent agent exception will not apply in the case of an agent acting on behalf of an insurance company who has, and habitually exercises, a general contracting authority. Accordingly, an insurance company of one country will be deemed to have a permanent establishment in the other country if it has an agent with general contracting authority in that country, regardless of whether the agent is of dependent or independent status. Other U.S. income tax treaties do not contain a similar provision.

#### *Article 6. Income from real property*

The existing convention generally provides that real property and natural resources rentals or royalties and other real property income (not including income derived from obligations secured by the property) may be taxed in the country where the real property or natural resource is located. In addition, it provides that a Belgian resident who derives this type of rental or royalty income from the United States may elect to be subject to U.S. tax on that income as if he were engaged in a trade or business in the United States through a permanent establishment.

A similar provision is included in the proposed convention. The principal change made by this provision is the elimination of the provision dealing with the net basis election allowed Belgian individuals with respect to real property income from U.S. sources. This provision is no longer necessary in view of the similar election added to the Internal Revenue Code by the Foreign Investors Tax Act of 1966.

Accordingly, under the proposed convention, real property income and natural resources royalties (including gains from the sale or exchange of the property or right giving rise to the royalty, but not including interest on debts secured by real property or a royalty interest) will be taxable by the country in which the property or natural resource is located.

#### *Article 7. Business profits*

The existing convention provides that a resident of one country is taxable by the other country on industrial and commercial profits only to the extent the profits are allocable to a permanent establishment in the other country.

The proposed convention, in general, continues this rule with various revisions which conform it to the treatment of business profits in other recent U.S. tax conventions and under the Internal Revenue Code.

This includes the adoption of the effectively connected concept (i.e., elimination of the force of attraction idea).

Under the proposed convention, business profits of a resident of one country are taxable in the other country to the extent they are attributable to a permanent establishment which the resident has in the other country. In computing the business profits which are subject to tax, the proposed convention allows the deduction of all expenses, wherever incurred, which are reasonably connected with the business profits.

It is further provided that the purchase of merchandise by a permanent establishment, or by the resident of which it is a permanent establishment, for the account of the resident will not of itself cause profits to be attributed to the permanent establishment.

The proposed convention does not follow the approach of our other recent income tax treaties which set forth several types of income that are included within industrial and commercial profits. Rather, as a general rule, the proposed convention provides that industrial and commercial profits do not include items of income specifically dealt with by other articles of the convention except to the extent provided in those articles. In this regard the provisions of the proposed convention dealing with income such as dividends, interest, royalties and capital gains specifically provide that if those types of income are effectively connected with a permanent establishment they are to be treated as business profits.

The proposed convention also specifically includes rents and royalties derived from motion picture films and films or tapes for radio or television broadcasting within business profits. Under the existing convention, this type of income is dealt with under the royalty article and thus is exempt from tax unless the recipient has a permanent establishment in the source country. The effect of including these rents and royalties within business profits is the same as if they were dealt with under a royalties article which embodied the effectively connected concept in that they will be exempt from tax in the source country unless they are attributable to a permanent establishment which the recipient has in that country.

#### *Article 8. Shipping and transport*

The existing convention, like most other U.S. tax conventions, provides that income derived by a resident of one country from the operation of ships or aircraft registered in that country will be exempt from tax by the other country. The proposed convention generally continues this rule and in addition broadens the exemption provided in two respects. First, the registration requirement in the case of aircraft is liberalized. It is provided that a resident of one country will qualify for the exemption from tax by the other country if the resident's aircraft are registered in the other country, or in a third country with which the other country has an income tax treaty exempting the income, as well as where the aircraft is registered in his country of residence. Second, the proposed convention extends the exemption to gains derived by a resident of one country from the sale or other disposition of ships or aircraft in situations where the income from the operation of the ships or aircraft is exempt from tax by the other country under the general rule. Although some of our other income tax treaties do not condition the availability of the exemption on the ships or aircraft being registered in the owner's or

operator's country of residence, none of our other treaties extend the exemption to gains arising on the sale or other disposition of the ships or aircraft.

*Article 9. Associated enterprises*

The existing convention and most other U.S. income tax conventions contain a provision similar to section 482 of the Internal Revenue Code which allows the allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons. The proposed convention includes a provision of this nature.

*Article 10. Dividends*

Under the existing convention, the rate of withholding tax in the source country on dividends derived by a resident of the other country may not exceed 15 percent, if the recipient does not have a permanent establishment in the source country.<sup>1</sup>

In general, the principal change made by the proposed convention in the treatment of dividends is the adoption of the effectively connected concept which is embodied in the Foreign Investors Tax Act of 1966, the OECD model convention and other recent U.S. tax treaties. Accordingly, the reduced rate of tax (15 percent) on dividends will apply unless the recipient has a permanent establishment in the source country and the dividends are effectively connected with the permanent establishment. Where dividends are effectively connected with the permanent establishment, they will be taxed as business profits. In this regard, the proposed convention provides that Belgium may impose on Belgian source dividends treated as business profits its movable property prepayment (*precompte mobilier*), or dividend withholding tax, which under Belgian law is imposed on all dividends paid to residents or nonresidents and either satisfies the taxpayer's income tax liability with respect to the dividend or is allowed as a credit against that tax liability.

In the absence of a convention, the applicable tax rate on dividends would be 30 percent in the case of the United States and 20 percent in the case of Belgium.

The proposed convention also continues in general the rule of the existing convention that dividends paid by a corporation of one country to a person other than a resident of the other country will be exempt from tax by the other country. In addition, however, the proposed convention eliminates the rule contained in the existing convention that Belgium may tax dividends paid by a U.S. corporation to a citizen or resident of the United States if the dividends are collected in Belgium. Belgian law provides that dividends collected or received by an individual (resident or nonresident) within Belgium from sources outside of Belgium are subject to a 20 percent prepayment (*precompte mobilier*). Accordingly, under this provision of the proposed convention, Belgium will not collect this tax in the case of

<sup>1</sup> Technically, under the existing convention, the rate of Belgian withholding tax imposed on dividends derived by U.S. residents from Belgian sources is 15 percent if the stock is held in registered form and is 18.2 percent if the stock is held in bearer form. In the latter case, the Belgian tax is imposed at a stated rate of 15 percent on a grossed up amount of the dividend which produces the effective rate of 18.2 percent. In 1967, Belgium eliminated from its internal law the grossed up method of computing tax on dividends. It is understood that in view of this, Belgium subsequently agreed to impose its withholding tax on dividends paid to U.S. residents at an effective rate of 15 percent in all cases.

dividends received in Belgium by a citizen or resident of the United States from a U.S. corporation.

*Article 11. Interest*

The existing convention limits the rate of withholding tax in the source country on interest derived by a resident of the other country to 15 percent, if the recipient does not have a permanent establishment in the source country.

The proposed convention generally makes three changes in the treatment of interest. First, although the proposed convention continues the 15 percent rate of tax on dividends generally, it exempts from source country tax interest which arises in the following three types of situations: (1) interest on commercial credit (including commercial paper) which results in general from financing arrangements made in connection with the sale of goods, merchandise or services by a resident of one country to a resident of the other country; (2) interest on interbank transactions; and (3) interest on deposits in banks or other financial institutions. In the latter two situations, the exemption is not available if the loan is represented by a bearer instrument.

Second, the proposed convention exempts from source country tax interest received by the other State or a tax-exempt instrumentality of the other State. Third, the proposed convention adopts the effectively connected concept. Thus, the generally applicable reduced rate of tax on, or the limited exemptions for, interest will apply, unless the recipient has a permanent establishment in the source country and the interest is effectively connected with the permanent establishment. This treatment of interest generally conforms to that provided by the OECD model convention and other U.S. tax conventions. The OECD model convention does not contain a total interest exemption, but a number of other U.S. tax treaties do provide a generally applicable exemption for interest rather than a reduced rate.

In the absence of a convention, the U.S. tax rate on interest paid to a nonresident would be 30 percent and the Belgian tax rate would be 20 percent.

The proposed convention contains a definition of interest which is similar to the definition contained in the OECD model convention, except that in the case of Belgium, interest also includes prizes on lottery bonds. Additionally, the proposed convention contains a limitation on the application of the interest article, which is found in the OECD model convention and other recent U.S. income tax treaties, in situations where the payor and recipient are related, to the amount of interest which would have been agreed upon by the payor and recipient if they were not related.

The proposed convention also contains a source rule for interest which, in general, conforms to the interest source rule contained in the Internal Revenue Code. In addition, as in the case of the dividend provision, the proposed convention provides that Belgium will not impose its prepayment tax on interest received in Belgium from U.S. sources by a U.S. citizen or resident.

*Article 12. Royalties*

Under the existing convention, industrial and artistic royalties derived from one country by a resident of the other country are exempt from tax in the source country, if the recipient does not have a permanent establishment in the source country. The principal change

made by the proposed convention in the treatment of royalties is the adoption of the effectively connected concept. In other words, the exemption from tax on royalties will apply unless the recipient has a permanent establishment in the source country and the royalties are effectively connected with the permanent establishment. This treatment of royalties is substantially identical to that provided in the OECD model convention.

In the absence of a convention, royalties derived from the United States by a nonresident would be subject to a 30 percent tax. Royalties derived from Belgium by a nonresident generally would be subject to tax computed at a 20 percent rate on 85 percent of the gross amount of the royalty (the 15 percent not taxed being an allowance for estimated expenses).

The proposed convention contains a source rule relating to non-mineral royalties which differs from that provided under the Internal Revenue Code and our other recent income tax treaties. Under the Internal Revenue Code, the source of a royalty paid for the use of property or a property right is the country where the property or property right is used. Under Belgian law the source of a royalty generally is the country of residence of the payor of the royalty. The proposed convention, in effect, adopts the Belgian rule and accordingly provides that generally the source of a nonmineral royalty is the country of residence of the person paying the royalty.

The proposed convention differs from the existing convention and the OECD model convention in form but not in substance with respect to the treatment of film royalties. Under the existing convention, such royalties are exempt from tax in the source country pursuant to the royalties provision, if the recipient does not have a permanent establishment in the source country. The proposed convention does not include such royalties within the scope of the royalties article. Instead, as previously indicated, they are treated as business profits and accordingly are exempt from tax under the business profits article unless they are attributable to a permanent establishment which the recipient maintains in the source country.

As in the case of the interest provision, the royalty provision of the proposed convention does not apply to that part of a royalty paid to a related person which is considered excessive.

#### *Article 13. Capital gains*

The existing convention has no general provision regarding the treatment of capital gains.

The proposed convention generally provides that capital gains derived by a resident of one country will be exempt from tax by the other country unless the recipient of the gain has a permanent establishment (or fixed base) in the other country and the property giving rise to the gain is effectively connected with the permanent establishment (or fixed base). In the case of an individual resident of one country who is not taxable under the general rule, gains derived from the other country will be exempt from tax by that country unless the individual is present in that country for 183 days or more during a taxable year. These exemptions from tax for capital gains do not apply with respect to gains derived by a resident of one country on the sale or exchange of real property located in the other country. The treatment of capital gains contained in the proposed

convention conforms to the recent French income tax treaty and the proposed Finnish income tax treaty, as well as to other U.S. tax conventions (except for the fixed base concept which is derived from the OECD model convention).

In the absence of a convention, the United States imposes a 30 percent tax on capital gains derived from the United States by non-resident alien individuals who are present in this country for 183 days or more during the taxable year. Generally, Belgium does not tax nonresident individuals on capital gains arising from casual sales of nonbusiness assets.

*Articles 14 and 15. Independent and dependent personal services*

Under the existing convention, an individual who is a resident of one country is exempt from tax in the other country on income from personal services performed there, if (1) the individual is not present in the other country for more than 90 days during the year and the income does not exceed \$3,000, or (2) he is not present in that country for more than 183 days during the year and the services are performed for a resident or corporation of his country of residence. The former exemption does not apply to the compensation of officers or directors of corporations of the source country.

The proposed convention, in general, adopts the treatment of income from independent and dependent personal services provided in the OECD model convention. This treatment also generally accords with that provided in other recent U.S. tax conventions.

Under the proposed convention, income from the performance of independent activities in one country (the source country) by a resident of the other country generally will not be taxable in the source country unless the individual either (1) is present in the source country for 183 days or more during the year, or (2) maintains a fixed base in the source country for 183 days or more during the year and the income is attributable to the fixed base. In the case of public entertainers (such as actors, athletes, etc.), however, the proposed convention, in effect, continues the rule of the existing convention. In other words, income which a public entertainer derives in the source country will be taxable by that country if he either is present in that country for more than 90 days during the year or if his income from that country for the year exceeds \$3,000.

In the case of income from dependent personal services (employment income) performed in one country (the source country) by a resident of the other country, the proposed convention provides that the income will not be taxable in the source country if three requirements are met: (1) The individual is present in the source country for less than 183 days during the year; (2) the individual is an employee of a resident of, or a permanent establishment in, his country of residence, and (3) the remuneration is not borne by a permanent establishment of the employer in the source country.

*Article 16. Directors' fees*

The existing convention, by excluding directors' fees from the personal service income article, allows the source country to tax directors' fees paid by a corporation of that country to a resident of the other country.

The proposed convention generally continues this treatment and provides that a director's fee paid to a resident of one country as a

member of the board of directors of a corporation of the other country may be taxed by the other country if the fee is not deductible in that country by the corporation paying it, but rather is treated as a distribution of profits.

This provision of the proposed convention will generally have its principal application with respect to residents of the United States who are directors of Belgian corporations, since under the Belgian corporate income tax, no deduction is allowed to a corporation for fees paid to directors as such.

*Article 17. Social security payments*

The proposed convention contains a provision regarding social security payments which is similar to that found in the French treaty and the proposed treaty with Finland. It is provided that only the payor country may tax social security payments (and similar pensions) made to a resident of the other country. The existing convention and the OECD model convention do not contain a similar provision.

*Article 18. Private pensions and annuities*

Under the existing convention, private pensions and annuities derived by the residents of one country from the other country are exempt from tax in the other country.

The proposed convention continues this rule and includes alimony within its scope.

*Article 19. Government functions*

The existing convention provides that residents of one country (who are citizens of the other country) are exempt from tax in that country on compensation, including pensions and annuities, paid by the other country or a political subdivision thereof.

The proposed convention makes two modifications in this provision: First, it follows the approach of our other recent income tax treaties by limiting the application of the exemption to persons performing governmental services. Second, the proposed convention expands the availability of the exemption from source country taxation to include citizens of a third country who come to that country for the express purpose of being employed by the other country or a political subdivision thereof. This treatment is similar to that provided by the OECD model convention.

The proposed convention also contains a provision which is found in the OECD model convention and the French treaty regarding the treatment of income for personal services of a nongovernmental nature paid by a country. It is provided that income from services performed in connection with a trade or business carried on by a country or political subdivision thereof will be treated under the proposed convention in the same manner as income from personal services performed for a private employer. Thus, this type of income will be entitled to the same benefits which would have been available if it had been paid by a nongovernmental employer.

*Article 20. Teachers*

The existing convention provides that a teacher who is a citizen of one country will be exempt from tax in the other country on income from teaching in the other country, if he is present in the host country for a period not exceeding two years pursuant to an

agreement between the countries or between teaching institutions of the two countries.

The proposed convention follows the approach of our other recent income tax treaties and extends the exemption to research activities, as well as teaching, if the research is undertaken in the public interest and not primarily for the benefit of private persons. It also eliminates the requirement that the visiting teacher must be a citizen of the other country for the exemption to apply. Accordingly, a resident of one country will be exempt from tax in the other country on income from teaching or research for a period of two years, if he is present in the host country at the invitation of the government or an accredited educational institution for the purpose of teaching or engaging in research (in the public interest) at an accredited educational institution.

*Article 21. Students and trainees*

The existing convention provides a very limited exemption for students. Students or apprentices who are citizens of one country and who are present in the other country exclusively for the purpose of study or acquiring experience are exempt from tax in the host country on remittances from abroad.

The proposed convention provides a substantially more liberal exemption similar to that embodied in other recent U.S. treaties or proposed treaties. Under the proposed convention, residents of one country who become students in the other country will be completely exempt from tax in the host country on gifts from abroad used for maintenance or study and on any grant, allowance, or award received from a governmental or charitable organization. In addition, a limited exemption is provided for personal service income derived from sources within the country in which the individual is studying. This exempts from tax in the host country \$2,000 per year of personal service income (such as income from a part-time job). The exemptions provided by this provision (the complete as well as the limited one) and the visiting teachers exemption may not be utilized for a period of longer than five years from the date of the individual's arrival in the host country.

In addition to the exemptions regarding students, the proposed convention follows the approach of other recent U.S. treaties and provides a limited exemption for personal service income of residents of one country who are employees of a resident of that country and who are temporarily present in the other country to study at an educational institution or to acquire technical, professional or business experience. This exemption is available for a period of 12 months and is limited to \$5,000. The proposed convention also provides a \$10,000 exemption for income from personal services performed in connection with training, research or study by a resident of one country who is temporarily present in the other country as a participant in a Government sponsored exchange training program.

*Article 22. Income not expressly mentioned*

The proposed convention provides that income of a resident of one country which is not expressly dealt with in the convention may not be taxed by the other country unless the income is from sources within the other country. This accords with the approach of other U.S. income tax treaties.

*Article 23. Relief from double taxation*

The usual savings clause is included in the proposed convention. This clause provides that with certain exceptions the proposed convention is not to affect the taxation by a country of its own residents and citizens. The primary exceptions include the nondiscrimination and social security payments provisions and the provisions of this article regarding relief from double taxation.

Under the existing convention, the United States allows its citizens, residents, and corporations a tax credit for Belgian income taxes. A per-country limitation is imposed on the amount of the credit.

The proposed convention continues this general method of avoiding double taxation by providing that a U.S. citizen or resident will be allowed a credit against U.S. tax for the appropriate amount of income taxes paid to Belgium. The credit allowed under this provision is subject to the provisions of United States law applicable to the year in question and is limited to the amount of United States tax attributable to income from sources within Belgium. Since this provision does not contain a specific formulation of the limitation on the credit allowed (i.e., the per country limitation which is usually found in other U.S. income tax treaties), a foreign tax credit claimed by a U.S. taxpayer under this provision of the proposed convention will be subject to the applicable limitation provided by the Internal Revenue Code.

The proposed convention also in substance follows the proposed treaties with Brazil, Finland, and Trinidad and Tobago by providing that income which is taxed by Belgium pursuant to the proposed convention will be treated for purposes of the foreign tax credit as income from sources within Belgium. Thus, a foreign tax credit will be available with respect to this income, even though under the Internal Revenue Code the income might have its source elsewhere in which case a foreign tax credit would not be available under the per country limitation, or at all if the source of the income was the United States.

As is the case under the existing convention, Belgium will employ a variety of methods to afford relief from double taxation to its residents. The general means by which Belgium will grant relief from double taxation to its residents on income taxed by the United States is the exemption method. In addition, however, Belgium will also grant deductions, credits, or reduced rates of tax.

Under the proposed convention, the basic form of relief granted by Belgium is exemption with progression. A Belgian resident who receives income which is specifically dealt with in the proposed convention and which has been taxed by the United States under the proposed convention will be exempt from Belgian tax on that income, but Belgium may take the income into account in computing the rate of tax applicable to the remainder of the individual's income. This relief provision does not apply to income for which there is a specific relief provision: Generally, dividends and interest taxed by the United States at the reduced rate (and not as business profits) and income not specifically dealt with in the proposed convention. Thus, this general relief provision will be available with respect to income such as income from real property located in the United States which is owned by a Belgian resident and business profits (including effectively connected passive income) attributable to a

United States permanent establishment of a Belgian resident. In this regard, the proposed convention provides a limitation on the exemption in the case of a U.S. permanent establishment of a Belgian resident which incurs a loss that is offset against Belgian income, and which also reduces the amount of the permanent establishment profits in other years that are subject to United States tax by reason of the net operating loss carryover. In this case, the exemption provided by Belgium to the profits of those other years would be reduced to the extent the profits had been reduced for United States tax purposes by reason of the net operating loss. In other words, the amount of the net operating loss deducted must be added back to the Belgian tax base.

The second Belgian relief provision of the proposed convention provides that in the case of a Belgian resident who receives U.S. source interest or royalties which have been taxed by the United States under the proposed convention (other than as business profits), Belgium will allow a lump sum foreign tax credit against the resident's tax on that income. At present this credit amounts to 15 percent of the net amount of the income. In the case of U.S. source dividend income received by an individual Belgian resident, the 15 percent lump sum credit also will be allowed.

The third Belgian relief provision deals with income received by a Belgian resident which is not expressly dealt with under the proposed convention and which has been taxed by the United States. In this case the income will be taxed at one-quarter of the normal rate in the case of corporations and at one-half the normal rate in the case of individuals. This is the rate of tax which Belgium would apply under its law if the income were taxed as foreign source earned income which had been subjected to foreign tax.

In the case of dividends received by a Belgian corporation from a U.S. corporation which are taxed by the United States at the reduced 15 percent rate under the proposed convention (i.e., the dividends are not effectively connected with a U.S. permanent establishment of the Belgian corporation), the proposed convention in effect provides that Belgium will allow an intercorporate dividends exemption to the Belgian corporation of 95 percent of the net dividend where the Belgian corporation owns less than 50 percent of the paying U.S. corporation. In other cases, the exemption will be 90 percent of the net dividend. This exemption is the same as that accorded by Belgium to dividends received by one Belgian corporation from another.

This relief provision, however, does not exempt the Belgian recipient of the dividend from the movable property prepayment (*pre-compte mobilier*)—at present 10 percent—which is generally imposed on foreign source dividends received by a Belgian corporation. An additional procedure, however, is provided by which the Belgian corporation may elect to be exempt from the prepayment on the dividends. Generally, if it so elects, the dividends will be subject to the prepayment when they are redistributed by the Belgian corporation to its shareholders. Under Belgian law dividends which are subject to the prepayment when received by a Belgian corporation are not again subjected to the prepayment when redistributed by the corporation. The proposed convention also provides that if in the future Belgium limits the availability of its intercorporate dividends exemp-

tion to situations where the recipient corporation owns at least 10 percent of the paying corporation, then the election provided by this provision would be similarly limited.

A special rule is also provided by this provision of the proposed convention in the case of a U.S. citizen who is a resident of Belgium and who receives U.S. source income which is neither exempt from Belgian tax nor subject to a reduced rate of tax. In such a case, it is provided that if the income is dividends, interest, or royalties, the amount of Belgian tax on the income is not to exceed 20 percent of the income after allowance of the 15 percent lump sum foreign tax credit. In other words, the U.S. citizen first computes the lump sum credit, and then the Belgian tax on his remaining income is limited to 20 percent of that income. In the case of other types of income received by a U.S. citizen, the proposed convention in effect provides that they will be taxed at one-half the normal Belgian rates (i.e., the rate at which they would be taxed under Belgian law if they were treated as foreign source earned income which as been subjected to foreign tax).

Finally, the proposed convention provides that if a corporation is treated for tax purposes by the United States as a U.S. corporation and by Belgium as a Belgian corporation, then relief from double taxation is to be provided in accordance with the principles discussed above.

#### *Article 24. Nondiscrimination*

Under the existing convention, a limited nondiscrimination provision is provided which prevents one country from imposing higher taxes on citizens and corporations of the other country than it imposes on its own citizens and corporations.

The proposed convention contains the more comprehensive nondiscrimination provisions which are found in our other recent treaties and which apply to taxes imposed at the state and local level as well as at the national level. It provides that one country cannot discriminate by imposing more burdensome taxes on its residents who are citizens of the other country, or on permanent establishments of residents of the other country, than it imposes on its comparable taxpayers. The proposed convention also extends the nondiscrimination provision to corporations of one country which are owned by residents of the other country.

The proposed convention further provides that the nondiscrimination provision will not prevent Belgium from taxing the business profits of a Belgian permanent establishment of a U.S. resident (which is a U.S. corporation or unincorporated entity) at a rate which is the highest rate at which a Belgian corporation's profits may be taxed. (The allowable rate of tax on the permanent establishment is that computed before application of the Belgian surcharges.) It is further provided, however, that the rate of tax (before the surcharges) on those profits of the permanent establishment which are deemed to have been distributed shall be the rate imposed on distributed profits of a Belgian corporation (as long as Belgium taxes distributed profits of Belgium companies at a lower rate than the highest rate it imposes on retained profits). For this purpose the Belgian permanent establishment will be deemed to distribute the same percentage of its profits which the U.S. resident maintaining the permanent establishment distributes of its total profits. At the present time, a Belgian company's

distributed profits are taxed at a 30 percent rate and its undistributed profits are taxed at rates ranging from 25 to 35 percent. In the absence of a treaty provision, the profits of a Belgian permanent establishment of a nonresident company are subject to a 35 percent tax (whether or not they are remitted to the nonresident company). Accordingly, the effect of this provision of the proposed convention is to allow Belgium to tax the undistributed profits of a U.S. resident's Belgian permanent establishment at the 35 percent rate. However, the portion of the permanent establishment's profits which are deemed distributed may only be taxed by Belgium at the lower 30 percent rate (or such other lower rate as Belgium may impose on distributed profits in the future).

*Articles 25, 26, and 27. Administrative provisions*

The existing convention contains various administrative provisions. Under the proposed convention, these provisions are modernized and expanded generally along the lines of the provisions contained in other U.S. tax treaties.

In general, the proposed convention provides—

(1) For consultation and negotiation between the two countries to resolve differences arising in the application of the proposed convention and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the terms of the proposed convention;

(2) For the exchange between the countries of legal information and of information pertinent to carrying out the provisions of the proposed convention or to preventing fraud or fiscal evasion with respect to the taxes covered by the proposed convention; and

(3) That each country is to assist the other in collecting taxes imposed by the other country to the extent necessary to insure that the benefits provided by the proposed convention are enjoyed only by persons entitled to those benefits.

The proposed convention specifically includes the definition of terms as an item on which countries are to consult and attempt to reach mutual agreement. Although most of our other income tax treaties contain a mutual agreement procedure, generally, they do not have a specific agreement provision relating to definitional matters. A similar provision, however, is included in the proposed conventions with Finland and Trinidad and Tobago.

*Article 28. Miscellaneous*

The proposed convention provides that its provisions are not to affect the fiscal privileges which diplomatic or consular officials enjoy under the general rules of international law or the provisions of special agreements. A similar provision is contained in the OECD model convention and in a number of our other income tax treaties.

In addition the proposed convention provides, as do most other U.S. income tax treaties, that it is not to be interpreted to deny any tax benefit available presently or in the future under the tax laws of the two countries or under any other agreement between the countries.

*Article 29. Extension to territories*

The proposed convention provides a method similar to that found in some of our other income tax conventions by which the convention

may be extended to areas, not otherwise covered by the proposed convention, for whose international relations the United States is responsible, if the area imposes taxes substantially similar to those covered by the convention. The convention may be extended pursuant to this provision either in its entirety by a written notification given Belgium by the United States and assented to by Belgium in a written communication which notification and communication are then to be ratified by the two countries.

*Article 30. Entry into force*

The proposed convention will enter into force one month following the exchange of the instruments of ratification. It will become effective for taxable years beginning on or after January 1, 1971 (or in the case of withholding taxes, with respect to payments made on or after that date).

When the proposed convention enters into effect, the various existing conventions will terminate as they apply between Belgium and the United States (the convention of October 28, 1948; the supplementary conventions of September 9, 1952, and August 22, 1957; and the protocol of May 21, 1965).

*Article 31. Termination*

The proposed convention will continue in force indefinitely, but either country may terminate the proposed convention at any time after 5 years from its entry into force by giving notice through diplomatic channels. In addition, it is provided that the provisions of the social security payments article may be terminated by either country at any time.

## PROPOSED INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND FINLAND

(Memorandum Prepared by the Staff of the Joint Committee on Internal Revenue Taxation)

The presently applicable income tax convention between the United States and Finland, which was signed on March 3, 1952, would be replaced by the proposed convention.

Since 1952, a number of changes have been made in the tax laws of both the United States and Finland and, in addition, in recent years there has been a trend toward the modernization and standardization of international tax relationships. This trend is reflected in the model income tax convention of the Organization for Economic Cooperation and Development (OECD) and in the U.S. income tax treaties which have been revised in recent years. These various factors are reflected in the proposed convention.

In general, the proposed convention with Finland follows the pattern embodied in our other recent income tax treaties. The change of most significance which is made by the proposed convention is the adoption of the effectively connected concept (i.e., the abandonment of the so-called force of attraction doctrine). Thus, if a resident of one country derives investment income from the other country, he will be able to enjoy the reduced rates of, or exemptions from, tax provided by the proposed convention, even if he has a permanent establishment in the other country, provided the income is not effectively connected with that permanent establishment.

The other more important features of the proposed convention are as follows:

(1) It is specifically provided that the countries may by mutual agreement establish common meanings for terms used in the convention in order to prevent double taxation. A specific provision of this nature is not contained in our other income tax treaties (other than the proposed conventions with Trinidad and Tobago and Belgium).

(2) Business profits and effectively connected income of a permanent establishment located in one country will be treated as being from sources within that country even though the income might have its source elsewhere under the Internal Revenue Code. This is designed to help insure that a U.S. taxpayer who incurs Finnish taxes on this type of income will be entitled under the foreign tax credit provisions of the proposed treaty, which place a per-country limitation on the credit, to a credit against his U.S. tax liability on that income for the Finnish taxes.

(3) Royalties on motion picture films (and on radio and television tapes), which are not covered by the existing convention, will be exempt from tax unless they are attributable to a permanent establishment in the source country.

(4) The 5 percent rate of source country withholding tax on intercorporate dividends, which is now available only where there is a 95 percent ownership interest, will be available if there is at least a 10 percent ownership interest. In the absence of a treaty, dividends would be taxed by the United States at a 30-percent rate, and by Finland at a 15-percent rate.

(5) The present exemption from source country tax for artistic royalties is extended to industrial and commercial royalties. These royalties, in the absence of a convention, would be taxed by the United States at a 30-percent rate and would be taxed by Finland at the regular corporate or individual rates.

(6) Capital gains (other than on real property) which a resident of one country derives from the other country will be exempt from source country taxation, unless they are effectively connected with a permanent establishment (or a fixed base of an individual) in the source country. In addition, nonbusiness capital gains of an individual will be exempt from source country taxation provided the individual is not present in that country for more than 183 days during the year. In the absence of a treaty, short-term capital gains (real property held less than 10 years and other capital assets held less than 5 years) would be taxed by Finland at the regular corporate and individual tax rates. A 30-percent U.S. tax would be imposed on capital gains of nonresident individuals present in this country for 183 days or more during the year.

A detailed explanation of the proposed convention on an article-by-article basis is presented below.

#### *Article 1. Taxes covered*

The proposed convention applies to the United States Federal income tax except for the accumulated earnings tax imposed by section 531 of the Internal Revenue Code and the personal holding company tax imposed under section 541.

In the case of Finland, the proposed convention applies to the state income tax and the communal tax. These are the national and municipal income taxes imposed by Finland on individuals and corporations. The proposed convention also applies to the state capital tax imposed by Finland which is a graduated tax imposed on individuals (resident and nonresident) with respect to certain forms of property. Finally, the proposed convention applies to the sailors' tax imposed by Finland which is an income withholding tax imposed on the compensation of crewmen of Finnish ships in lieu of the national and municipal income taxes.

The proposed convention also contains the provision generally found in U.S. income tax treaties to the effect that the convention will apply to substantially similar taxes which either country may subsequently impose. In addition, the nondiscrimination provisions of the proposed convention will apply to taxes imposed at the state or local level as well as at the national level.

#### *Article 2. General definitions*

The standard definitions contained in most U.S. income tax treaties are contained in the proposed convention.

The proposed convention also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the convention. In

addition, however, the proposed convention provides in a manner similar to the proposed conventions with Trinidad and Tobago and Belgium, that where a term is defined in a different manner by the two countries, the competent authorities of the countries may establish a common meaning for the term in order to prevent double taxation or to further any other purpose of the convention. Although most of our other income tax treaties contain a mutual agreement procedure, generally, they do not have a specific agreement provision relating to definitional matters.

#### *Article 3. Fiscal domicile*

Generally, only residents of the two countries are entitled to the benefits of the proposed convention. The proposed convention defines "resident of Finland" and "resident of the United States" and in addition provides a set of rules to determine residence for purposes of the convention in the case of an individual with dual residence. This provision of the proposed convention is based on the OECD model convention's fiscal domicile article and is similar to the provision found in the French treaty and the proposed Belgian treaty.

Under the proposed convention, if both countries consider an individual to be a resident according to their general rules for determining residence, the individual will be deemed for all purposes of the convention to be a resident of the country in which he has his permanent home, his center of vital interests, or his habitual abode. If the residence of an individual cannot be determined by these tests applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement.

#### *Article 4. General rules of taxation*

The existing convention contains general rules regarding the manner in which one country may tax residents of the other country which are of limited scope.

The proposed convention contains the more comprehensive set of general rules which are found in most of our other income tax treaties. Thus, one country may tax residents of the other country only on income from sources within the taxing country. Since under the proposed convention (article 6) industrial or commercial profits attributable to a permanent establishment located in a country are treated as from sources within that country, under this provision one country may tax residents of the other country on business profits attributable to a permanent establishment located in the taxing country and on other income from sources within the taxing country.

The taxation under the proposed convention must be in accordance with the limitations contained in the proposed convention. Each country, however, may tax without regard to the proposed convention any income from sources within that country to which the convention is not expressly applicable. In addition, the proposed convention is not to be interpreted to deny any tax benefits available presently or in the future under the tax laws of the two countries or under any other agreement between the countries.

The usual savings clause is included in the proposed convention. This clause provides that with certain exceptions the proposed convention is not to affect U.S. taxation of its own citizens and residents.

The primary exceptions include the foreign tax credit, the nondiscrimination provision, and the benefits relating to social security payments. The savings clause does not apply in the case of Finland since Finland bases its taxation on residence rather than citizenship.

*Article 5. Relief from double taxation*

Under the existing convention the United States allows its citizens, residents, and corporations a tax credit for Finnish income taxes in accordance with the foreign tax credit provisions of the Internal Revenue Code of 1939.

The proposed convention continues this method of avoiding double taxation by providing that a U.S. citizen or resident (which includes corporations) may credit against its U.S. tax the appropriate amount of income taxes paid to Finland. As is the case in other recent U.S. tax treaties, the proposed convention does not specifically refer to the foreign tax credit provisions of the Internal Revenue Code. This makes it clear that modifications of the Code which affect the foreign tax credit will not be barred by the proposed credit article if the modifications do not contravene the general principles of the convention.

The proposed convention provides a per country limitation on the amount of the credit and, in addition, provides that the source rules contained in the proposed convention are to be applied in determining the credit. Of course, under the general rule that the proposed convention is not to deny existing tax benefits, if the source of income rules or the overall limitation on the credit provided by the Internal Revenue Code produce a more favorable credit, a U.S. taxpayer may use the Code rules.

Under the existing convention, Finland allows its residents and corporations a tax credit for income taxes paid to the United States (or its political subdivisions). A per-country limitation is imposed on the amount of the credit.

Under the proposed convention, Finland, to avoid double taxation, will employ both an exemption method and a tax credit method. First, where a resident of Finland derives income from the United States (other than dividends) which may be taxed by the United States under the convention, Finland will exempt that income from taxation. Although the proposed convention sets forth this exemption in the terms of a tax credit, it is in fact an exemption since the amount of the "credit" is the amount of Finnish tax imposed on the income in question. An exemption from Finnish tax will also be provided for intercorporate dividends paid by a U.S. corporation to a Finnish corporation as long as Finland continues to provide under its internal law an exemption for intercorporate dividends paid by one Finnish corporation to another. It is also provided that Finland may employ an exemption with progression system. Thus, a specific item of income may be taken into account by Finland in determining the rate of tax applicable to the total income of a Finnish resident taxable under Finnish law even though the item of income is exempt from Finnish tax under the proposed convention.

In the case of dividends from sources within the United States which are derived by Finnish residents, the proposed convention provides that Finland will allow a tax credit for the U.S. tax imposed on the dividends subject, however, to a per country limitation.

*Article 6. Source of income*

The existing convention does not contain source of income rules. Of course, source of income rules are one of the ways by which income tax treaties can eliminate double taxation, since the source of income is important in determining a country's jurisdiction to tax residents of the other country and also in determining the limitation on the foreign tax credit.

The proposed convention follows the general approach of some of our recent income tax treaties and provides source of income rules that conform in general to the source rules contained in the Internal Revenue Code. There is, however, a minor difference in the dividend and interest source rule and, in addition, the proposed convention follows the proposed treaties with Brazil, Trinidad and Tobago and Belgium by including a rule for determining the source of business profits.

Under the Internal Revenue Code, dividends or interest paid by a foreign corporation are considered to be in part from U.S. sources and, therefore, are taxable to that extent when paid to a nonresident alien individual or company, if more than 50 percent of the paying corporation's income for the previous three years was effectively connected with a U.S. business. Under the existing convention, if the foreign corporation is a Finnish corporation, dividends and interest paid by that corporation to a foreign person are exempt from U.S. income tax notwithstanding the relative amount of the corporation's U.S. business income. The proposed convention slightly expands the tax jurisdiction of the United States in the case of this type of dividend and interest income over that allowed under the existing convention. It provides that dividends and interest paid by a non-U.S. corporation will be treated as from U.S. sources if at least 80 percent of the corporation's gross income for the prior three years consisted of industrial and commercial profits attributable to a U.S. permanent establishment. Although this rule expands U.S. tax jurisdiction in the case of dividends or interest paid by a Finnish corporation, it also has the effect of limiting U.S. tax jurisdiction in the case of dividends or interest paid to a Finnish resident by a foreign corporation other than a Finnish corporation. This is because this type of income was not dealt with in the existing Finnish convention and is subject, under the proposed convention, to a source rule which is slightly more limited than that provided under the Internal Revenue Code.

The proposed convention also follows the proposed treaties with Brazil, Belgium, and Trinidad and Tobago by providing that industrial and commercial profits (including passive income so treated because it is effectively connected with a permanent establishment) will be treated as from sources within the country in which the permanent establishment is located. Although the inclusion of this source rule in the proposed convention does not produce a difference in the result which obtains under our other treaties insofar as jurisdiction to tax is concerned, it may produce a different result under the foreign tax credit article of the convention. This is because business profits attributable to a Finnish permanent establishment will be considered as from sources within Finland—even though under the Code source rules the income might have its source elsewhere—and, thus, a foreign

tax credit under the per country limitation will be available to a U.S. taxpayer for Finnish taxes imposed on this income.

*Article 7. Nondiscrimination*

Under the existing convention, a limited nondiscrimination provision is provided which prevents one country from imposing higher taxes on citizens and corporations of the other country than it imposes on its own citizens and corporations.

The proposed convention contains the more comprehensive nondiscrimination provisions which are found in other recent U.S. income tax treaties. It provides that one country cannot discriminate by imposing more burdensome taxes on its residents who are citizens of the other country, or on permanent establishments of residents of the other country, than it imposes on its comparable taxpayers. The proposed convention also extends the nondiscrimination provision to corporations of one country which are owned by residents of the other country.

*Article 8. Business profits*

Under the existing convention, a resident of one country is taxable by the other country on industrial and commercial profits to the extent the profits are allocable to a permanent establishment in that other country.

The proposed convention generally continues this rule with various revisions to conform it to the treatment of business profits in other recent U.S. tax treaties and under the Internal Revenue Code. This includes the adoption of the effectively connected concept (i.e., elimination of the force of attraction idea under which all income from sources in the country where the permanent establishment is located, in effect, is considered attributable to the permanent establishment).

Under the proposed convention, business profits of a resident of one country are taxable in the other country to the extent they are attributable to a permanent establishment which the resident has in the other country. In computing the business profits that are subject to tax, all expenses wherever incurred which are reasonably connected with the business profits may be deducted.

It is further provided that the purchase of merchandise by a permanent establishment, or by the resident of which it is a permanent establishment, for the account of the resident will not of itself cause profits to be attributed to the permanent establishment.

Under the proposed convention, several types of income which are included within industrial and commercial profits are set forth. These include investment income arising from a right or property which is effectively connected with the permanent establishment. Industrial and commercial profits also include rents or royalties derived from motion picture films and films or tapes for radio or television broadcasting. The existing convention does not deal with this type of income and, thus, each country now may tax film or tape royalties derived by a resident of the other country. Under the proposed convention, these rents and royalties (by being included within business profits) will be exempt from tax in the source country unless they are attributable to a permanent establishment which the recipient has in that country.

*Article 9. Permanent establishment*

The existing convention contains a limited definition of the term "permanent establishment." The permanent establishment concept,

of course, is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. Moreover, the permanent establishment concept is significant in determining whether the reduced rates of, or exemptions from, tax provided by the convention for dividends, interest, royalties, and capital gains are applicable.

A new definition of the term "permanent establishment" is contained in the proposed convention. This definition generally follows that contained in the OECD model convention and other recent U.S. income tax treaties. Basically, the proposed convention expands the definition to clarify the situations in which business activities carried on by a resident of one country in the other country will be considered a permanent establishment in that other country.

Generally, any fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country will be considered a permanent establishment. This includes a seat of management, an office, a factory, and a building site or construction or assembly project which exists for more than twelve months. This general rule is modified by providing that a fixed place of business which is used for any or all of a number of specified activities will not be considered a permanent establishment. These activities include the warehousing of goods for purposes of storage, display, delivery, or processing by another person.

The proposed convention also provides that a resident of one country will be deemed to have a permanent establishment in the other country if it has an agent in that country who has and habitually exercises a general contracting authority (other than for the purchase of merchandise) in that country. This agency rule does not apply, however, if the agent is a broker, general commission agent, or any other agent of an independent status provided the agent is acting in the ordinary course of his business.

#### *Article 10. Shipping and air transport*

The proposed convention continues the rule found in the existing convention and in most other U.S. income tax treaties that income derived by a resident of one country from the operation in international traffic of ships or aircraft registered in that country will be exempt from tax by the other country.

#### *Article 11. Related persons*

Most U.S. income tax conventions, including the existing convention, contain a provision similar to section 482 of the Internal Revenue Code which allows the allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons. The proposed convention includes a provision of this nature which is somewhat broader than that found in the existing convention in that it is applicable where only one of the related persons is a resident of one of the two countries; under the existing convention, both related persons must be residents of the treaty countries.

### *Article 12. Dividends*

The existing convention limits the rate of withholding tax in the source country on dividends derived by a resident of the other country to 15 percent generally, and to 5 percent in the case of dividends paid by a corporation in which the recipient has at least a 95 percent ownership interest (provided not more than 25 percent of the income of the paying corporation consisted of dividends and interest—i.e., it is not an investment company). These reduced rates of tax, however, do not apply if the recipient has a permanent establishment in the source country.

In general, the proposed convention makes two changes in the treatment of dividends. First, the required ownership interest which must exist for the 5 percent intercorporate rate to be available is reduced from 95 percent to 10 percent; the 15 percent rate is continued in the case of portfolio dividends. Second, the proposed convention adopts the effectively connected concept (i.e., it abandons the force of attraction idea). Accordingly, the reduced rate of tax on dividends will apply unless the recipient has a permanent establishment in the source country and, in addition, the dividends are effectively connected with the permanent establishment. This treatment of dividends generally conforms to that provided by the Foreign Investors Tax Act of 1966, the OECD model convention, and other recent U.S. income tax treaties.

As is the case under the existing convention, the limitations on Finnish tax imposed on dividends derived from sources within Finland by a United States resident apply to the combined amount of the Finnish income tax and the Finnish capital tax imposed on capital stock of a Finnish corporation owned by a U.S. resident.

In the absence of a convention, dividends paid by a Finnish corporation to a U.S. resident would be subject to a 15 percent withholding tax. A U.S. resident's capital stock in a Finnish corporation would be subject to tax at graduated rates ranging from approximately one-half of 1 percent to 2½ percent. Dividends paid by a U.S. corporation to a Finnish resident would be subject to a 30 percent withholding tax.

### *Article 13. Interest*

Under the existing convention, interest derived by a resident of one country from sources within the other country is exempt from tax in the source country if the recipient does not have a permanent establishment in that country. In addition, an exemption from the Finnish property tax is provided for bonds, bank deposits, and trade balances of a U.S. resident.

The proposed convention continues the exemption from source country tax for interest and, in addition, adopts the effectively connected concept. Thus, the exemption from source country tax for interest will apply unless the recipient has a permanent establishment in the source country and, in addition, the interest is effectively connected with the permanent establishment. This treatment generally conforms to that provided by other recent U.S. tax treaties and the OECD model convention.

The proposed convention does not contain the exemption from Finnish property tax for bonds, bank deposits or trade balances of a U.S.

resident, inasmuch as this exemption is now provided under Finnish law.

In the absence of a convention, U.S. source interest paid to a non-resident would be subject to a 30 percent U.S. tax. Interest derived from Finnish sources by a nonresident would be exempt from Finnish income tax.

A definition of interest is contained in the proposed convention which is substantially identical to that found in the OECD model convention and other recent U.S. income tax treaties. It also contains the limitation on the application of the interest article which is found in these conventions in situations where the payor and recipient are related, to the amount of interest which would have been agreed upon had they not been related.

#### *Article 14. Royalties*

Under the existing convention, artistic royalties (other than film royalties) derived by a resident of one country from sources within the other country are exempt from tax in the source country if the recipient does not have permanent establishment in the source country.

The proposed convention makes three principal changes in the treatment of royalties. First, it extends the exemption to industrial and scientific royalties. Second, the proposed convention adopts the effectively connected concept. Accordingly, the exemption from tax for royalties will apply unless the recipient has a permanent establishment in the source country and the royalties are effectively connected with the permanent establishment. This treatment generally follows that provided in the OECD model convention. Third, as previously discussed (in connection with article 6), the proposed convention treats film royalties as business profits, thus exempting those royalties from source country taxation unless they are attributable to a permanent establishment located in the source country.

In addition, as in the case of the interest provision, the royalty provision of the proposed convention does not apply to that part of a royalty paid to a related person which is considered excessive.

In the absence of a convention, Finland generally would tax royalties derived by a U.S. resident at the regular corporate or individual tax rates. Royalties derived from the United States by Finnish residents would be subject to a 30 percent tax.

#### *Article 15. Income from real property*

The existing convention provides that income from real property (not including interest on obligations secured by the property) and natural resources royalties may be taxed in the country where the real property or natural resources are located. In addition, it provides that a resident of one country who derives real property income from the other country may elect to be taxed in the source country as if he were engaged in a trade or business in that country through a permanent establishment.

A similar provision is included in the proposed convention. The principal change made by this provision is the elimination of the net basis election provision of the existing convention, which is no longer needed since both Finland and the United States tax allow income from real property to be taxed on a net basis.

Accordingly, under the proposed convention real property income and natural resources royalties (including gains from the sale or exchange of the property or right giving rise to the royalty, but not including interest on debts secured by real property or a royalty interest) will be taxable by the country in which the property or natural resource is located.

#### *Article 16. Capital gains*

The existing convention does not deal with the treatment of capital gains. The proposed convention generally provides that capital gains derived by a resident of one country will be exempt from tax by the other country, unless the recipient of the gain has a permanent establishment in the other country and the property giving rise to the gain is effectively connected with the permanent establishment. In the case of an individual resident of one country who is not taxable under the general rule, gains derived from the other country will be exempt from tax by that country unless the individual either maintains a fixed base in that country and the property giving rise to the gain is effectively connected to the fixed base or the individual is present in that country for more than 183 days during a taxable year. These exemptions from tax for capital gains do not apply with respect to gains derived by a resident of one country on the sale or exchange of real property located in the other country. The treatment of capital gains contained in the proposed convention conforms to the recent French income tax treaty and the proposed Belgium income tax treaty, as well as to other U.S. tax conventions (except for the fixed base concept which is derived from the OECD model convention).

In the absence of a convention, the United States imposes a 30 percent tax on capital gains derived from the United States by non-resident alien individuals who are present in this country for 183 days or more during the taxable year. Finland taxes capital gains at the regular corporate and individual tax rates, other than gains on the sale of real property which has been held for at least 10 years and gains from the sale of other kinds of capital assets held for at least 5 years which are exempt from tax by Finland.

#### *Article 17. Capital taxes*

The existing convention does not cover capital taxes. As previously indicated (article 1), the proposed convention applies to the capital tax imposed by Finland. This provision of the proposed convention, in effect, provides that a resident of the United States will be exempt from the capital tax imposed by Finland on nonbusiness personal property (i.e., on property other than real property or property effectively connected with a Finnish permanent establishment) and on U.S. registered ships and aircraft and personal property pertaining to the operation of those ships and aircraft.

Although this provision of the proposed convention is reciprocal in form, it only will affect the taxation by Finland of U.S. residents since the United States does not impose a capital tax. In the absence of a convention, individuals who are not residents of Finland are subject to the Finnish national capital tax with respect to the net amount of various types of property located in Finland. This tax is imposed at rates ranging from approximately one-half of 1 percent to 2½ percent.

*Articles 18 and 19. Independent and dependent personal services*

Under the existing convention, an individual who is a resident of one country is exempt from tax in the source country on income from personal services performed there, if the individual is not present in that country for more than 183 days during the year and if either the services are performed for a resident or corporation of his country of residence or the income does not exceed \$10,000.

The proposed convention provides a more liberal treatment of personal services income which generally accords with that provided in other recent U.S. tax treaties.

In the case of income from the performance of independent activities in one country (the source country) by a resident of the other country, the proposed convention eliminates the \$10,000 limit on the exemption. Accordingly, this type of personal service income will be exempt from source country tax provided the person performing the services is not present in the source country for more than 183 days during the year, regardless of the amount of the income.

In the case of income from dependent personal services (employment income) performed by a resident of one country in the other country, the proposed convention generally follows our other recent treaties and provides that the income will be exempt from source country taxation if three requirements are met: (1) the individual is not present in the source country for more than 183 days during the year; (2) the remuneration is paid by, or on behalf of, an employer who is not a resident of the source country; and (3) the remuneration is not borne by a permanent establishment of the employer in the source country.

*Article 20. Teachers*

Under the existing convention, teachers who are residents of one country and who are temporarily present in the other country for the purpose of teaching at an educational institution in that country are exempt from tax in that country on income derived from teaching activities for a period of two years.

The proposed convention follows the approach of other recent U.S. tax treaties and extends this exemption to income from research, other than research undertaken primarily for the benefit of private persons rather than in the public interest. Accordingly, a resident from one country will be exempt from tax in the other country on income from teaching and research for a period of two years, if he is present in the host country at the invitation of the government or an accredited educational institution for the purpose of teaching or engaging in research (in the public interest) at an accredited educational institution.

*Article 21. Students and trainees*

The existing convention provides a very limited exemption for students. Students or apprentices who are residents of one country and who are present in the other country exclusively for the purpose of studying or acquiring business or technical experience are exempt from tax in the host country on remittances from abroad.

The proposed convention provides a substantially more liberal exemption similar to that embodied in the 1965 Supplementary Convention with the Netherlands, the recent French treaty, and the pro-

posed treaties with Brazil, Belgium, and Trinidad and Tobago. Under the proposed convention, residents of one country who become students in the other country will be completely exempt from tax in the host country on gifts from abroad used for maintenance or study and on any grant, allowance or award received from a governmental or charitable organization. In addition, a limited exemption is provided for personal service income derived from sources within the country in which the individual is studying. Under this provision, the host country will exempt from tax \$2,000 per year of personal service income (such as income from a part-time job). These exemptions (the complete, as well as the limited one) and the visiting teachers exemption may not be utilized for a period of more than 5 years in total.

In addition to the exemption regarding students, the proposed convention follows the approach of other recent U.S. tax treaties and provides a limited exemption for personal service income of residents of one country who are employees of a resident of that country and who are temporarily present in the other country to study at an educational institution or acquire technical, professional or business experience. This exemption is available for a period of one year and is limited to \$5,000. The proposed convention also provides an exemption for income from personal services performed in connection with training, research or study by residents of one country who are temporarily present in the other country as participants in Government sponsored exchange training programs. This exemption is limited to \$10,000.

#### *Article 22. Governmental functions*

The existing convention provides that residents of one country (other than citizens of that country unless the person is also a citizen of the other country) are exempt from tax in that country on compensation, including pensions, paid by the other country or a political subdivision thereof.

The proposed convention follows the approach of our other recent income tax treaties by restricting the availability of the exemption to citizens of the paying country who are performing governmental functions.

#### *Article 23. Rules applicable to personal income articles*

The proposed convention provides that reimbursed travel expenses are exempt from tax under the personal income article without regard to maximum amount of the exemption. The proposed convention also provides that only the benefits of the most favorable personal income article may be claimed by a taxpayer for a year if more than one of those articles is applicable in that year.

The proposed convention also contains a provision not found in our other income tax treaties which, in effect, exempts a resident of one country who is present in the other country as a teacher or student from tax in his country of residence on at least 30 percent of the amount of his income from personal services (which he derives as a teacher or student and which is exempt from tax in the host country under the proposed convention). This provision, although reciprocal in form, only affects Finnish taxation of Finnish students and teachers who are temporarily present in the United States. This is because the

United States, under the savings clause, may tax its residents without regard to the proposed convention.

This provision, which it is understood was requested by Finland, provides that a resident of one country who is temporarily present in the other country as a teacher or student may deduct in determining his income tax in his country of residence the following amounts: (1) all traveling expenses (including meals and lodging and incidental expenses) while traveling between the two countries; and (2) all ordinary and necessary living expenses (including meals and lodging) while temporarily present in the host country. These deductible expenses are presumed in any event to be at least 30 percent of the amount of the student's or teacher's income which is exempt from tax in the host country under the visiting teachers article or the students article of the proposed convention.

*Article 24. Private pensions and annuities*

Under the existing convention, private pensions and annuities derived from one country by residents of the other country are exempt from tax in the source country.

The proposed convention continues this rule and includes alimony within its scope.

*Article 25. Social security payments*

The proposed convention provides that when social security payments or other public pensions are paid by one country to a resident of the other country, only the payor country may tax these payments. Although the existing convention and the OECD model convention do not contain a corresponding provision, the French and the proposed Belgium treaties do contain a provision of this nature.

*Article 26. Diplomatic and consular officers*

The proposed convention provides, as do a number of our other income tax treaties and the existing convention, that its provisions are not to affect the fiscal privileges which diplomatic and consular officials enjoy under the general rules of international law or the provisions of special agreements.

*Article 27. Investment or holding companies*

The proposed convention contains a provision which denies the benefits of the dividends, interest, and royalties articles to a corporation which is entitled in its country of residence to special tax benefits resulting in a substantially lower tax on those types of income than the tax generally imposed on corporate profits by that country, if 25 percent or more of the capital of the corporation is owned by corporations or individuals who are nonresidents of that country (or by U.S. citizens, in the case of a Finnish corporation). A similar provision is contained in the Luxembourg convention and in other recent proposed U.S. tax treaties.

The purpose of this provision is to prevent residents of third countries from using a corporation in one treaty country, which is preferentially taxed in that country, to obtain the tax benefits in the other treaty country which the proposed convention provides for dividends, interest, and royalties derived from that other country. This accords with the purpose of an income tax convention between two countries which is to lessen or eliminate the amount of double taxation of in-

come derived from sources within one country by a resident of the other country.

At the present time, neither Finland nor the United States grants to investment or holding companies the type of tax benefits with respect to dividends, interest, or royalties which would make this provision of the proposed convention applicable. Thus, the provision will have effect only if Finland or the United States should subsequently enact special tax measures granting preferential tax treatment to dividends, interest and royalties received by an investment or holding company.

*Articles 28-30. Administration provisions*

Various administration provisions are contained in the existing convention. The proposed convention modernizes and expands these provisions generally along the lines of the provisions contained in other U.S. tax treaties.

In general, the proposed convention provides—

- (1) For consultation and negotiation between the two countries to resolve differences arising in the application of the proposed convention and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the terms of the proposed convention;
- (2) For the exchange between the countries of legal information and of information pertinent to carrying out the provisions of the proposed convention or to preventing fraud or fiscal evasion with respect to the taxes covered by the proposed convention; and
- (3) That each country is to assist the other in collecting taxes imposed by the other country to the extent necessary to insure that the benefits provided by the proposed convention are enjoyed only by persons entitled to those benefits.

*Article 31. Entry into force*

The proposed convention will enter into force two months following the exchange of the instruments of ratification. It will become effective generally for taxable years beginning on or after January 1 of the year following the exchange of the instruments of ratification. Reductions in U.S. withholding taxes under the proposed convention generally will apply to amounts received on or after the date the proposed convention enters into force. When the proposed convention enters into effect, the existing convention which was signed on March 3, 1952, and which entered into force on December 18, 1952, will terminate.

*Article 32. Termination*

The proposed convention will continue in force indefinitely but either country may terminate the proposed convention after 1973 by giving notice through diplomatic channels. In addition, it is provided that the provisions of the social security payments article may be terminated by either country at any time.

## **PROPOSED INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND TRINIDAD AND TOBAGO**

(Memorandum Prepared by the Staff of the Joint Committee on Internal Revenue Taxation)

The existing income tax convention with Trinidad and Tobago which was signed on December 22, 1966, ceased to be effective as of the end of 1969. It was a treaty of limited scope and had been entered into pending agreement by the countries on a more comprehensive income tax convention.

The proposed convention with Trinidad and Tobago is a comprehensive convention which follows in most respects the general pattern embodied in other recent U.S. income tax treaties. The proposed convention departs from our other income tax treaties in two principal respects in order to reflect the fact that Trinidad and Tobago is a developing country, rather than a developed country. The principal aspect of the proposed treatment which differs from the general pattern is the inclusion within the treaty of a provision which provides for the deferral of both countries' taxes which would otherwise be imposed on the transfer of technical assistance (such as patents, designs, etc., knowhow, and ancillary and subsidiary services) by a U.S. corporation to a Trinidad and Tobago corporation in return for stock of the Trinidad and Tobago corporation. This provision is designed to induce the flow of knowhow and related services to Trinidad and Tobago.

The other principal aspect of the proposed convention which differs from the general pattern is the unilateral reduction by Trinidad and Tobago of its withholding taxes on dividends and interest which flow from that country to the United States. The U.S. withholding taxes on this type of income are not reduced under the proposed convention so as not to encourage an outflow of capital to the United States from Trinidad and Tobago.

The other more important features of the proposed convention are as follows:

(1) The terms "United States" and "Trinidad and Tobago" are to include the countries' respective continental shelves, insofar as income arising from the exploration and exploitation of natural resources on the continental shelves is concerned. Accordingly, a country's jurisdiction to tax under, and the benefits provided by, the proposed convention will extend to this type of income. Our other income tax treaties (except for the proposed treaty with Belgium) do not contain a provision of this type. However, a similar provision was added to the Internal Revenue Code by the Tax Reform Act of 1969.

(2) The two countries may under the mutual agreement procedure establish common meanings for undefined terms used in the proposed convention. This provision, which will help insure the availability of the benefits provided by the proposed convention, is not contained in

other recent U.S. tax treaties (other than the proposed conventions with Belgium, Finland, and the Netherlands).

(3) A source rule is provided under which business profits and effectively connected income of a permanent establishment in one country will be considered to be from sources within that country, even though the income might have its source elsewhere under the Internal Revenue Code. This is designed to help insure that a U.S. taxpayer who pays taxes to Trinidad and Tobago on this type of income will be entitled under the foreign tax credit provisions of the proposed treaty, which would place a per country limitation on the credit, to a credit for the Trinidad and Tobago taxes.

(4) The rate of Trinidad and Tobago withholding tax on inter-corporate dividends (where the recipient has a 10-percent ownership interest in the paying company) is reduced from 25 percent to 10 percent. The branch profits tax imposed by Trinidad and Tobago is similarly reduced from 25 percent to 10 percent.

(5) The rate of Trinidad and Tobago withholding tax on interest is reduced from 30 percent to 15 percent in cases where the recipient is a U.S. bank or other financial institution not having a permanent establishment in Trinidad and Tobago.

(6) Artistic royalties will be exempt from source country taxation and industrial and scientific royalties will be subject to a 15 percent rate of source country withholding taxation. In the absence of a treaty, these royalties would be taxed by both the United States and Trinidad and Tobago at a rate of 30 percent.

A detailed analysis of the proposed convention on an article-by-article basis is presented below.

#### *Article 1. Taxes covered*

The proposed convention applies to the U.S. Federal income tax with the exception of the accumulated earnings tax imposed by section 531 of the Internal Revenue Code and the personal holding company tax imposed under section 541. In the case of Trinidad and Tobago, the proposed convention applies to the corporation tax and the income tax.

The proposed convention also contains the provision generally found in U.S. income tax treaties to the effect that the convention will apply to substantially similar taxes which either country may subsequently impose. In addition, the nondiscrimination provisions will apply to taxes imposed at the State or local level as well as at the national level.

#### *Article 2. General definitions*

The standard definitions found in most of our income tax treaties are contained in the proposed convention. There is one provision, however, in the proposed convention which differs from existing treaties. This provision includes within the definition of the term "United States" the territorial sea of the United States and the continental shelf of the United States insofar as the exploration and exploitation of natural resources on the continental shelf is concerned. This expanded definition, however, is applicable for purposes of the proposed convention only to the extent that the person, property, or activity of concern is connected with the exploration and exploitation of natural resources. A similar definition of Trinidad and Tobago is contained in the proposed convention.

The definition of continental shelf areas contained in the proposed convention is similar to that contained in the proposed Belgian convention and to that provided in the Internal Revenue Code (as amended by the Tax Reform Act of 1969) except that under the Code the continental shelf definitions apply only with respect to mines, oil and gas wells, and other natural deposits. Under the proposed convention, the applicability of the definition is not expressly restricted in this manner since it applies with respect to the exploration for or exploitation of any natural resource. In practical operation, however, the applicability of the provision usually will be similarly restricted. The activity of fishing is not intended to be considered the exploration or exploitation of natural resources of the continental shelf, and thus the definition of continental shelf is not to apply with respect to this activity.

The proposed convention also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the convention. In addition, however, the proposed convention provides that where a term is defined in a different manner by the two countries or where the definition of a term cannot be readily determined under the laws of one of the countries, then the competent authorities of the two countries may establish a common meaning of the term under the mutual agreement procedures provided by the proposed convention in order to prevent double taxation or to further any other purpose of the convention. A similar provision is contained in the proposed conventions with Belgium and Finland. While most other U.S. income tax treaties contain a mutual agreement procedure, generally they do not contain a specific provision of this nature relating to definitional matters.

### *Article 3. General rules of taxation*

The proposed convention contains the basic general rules of taxation regarding the manner in which one country may tax residents and corporations of the other country which are found in most of our other income tax conventions. Thus, one country may tax residents of the other country only on income from sources within the taxing country. In this regard, it should be noted, however, that (as discussed in connection with article 5) the source rules contained in the proposed convention, which are to be used for purposes of this basic rule, provide that industrial or commercial profits attributable to a permanent establishment located in a country are treated as from sources within the country. The taxation under the proposed convention must be in accordance with the limitations contained in the proposed convention. Each country, however, may tax without regard to the proposed convention any income to which the convention is not expressly applicable.

The proposed convention is not to be interpreted to deny any tax benefits available presently or in the future under the tax laws of the two countries or under any other agreement between the countries.

The usual savings clause is included in the proposed convention. This clause provides that with certain exceptions the proposed convention is not to affect the taxation by a country of its own residents (and, in the case of the United States, of its own citizens). The primary exceptions include the foreign tax credit, the nondiscrimination

provision, and the provision allowing tax deferral for technical assistance.

*Article 4. Relief from double taxation*

The previous convention with Trinidad and Tobago which terminated at the end of 1969 contained a provision regarding the allowance of a foreign tax credit by each of the countries for taxes paid to the other country. The proposed convention continues this method of avoiding double taxation. As in the case of other recent U.S. tax conventions and the previous convention with Trinidad and Tobago, the proposed convention does not specifically refer to the foreign tax credit provisions of the Internal Revenue Code or of the tax laws of Trinidad and Tobago. This makes it clear that modifications of the Code or of the tax laws of Trinidad and Tobago which affect the foreign tax credit will not be barred by the proposed convention if the modifications do not contravene the general principles of the convention.

Under the proposed convention, a citizen, resident, or corporation of the United States will be allowed to credit against its U.S. tax the amount of income tax paid to Trinidad and Tobago. Moreover, a U.S. corporation which receives a dividend from a Trinidad and Tobago corporation in which it has at least a 10-percent ownership interest will be allowed a credit for the Trinidad and Tobago tax paid on the corporate profits out of which the dividend is paid, if the U.S. corporation includes the amount of Trinidad and Tobago tax in its gross income. The credit allowed by the United States under the proposed convention is subject to the so-called per-country limitation. Of course, if the overall limitation on the foreign tax credit which is provided by the Internal Revenue Code produces a more favorable result, a U.S. taxpayer may use that provision rather than the per-country limitation contained in the proposed convention.

The foreign tax credit allowed by the United States under this provision of the proposed convention conforms generally to the foreign tax credit allowed under the Internal Revenue Code (secs. 901-906). There is, however, one significant difference regarding the so-called deemed paid credit, i.e., the credit allowed to certain U.S. corporations for Trinidad and Tobago taxes paid on the corporate profits out of which a dividend is paid. To receive this credit under the proposed convention, the recipient U.S. corporation must include in its income the amount of Trinidad and Tobago tax for which a deemed paid credit is claimed. In other words, the dividend must be grossed up. Under the Internal Revenue Code, however, a dividend does not have to be grossed up in order for the recipient U.S. corporation to claim a deemed paid credit, if the dividend is paid by a less developed country corporation and most Trinidad and Tobago corporations will be considered less developed country corporations. Inasmuch as the computation of the deemed paid tax credit without gross-up under the Internal Revenue Code will generally produce a more favorable result than the grossed-up computation under the proposed convention, it will be to the advantage of U.S. corporations in many cases to use the code rules in computing the deemed paid credit. Of course, in these cases U.S. corporations may continue to use the Code rules rather than those found in the proposed convention.

Under the proposed convention, Trinidad and Tobago will allow its taxpayers a credit for income taxes paid to the United States. Also, a Trinidad and Tobago corporation which receives a dividend from a U.S. corporation in which it has at least a 10-percent ownership interest will be allowed a credit for the U.S. tax paid on the corporate profits out of which the dividend is paid. In the absence of the proposed convention, this credit would be allowed under Trinidad and Tobago law only where the recipient corporation had at least a 25-percent ownership interest in the paying corporation. The credit allowed by Trinidad and Tobago under the proposed convention is subject to a per-country limitation.

*Article 5. Source of income*

One of the ways by which income tax treaties can eliminate double taxation is to provide rules for determining the source of income. The source of income is important in view of the general rule in treaties that one country may tax residents and corporations of the other country only on income from sources within the taxing country, and also in view of the fact that the limitation in the foreign tax credit provision is based on the source of income.

The proposed convention with Trinidad and Tobago follows the general approach of recent U.S. tax treaties and provides source of income rules that conform in general to the source rules contained in the Internal Revenue Code. There is, however, a minor difference in the dividend source rule, and, in addition, the proposed convention follows the proposed treaties with Brazil, Finland, and Belgium by including a rule for determining the source of business profits.

Under the Internal Revenue Code, dividends paid by a foreign corporation are considered to be in part from U.S. sources, and therefore are taxable to that extent by the United States when paid to a non-resident alien individual or company, if more than 50 percent of the paying corporations' income for the previous three years was effectively connected with a U.S. business. The proposed convention slightly limits the tax jurisdiction of the United States which arises by virtue of this source rule. It applies the 50 percent test with respect to industrial or commercial profits which are effectively connected with a permanent establishment in the United States of a Trinidad and Tobago corporation and limits the amount of dividends paid by such a corporation which will be treated as U.S. income under this rule to that amount of money or other property transferred from the permanent establishment in the United States to the Trinidad and Tobago corporation during the relevant period. In other words, dividends paid by a Trinidad and Tobago corporation are not to be considered U.S. source income under this rule to the extent the profits of the permanent establishment are reinvested in the United States by the permanent establishment rather than remitted to the Trinidad and Tobago corporation.

The proposed convention also contains a rule regarding the source of industrial and commercial profits including passive income which is treated as industrial and commercial profits because it is effectively connected with a permanent establishment. This rule is found in some of our recent proposed treaties, but not in other U.S. income tax treaties or under the Internal Revenue Code. Under the Code and other U.S. tax treaties, the country in which a permanent establishment is located may tax the business profits which are effectively connected

with the permanent establishment regardless of the source of those profits. Insofar as jurisdiction to tax is concerned, the proposed Trinidad and Tobago treaty achieves the same result by providing that these business profits are from sources within the country where the permanent establishment is located. The practical results of the two approaches are basically the same with one exception. Since business profits attributable to a Trinidad and Tobago permanent establishment are considered to be from sources within Trinidad and Tobago—even though under the usual source rules, the income would have its source elsewhere—a foreign tax credit under the per country limitation will be available to a U.S. taxpayer for Trinidad and Tobago taxes imposed on this income.

*Article 6. Nondiscrimination*

The proposed convention contains the more comprehensive nondiscrimination provisions which have been embodied in other recent U.S. income tax treaties. It provides that one country cannot discriminate by imposing more burdensome taxes on its residents who are nationals of the other country, or on permanent establishments of nationals or corporations of the other country, than it imposes on its comparable taxpayers. This provision, however, does not prevent Trinidad and Tobago from imposing its branch profits tax pursuant to the limitations contained in the proposed convention nor does it prevent the United States from imposing a comparable tax. The proposed convention also extends the nondiscrimination provision to corporations of one country which are owned by nationals or corporations of the other country.

*Article 7. Tax deferral for technical assistance*

The proposed convention contains a provision which is not found in other U.S. income tax treaties that is designed to induce the flow of know how and related services to less developed countries. This provision provides for the deferral of U.S. and Trinidad and Tobago income taxes in cases involving the transfer of technical assistance by a U.S. corporation to a Trinidad and Tobago corporation. A similar provision is contained in the proposed Israeli income tax convention which is pending before the Senate Foreign Relations Committee.

Under the proposed convention, a U.S. resident may elect to defer the U.S. and Trinidad and Tobago tax which would otherwise arise as a result of the receipt of stock of a Trinidad and Tobago corporation by the U.S. corporation in return for the transfer of technical assistance to the Trinidad and Tobago corporation. The taxes would be deferred until the stock is disposed of. Specifically, this provision applies where the U.S. corporation transfers to the Trinidad and Tobago corporation—

- (1) a patent, invention, model, design, secret formula or process, or similar property rights; or
- (2) information concerning industrial, commercial or scientific knowledge, experience, or skill.

In addition, the provision is applicable to the provision of technical, managerial, architectural, scientific, skilled or industrial, commercial or like services if they are ancillary and subsidiary to the transfer of the rights referred to in (1) above or the information referred to in (2) above. The "property" or services provided by the U.S. corpora-

tion must be for use in connection with a trade or business actively conducted by the recipient Trinidad and Tobago corporation in its own country. In addition, a transfer must be made in accordance with the laws of the two countries regulating foreign investments.

Under the Internal Revenue Code, a taxpayer may receive deferral of U.S. tax where he transfers property to a foreign corporation generally if two conditions are satisfied. First, the recipient foreign corporation must be at least 80 percent controlled by the U.S. corporation (sec. 351). Second, the Internal Revenue Service must give advance approval of the transaction (sec. 367). Thus, the effect of the proposed convention vis-a-vis U.S. law is to eliminate the 80 percent test, to relieve U.S. taxpayers of the requirement that they obtain an advance ruling from the Treasury Department, and also to eliminate the necessity which arises under the Internal Revenue Code of distinguishing between transfers of property and transfers of services.

The proposed convention, in addition to allowing the deferral of U.S. taxes, also provides for the deferral of the Trinidad and Tobago taxes which would arise in connection with the transaction. The provision is reciprocal in form and thus would also be applicable if a Trinidad and Tobago corporation were to transfer any of the specified property rights or services to a U.S. corporation.

Under the proposed convention, the competent authorities of each country are given authority to prescribe the necessary regulations for purposes of the tax deferral provision. In addition, the Trinidad and Tobago competent authority is given the power to prescribe standards for determining whether the services which may be transferred under this provision are ancillary and subsidiary to property rights or information which have been transferred, as is required by the proposed convention.

#### *Article 8. Business profits*

The proposed convention contains provisions regarding the taxation of business profits which generally accord with similar provisions found in other U.S. income tax treaties. The proposed convention includes the effectively connected concept which is found in the Internal Revenue Code and in our more recent income tax treaties.

Under the proposed convention, business profits of a resident of one country are taxable in the other country to the extent they are attributable to a permanent establishment which the resident has in the other country. In computing the taxable business profits, the proposed convention allows the deduction of all expenses, wherever incurred, which are reasonably connected with the business profits.

It is further provided that profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment, or by the resident of which it is a permanent establishment, for the account of that resident. The proposed convention also provides that in determining the profits attributable to a permanent establishment the same method is to be used from year to year unless there is good and sufficient reason to do otherwise.

The proposed convention sets forth examples of types of income which are considered industrial and commercial profits and in so doing follows the approach of our other recent treaties and the Internal Revenue Code by including within such profits investment income

arising from a right or property which is effectively connected with the permanent establishment. The types of passive income included within industrial or commercial profits are dividends, interest, royalties, and income from real property.

*Article 9. Definition of permanent establishment*

One of the basic devices used in income tax treaties to avoid double taxation is the permanent establishment concept. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided by the convention for dividends, interest, and royalties are applicable.

The proposed convention follows the pattern of the OECD model convention and other recent U.S. income tax treaties by defining a permanent establishment as a fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country. This includes a seat of management, an office, a store or other sales outlet, a factory, and any building, construction or installation project which lasts for 6 months or more. This general rule is modified to provide that a fixed place of business which is used for any or all of a number of specified activities will not constitute a permanent establishment. These activities include the processing of goods belonging to the resident and the purchase of goods for the account of the resident under arrangements or conditions which are or would be made between independent persons and the storage or delivery of goods belonging to the resident (other than goods or merchandise held for sale by the resident in a store or other sales outlet).

The proposed convention also provides that a resident of one country will be deemed to have a permanent establishment in the other country if it—

(1) engages in industrial or commercial activity in the other country through an agent who has and who habitually exercises a general contracting authority (other than for the purchase of merchandise) in that country or who maintains in that country a stock of goods belonging to the resident from which he regularly fills orders or makes deliveries;

(2) maintains equipment or machinery for rental or other purposes within the other country for a period of 6 months or more; or

(3) sells in the other country goods or merchandise which either were subjected to substantial processing in that country (wherever purchased) or were purchased in that country and not subjected to substantial processing outside of that country.

The third situation described above which gives rise to a permanent establishment is not contained in other U.S. income tax treaties. A somewhat similar provision is found, however, in the proposed Belgian convention.

The proposed convention also contains the usual rule that the agency rule will not apply if the agent is a broker, general commission agent, or other agent of independent status acting in the ordinary course of its business.

### *Article 10. Ships and aircraft*

The proposed convention adopts the approach found in most U.S. income tax treaties by providing that income which a resident of one country derives from the operation in international traffic of ships or aircraft will be exempt from tax by the other country. In the case of a resident of the United States, the ships or aircraft must be registered in the United States.

### *Article 11. Related persons*

The proposed convention contains, as do most U.S. income tax treaties, a provision similar to section 482 of the Internal Revenue Code which allows the allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons.

### *Article 12. Dividends*

The prior convention with Trinidad and Tobago reduced the rate of withholding tax on dividends paid by a corporation of one country to a corporation of the other country with at least a 10 percent ownership interest in the paying corporation to 5 percent. This reduced rate was not available, however, if the recipient of the dividends had a permanent establishment in the other country (i.e., the prior treaty contained the force of attraction concept). In addition, in other cases the source country withholding tax on dividends was reduced to 25 percent. The prior convention also reduced the rate of the so-called branch profits tax imposed by Trinidad and Tobago to 5 percent.

The proposed convention differs from the prior convention in that only the Trinidad and Tobago withholding tax rates are reduced. In other words, the usual 30 percent withholding tax imposed by the United States on dividends paid by a U.S. corporation to a Trinidad and Tobago resident will continue to apply under the convention. In the case of intercorporate dividend payments, the generally applicable 25 percent Trinidad and Tobago withholding tax is reduced to 10 percent. In addition, the proposed convention abandons the force-of-attraction doctrine and, thus, the reduced rate will be applicable unless the U.S. corporate recipient of the dividend has a permanent establishment in Trinidad and Tobago and the stock giving rise to the dividend is effectively connected with the permanent establishment.

Specifically, the proposed convention provides that the Trinidad and Tobago withholding tax will be reduced to 10 percent in the case of dividends paid by a Trinidad and Tobago corporation to a U.S. corporation which has at least a 10 percent ownership interest in the paying corporation (provided that not more than 25 percent of the paying corporation's income is derived from interest and dividends other than interest and dividends from subsidiary corporations or interest from a banking, insurance, or financing business). If the recipient of the dividend has a permanent establishment in Trinidad and Tobago with which the stock giving rise to a dividend is effectively connected, then the reduced rate is not available.

The proposed convention also limits in other cases the Trinidad and Tobago withholding tax on dividends to 25 percent, which is the current Trinidad and Tobago withholding tax rate on dividends. As is true in the case of intercorporate dividends, this limitation is not

applicable if the U.S. recipient of the dividend has a permanent establishment in Trinidad and Tobago with which the stock giving rise to the dividend is effectively connected.

The proposed convention further provides that dividends paid by a corporation of one country to a person other than a resident of the other country (and in the case of dividends paid by a Trinidad and Tobago corporation, to a person other than a citizen of the United States) will be exempt from tax by the other country, unless under the source rules provided by the convention the dividend is treated as being from sources within the other country. Thus, dividends paid by a Trinidad and Tobago corporation to a person other than a citizen or resident of the United States will be exempt from U.S. tax unless the dividend is treated as being from U.S. sources. As indicated in the discussion of the dividend source rules (article 5), the source rules of the proposed convention generally follow the source rules provided under U.S. statutory law.

The proposed convention also contains a provision regarding the so-called branch profits tax imposed by Trinidad and Tobago. Under Trinidad and Tobago law, the profits of a Trinidad and Tobago permanent establishment of a foreign corporation are subject to the regular 45 percent corporate tax and, in addition, are subject to a 25 percent branch profits tax unless the profits are reinvested in Trinidad and Tobago. In other words, these profits are taxed in the same manner as if they were earned by a subsidiary corporation and then the aftertax profits were paid as a dividend to the parent corporation. The proposed convention limits to 10 percent the Trinidad and Tobago branch profits tax on remittances by a Trinidad and Tobago permanent establishment of a U.S. corporation of profits which were effectively connected with the permanent establishment. In other words, such remittances will be treated under the proposed convention in the same manner as intercorporate dividends.

### *Article 13. Interest*

U.S. income tax treaties generally provide that interest derived from one country by a resident of the other country will either be exempt from, or subject to a reduced rate of, tax in the source country. As is true in the case of the proposed Brazilian convention, the proposed convention contains a more limited provision dealing with interest. It provides that interest received by the Government, or a wholly owned agency, of the United States or Trinidad and Tobago will be exempt from tax by the other country.

The proposed convention also reduces from 30 to 15 percent the Trinidad and Tobago tax imposed on interest derived from sources in Trinidad and Tobago by a U.S. resident which is a bank or other financial institution and which does not have a permanent establishment in Trinidad and Tobago. This reduction is unilateral, is limited to the specified type of recipient, and does not embody the effectively connected concept.

The proposed convention also contains a limitation on the application of the interest article which is similar to that found in the OECD model convention and other recent U.S. income tax treaties in situations where the payor and recipient are related. The proposed convention provides that if the interest paid to a related person is in excess of a fair and reasonable consideration for the indebtedness for which

it is paid, then the interest article will apply only to that part of the interest as represents a fair and reasonable consideration.

The proposed convention also provides that the provision of Trinidad and Tobago law, which, in effect, treats interest in certain cases as a dividend distribution rather than as interest, is to apply to interest paid to a U.S. resident only to the extent the U.S. resident cannot demonstrate to the satisfaction of the Trinidad and Tobago taxing authorities that the investment giving rise to the interest (including the fact that it is in the form of indebtedness) did not have as its purpose the avoidance of Trinidad and Tobago tax. Under Trinidad and Tobago law, interest on convertible debt and interest on securities of a Trinidad and Tobago company which are held by a nonresident parent company or brother-sister corporation are treated as dividends rather than as interest.

#### *Article 14. Royalties*

The OECD model convention and a number of U.S. income tax treaties provide an exemption from source country tax for nonmineral royalties paid to residents of the other country, provided the recipient does not have a permanent establishment in the source country (and in the case of more recent treaties, unless the property or right giving rise to the royalty is effectively connected with the permanent establishment).

The proposed convention with Trinidad and Tobago follows this general approach with respect to artistic royalties. In other words, artistic royalties derived by a resident of one country from sources in the other country will not be subject to tax in the source country unless the recipient has a permanent establishment in the source country and the property giving rise to the royalty is effectively connected with the permanent establishment.

In the case of industrial and scientific royalties, the proposed convention differs from the general treaty approach and follows the approach embodied in the proposed Brazilian treaty of providing a reduced rate of, rather than an exemption from, source country withholding tax. Under the proposed convention, industrial and scientific royalties derived from one country by a resident of the other country will be subject to a maximum 15 percent withholding tax rate in the source country, unless the recipient has a permanent establishment in the source country, and the property giving rise to the royalty is effectively connected with the permanent establishment.

In the absence of the convention, the United States and Trinidad and Tobago would impose a 30 percent withholding tax on royalties paid to a resident of the other country.

As in the case of the interest provision, the royalty provision of the proposed convention does not apply to that part of a royalty paid to a related person which is in excess of a fair and reasonable consideration.

The proposed convention does not cover royalties arising from the use of motion picture films or films or tapes for radio or television broadcasting as do a number of other U.S. income tax treaties.

#### *Article 15. Income from real property*

The proposed convention follows the approach of the Internal Revenue Code and most U.S. income tax treaties by providing that a resident of one country may elect to be taxed on a net basis in the other

country, as if the resident were engaged in business in that other country, on real property income (including gains from the sale or exchange of real property) and on mineral royalties arising from sources in that other country. This provision has the effect of reducing the source country tax on this income to an amount which in most cases will be fully creditable against the tax imposed on the income by the recipient's country of residence which is usually computed on a net basis.

In the absence of this provision, Trinidad and Tobago would tax a U.S. person on the gross amount of this type of income from Trinidad and Tobago sources unless the person was engaged in business in Trinidad and Tobago.

*Article 16. Investment or holding companies*

The proposed convention contains a provision which denies the benefits of the dividends, interest, and royalties articles to a corporation which is entitled in its country of residence to special tax benefits resulting in a substantially lower tax on those types of income than the tax generally imposed on corporate profits by that country, if 25 percent or more of the capital of the corporation is owned by non-residents of that country (or by U.S. citizens in the case of a Trinidad and Tobago corporation). A similar provision is contained in the Luxembourg convention and in other recent proposed U.S. tax treaties.

The purpose of this provision is to prevent residents of third countries from using a corporation in one treaty country, which is preferentially taxed in that country, to obtain the tax benefits in the other treaty country which the proposed convention provides for dividends, interest, and royalties derived from that other country. This accords with the purpose of an income tax convention between two countries which is to lessen or eliminate the amount of double taxation of income derived from sources within one country by a resident of the other country.

At the present time, neither Trinidad and Tobago nor the United States grants to investment or holding companies the type of tax benefits with respect to dividends, interest, or royalties which would make this provision of the proposed convention applicable. Thus, the provision will have effect only if Trinidad and Tobago or the United States should subsequently enact special tax measures granting preferential tax treatment to dividends, interest and royalties received by an investment or holding company.

*Article 17. Income from personal services*

Under the Internal Revenue Code, a nonresident alien is not taxed by the United States on income earned from services performed by him in the United States if—

(1) he is present in the United States for less than 90 days during the taxable year;

(2) his aggregate income from services performed in the United States does not exceed \$3,000; and

(3) he performs the services as an employee of a foreign individual, partnership, or corporation which is not engaged in business in the United States, or for a foreign branch maintained by a U.S. citizen, resident, partnership, or company.

Under Trinidad and Tobago tax law, tax is imposed on any income derived by a nonresident individual from the performance of personal services in Trinidad and Tobago.

Our income tax treaties generally follow the approach of the Internal Revenue Code but in addition extend the period a nonresident may be present in the host country (usually from 90 to 183 days) and, in effect, eliminate either the \$3,000 income limitation or the foreign employer requirement by not taxing nonresidents in the host country if either requirement is satisfied.

The proposed convention adopts the general treaty approach by extending the 90-day presence requirement to 183 days. The \$3,000 requirement is retained in the case of income derived from the performance of services in an independent capacity but is eliminated in the case of employment income. On the other hand, the foreign employer requirement is retained in the case of employment income but is eliminated for income derived from the performance of services in an independent capacity.

The proposed convention also follows the proposed Brazilian and Philippine conventions by imposing an additional specific dollar limitation on the amount of personal service income which public entertainers (such as actors, athletes, etc.) may receive tax free in the source country. If the compensation of these persons exceeds \$100 for each day the person is present in the source country for purposes of performing the entertainment services, the person is subject to tax. In addition, any person who receives income from providing services of public entertainers in the source country in excess of \$100 for each day the entertainers are present in the source country for the purpose of performing the entertainment services may not avail himself of the exemption provided by the convention for personal services income. If a Trinidad and Tobago public entertainer, however, satisfies the requirements of the Internal Revenue Code for exemption of personal service income which includes the \$3,000 per year limitation, he may avail himself of the Code exemption and thus avoid the \$100 per day limitation contained in the proposed convention.

#### *Article 18. Teaching and research*

Most U.S. income tax treaties provide some exemption from source country taxation to teachers who are residents of the other country and who are temporarily present in the source country at the invitation of the Government or an educational institution. The purpose of such a provision is to facilitate the exchange of teachers between countries. The proposed convention with Trinidad and Tobago follows the approach of our more recent treaties which contain more liberal exemption provisions than did earlier treaties. It is provided that a resident of one country will be exempt from tax in the other country on income from teaching and research for two years, if he is present in the host country for purposes of teaching or engaging in research at an accredited educational institution. The exemption, however, does not apply to income from research undertaken primarily for the benefit of private persons, rather than in the public interest, or to income which arises in cases where there is an agreement between the governments of the two countries for the provision of the services of the individuals.

*Article 19. Students and trainees*

It is generally provided in our income tax treaties that students who are residents of one country will be exempt from tax in the other country on certain types of income if they are present in the other country for purposes of attending school. This exemption is usually limited to gifts from abroad which are used by the student for his maintenance or education.

The proposed convention contains a substantially more liberal exemption similar to that embodied in the 1965 supplementary convention with the Netherlands, the recent French treaty, and the proposed conventions with Brazil, Belgium and Finland. Under the proposed convention, residents of one country who become students in the other country will be completely exempt from tax in the host country on gifts from abroad used by the student for maintenance or study and on any grant, allowance, or award received from a governmental or charitable organization. In addition, limited exemptions are provided for personal service income derived from sources within the country in which the individual is studying. In the case of students generally, \$2,000 per year of personal service income (such as income from a part-time job) is exempt from tax in the country in which the individual is a student. The limitation is increased to \$5,000 per year if the individual is studying for a profession or a professional specialty. These exemptions (the complete as well as the limited ones) may not be utilized for a period of longer than five years.

In addition to the exemptions regarding students, the proposed convention follows the approach of other recent U.S. income tax treaties and provides limited exemptions for personal service income of residents of one country who are employees of a resident or corporation of that country and who are temporarily present in the other country to study at an approved educational institution or to acquire technical, professional or business experience (\$5,000) and for income from personal services performed in connection with training, research or study by participants in Government-sponsored exchange training programs (\$10,000).

*Article 20. Governmental salaries*

As is the case in our other income tax treaties, the proposed convention provides that one country will not tax wages, salaries, pensions, or annuities paid by the other country to its nationals for governmental services.

*Article 21. Rules applicable to personal income articles*

The proposed convention provides that reimbursed travel expenses are exempt from tax under the personal income articles without regard to the maximum amount of the exemptions. The proposed convention also provides that only the benefits of the most favorable personal income article may be claimed by a taxpayer for a year with respect to the same income, if more than one of those articles is applicable to the income in that year.

*Article 22. Private pensions and annuities*

The proposed convention adopts the approach of most U.S. income tax treaties which exempts private pensions and annuities paid to residents of one country from tax in the other country. The proposed

convention also extends this treatment to alimony payments which are taxable to the recipient under the laws of his country of residence.

*Article 23-27. Administrative provisions*

The proposed convention contains the various administrative provisions found in most U.S. income tax treaties. In general, the proposed convention provides—

(1) For consultation and negotiation between the countries to resolve differences arising in the application or interpretation of the proposed convention and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the proposed convention ;

(2) For the exchange between the countries of legal information and of information relating to carrying out the provisions of the proposed convention or to preventing fraud or fiscal evasion with respect to the taxes covered by the proposed convention ; and

(3) That each country is to assist the other in collecting taxes imposed by the other country to the extent necessary to insure that the benefits provided by the proposed convention are enjoyed only by the persons entitled to those benefits.

*Article 28. Effective dates*

The proposed convention generally will become effective for taxable years beginning on or after January 1 of the year in which the instruments of ratification are exchanged. An exception to this general rule is provided in the case of the provision which allows tax deferral for technical assistance. This provision will be effective with respect to stock received on or after the date the proposed convention was signed (i.e., January 9, 1970).

In addition, Trinidad and Tobago unilaterally will take all necessary steps to make the reduced rates of Trinidad and Tobago withholding tax on dividends which are provided by the proposed convention effective from January 1, 1970, through December 31, 1970, rather than only from the later date when the convention enters into force.

The proposed convention will continue in effect indefinitely, but either country may terminate it after it has been in effect for five years by giving notice of termination.

*Article 29. Extension of convention*

The proposed convention contains a provision similar to that found in some of our other income tax treaties pursuant to which the convention may be extended to any areas of either of the two countries for whose international relations the country is responsible, if the area imposes taxes substantially similar to those covered by the convention.

The convention may be extended pursuant to this provision either in its entirety or with the necessary modifications. The extension is to be effected by a written notification of extension by the one country which is assented to by the other country in a written communication, which notification and communication are then to be ratified by each of the countries in accordance with their constitutional procedures.

## PROPOSED ESTATE TAX CONVENTION BETWEEN THE UNITED STATES AND THE NETHERLANDS

(Memorandum Prepared by the Staff of the Joint Committee on  
Internal Revenue Taxation)

At the present time, the United States has 12 estate tax treaties, the most recent of which is the 1952 Canadian treaty.

The proposed convention, although it has the same basic purpose as our other estate tax treaties—namely, the lessening of double taxation at death and the prevention of fiscal evasion—embodies a substantially different approach to the resolution of double taxation problems. One of the principal objectives of this approach is to reduce the instances of double tax jurisdiction, and thereby minimize the burdens of death taxation, in situations where employees of private businesses die while on a foreign assignment that is basically of a temporary nature.

Our existing estate tax conventions are based on the situs principle of taxation. These treaties set forth detailed rules for determining the situs of a decedent's property and provide that a country may tax property situated in it even though the decedent is domiciled in the other country. These existing treaties also provide that the country of domicile will allow a tax credit against its death tax with respect to the taxes imposed by the country in which the property is situated. Although these treaties have helped lessen the burdens of double taxation, in some instances the provisions give inadequate relief and, in addition, they generally do not adequately deal with the situation where both countries tax the worldwide estate of the decedent on the basis that each country considers the decedent to have been a domiciliary.

To resolve a substantial portion of these problems, the proposed convention, in general, confers primary death tax jurisdiction on the country in which the decedent was domiciled, limits situs country taxation to the decedent's real property or business assets of a permanent establishment located in that country, and provides a system of tax credits under which the country in which the decedent was not domiciled, even if he was a citizen of that country, will assert only secondary worldwide tax jurisdiction with respect to the decedent's estate in the sense that it will allow a credit for the taxes imposed by the country of domicile.

Generally, these basic rules of the proposed convention produce the following pattern of death taxation. A U.S. citizen who was domiciled in the Netherlands for less than 7 out of the 10 years prior to his death and who did not intend to indefinitely remain there will be considered domiciled only in the United States and thus will be subject to Dutch death taxes, at the lower rates which are generally applicable to nonresidents, only on his real property and business assets situated in the Netherlands. In this type of case, the United States will then allow a credit against the Federal estate tax on the property

which has been taxed by the Netherlands for the Dutch death taxes imposed on that property. Moreover, in computing the amount of the Dutch estate tax, the proposed convention provides for the allowance of a 50-percent marital deduction and for the exemption from tax of small estates (\$30,000 or less).

Where a U.S. citizen is domiciled in the Netherlands for more than 7 out of the 10 years prior to his death, then both the United States and the Netherlands will impose their death taxes on the worldwide estate of the decedent. However, in this case the United States will relinquish its primary jurisdiction and will allow a credit against the Federal estate tax for the Dutch estate tax imposed on the same property, even where that property is located in the United States.

In the case of a Dutch citizen who was present in the United States, the above results on a reciprocal basis would be obtained.

In essence, the basic approach of the proposed convention is (1) to always allow the situs country primary tax jurisdiction with respect to the property it may tax under its situs jurisdiction, (2) to give the country of citizenship primary tax jurisdiction with respect to the rest of the decedent's worldwide estate during the first 7 years the decedent is temporarily present in the other country, and (3) then to give the country of domicile primary tax jurisdiction where the decedent was domiciled in that country for more than 7 out of the 10 years prior to his death. This approach is designed to recognize that when a decedent has been domiciled for only a temporary period in a country, his ties with that country are not sufficient to justify the assertion of primary estate tax jurisdiction by that country, on the one hand, and to recognize, on the other hand, that where a decedent who is a citizen of one country has been domiciled in the other country for a substantial period of time, generally his closest ties will be with the country of domicile rather than the country of citizenship, thus making it appropriate to confer primary estate tax jurisdiction on the country of domicile and secondary jurisdiction on the country of citizenship.

A detailed analysis of the proposed convention on an article-by-article basis is presented below.

#### *Article 1. Estates covered*

The proposed convention provides that it will apply to estates of decedents who are domiciled in, or are citizens of, one or both of the countries at the time of their death. Thus, it will apply to decedents who are U.S. citizens or domiciliaries at the time of their death and will apply to decedents who at the time of death are domiciliaries of the Netherlands, or are citizens of the Netherlands who had been living outside of the Netherlands for less than 10 years. (Although the Netherlands does not impose its death taxes on the basis of citizenship, but rather imposes them on the basis of domicile, it treats Dutch citizens who have been nonresidents of the Netherlands for less than 10 years as domiciled in the Netherlands.)

The proposed convention does not treat U.S. possessions citizens who are residents of a possession as U.S. citizens or domiciliaries. Accordingly, the proposed convention will not apply to estates of these possessions citizens-residents, unless it is applicable by reason of the person being domiciled in the Netherlands.

Since the purpose of the proposed convention is to avoid double taxation of estates and to prevent fiscal evasion of death taxes, it is

provided (in article I of the protocol) that the provisions of the proposed convention are not to affect property rights under laws relating to descent, distribution, succession, inheritance, or similar matters.

#### *Article 2. Taxes covered*

The proposed convention applies to the U.S. Federal estate tax which is imposed on the worldwide estates of decedents who are U.S. citizens or residents and on the U.S. estates of nonresident aliens. In the case of the Netherlands, it applies to the Dutch succession duty, which is imposed on the worldwide estates of decedents who are residents of the Netherlands, and the Dutch transfer duty, which is imposed on certain types of assets situated in the Netherlands of decedents who were nonresidents.

As is generally true in the case of our other estate tax treaties, the proposed convention does not apply to death taxes imposed by State or local governments. In addition, the proposed convention contains a provision similar to that generally found in other U.S. estate tax treaties which provides that the convention will apply to any death taxes either country may subsequently impose in the form of taxes on estates or inheritances, transfer duties, and taxes on gifts in contemplation of death.

#### *Article 3. General definitions*

The standard definitions generally found in most existing U.S. estate tax treaties are contained in the proposed convention. Under the proposed convention, the Netherlands is defined to mean that part of the Netherlands situated in Europe and thus does not include either the Netherlands Antilles or Surinam.

The proposed convention also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the convention. In addition, it is further provided (in article II of the protocol) that where a term is defined in a different manner by the two countries, or where the definition of a term is not readily determinable under the laws of one or both of the countries, then the competent authorities of the two countries may establish a common meaning of the term in order to prevent double taxation or to further any other purpose of the proposed convention. Although a provision of this nature is not found in our other estate tax treaties, a similar provision is contained in the proposed income tax treaties with Belgium, Finland, and Trinidad and Tobago.

#### *Article 4. Fiscal domicile*

The concept of domicile is important for death tax purposes since it is one of the principal means employed by countries to assert jurisdiction over the worldwide estates of decedents. (The other principal basis used for this purpose is citizenship.) The tests employed, however, by countries to determine the domicile (i.e., residence for death tax purposes as the term is used in the proposed convention) of a decedent often are quite different. Under the Internal Revenue Code a decedent is considered a domiciliary of the United States for purposes of the Federal estate tax, if the person was residing in the United States and had the intent to remain in the United States indefinitely (or had been residing in the United States with such an intent and had subsequently left this country without an intent to remain indefinitely

at his new place of residence). Under Dutch law, on the other hand, a decedent is considered to be domiciled in the Netherlands for purposes of Dutch death taxes, if the person had an habitual abode in the Netherlands even though he did not intend to remain there indefinitely.

Our existing estate tax treaties generally merely provide that each country is to determine the domicile of a decedent in accordance with the provisions of its own law. In cases where this results in both countries considering a decedent to have been a domiciliary, then both countries usually apply their death taxes on the worldwide estate of the decedent. To provide relief from double taxation in these cases, our existing conventions, rather than attempting to resolve the double domicile problem, provide for a prorated or split foreign tax credit; i.e., each country allows a credit for a portion of the other's tax. This means of granting relief from double taxation, however, has often proved inadequate. Accordingly, as previously indicated, the proposed convention provides a series of rules to resolve double domicile problems, so that for purposes of applying the proposed convention a decedent will be considered as domiciled in only one of the countries. That country then will have the primary death tax jurisdiction with respect to the worldwide estate of the decedent, other than with respect to real property or business assets situated in the other country. In essence, these rules of the proposed convention are based on the concept that primary death jurisdiction should be exercised only by the country of true domicile and not by the country of mere presence or residence or citizenship where the decedent has been domiciled in the other country for a substantial period of time prior to death and in all likelihood, has his most significant ties with that country.

In determining the domicile of a decedent under the proposed convention, each country will first determine whether it would consider the decedent to be a domiciliary under its own laws. In this regard, it is provided (in article V of the protocol) that the Netherlands will not assert its 10-year rule with regard to Dutch citizens who were living in the United States for less than 10 years prior to their death and who intended to indefinitely remain in the United States. Thus, in these cases the Netherlands will not consider a decedent to be a Dutch domiciliary, and, accordingly, the decedent will be considered under the convention to have been domiciled in the United States. Although the Netherlands would still assert its death tax with respect to the worldwide estate of the decedent on the basis of his Dutch citizenship, this would be a secondary tax jurisdiction and thus the Netherlands would allow a tax credit for the U.S. death taxes.

If after the application of the provisions of the internal laws of each country, a decedent is considered to be domiciled in both countries, the proposed convention provides a series of rules by which an exclusive domicile for the decedent will be determined; in other words, by which the double domicile problem will be resolved. The principal rule is the 7-out-of-10-year rule. Under this rule a decedent who is a citizen of only one of the countries will be considered domiciled in the country of citizenship, if he was domiciled in the other country for less than 7 out of the 10 years prior to his death and if he was in the other country without a clear intent to indefinitely remain there for business, professional, education, training, tourism, or similar purposes (or was a spouse or a dependent of a person in

that country for one of these purposes). A decedent will not be considered to have had a clear intent to indefinitely remain in the other country unless all the evidence considered together is clear and convincing to the contrary.

In essence, the 7-out-of-10 year rule gives the country of citizenship the primary death tax jurisdiction with respect to the decedent's worldwide estate (other than real property or business assets of a permanent establishment situated in the other country) during the first 7 years he is domiciled in the other country. As is subsequently discussed, after a decedent has been domiciled in the other country for more than 7 years, the country of citizenship gives up its primary jurisdiction and instead will have a secondary death tax jurisdiction. In this case, the country of citizenship may assert its death tax on the worldwide estate of the decedent, but it must allow a full credit for the death tax imposed by the country of domicile.

In the case of U.S. citizens who are temporarily employed in the Netherlands or who are temporarily there for one of the other specified reasons, the effect of this provision will be to exempt their estate, other than real property or business assets situated in the Netherlands, from Dutch death taxes.

Since the Internal Revenue Code embodies a relatively restricted definition of domicile, generally most Dutch citizens temporarily present in the United States who will be considered as Dutch, rather than United States, domiciliaries under the proposed convention also would be so considered under U.S. law.

It is contemplated that the 7-out-of-10-year rule will resolve the great majority of double domicile situations. In cases where a double domicile problem still remains after application of that rule, the proposed convention further provides that a decedent will be deemed to be domiciled in the country in which he had his permanent home for at least 5 years immediately prior to death (under article III of the protocol, the decedent may only have one permanent home for this purpose), in the country with which his personal relations were closest, or in his country of citizenship. In cases where a decedent's domicile cannot be determined by these tests, applied in the order stated, and he is a citizen of both countries or of neither country, then the competent authorities of the countries are to settle the question by mutual agreement.

In this regard, it is provided (article VI of the protocol) that it is intended for all questions of double domicile to be resolved under the convention, and, accordingly, the competent authorities must resolve any double domicile questions within the time provided under the convention for filing tax refund or credit claims, which generally is from 5 to 11 years after the decedent's death. The type of cases covered by this second set of rules, in addition to dual or third country citizenship, include the situation where a citizen of one country was domiciled in the other country for more than 7 out of 10 years but did not intend to remain there indefinitely.

#### *Article 5. Application of domestic laws*

The proposed convention follows the approach of our existing estate tax treaties and provides that each country is to apply its domestic death tax laws except as otherwise provided in the proposed convention. The principal effect of this provision is that each country

will apply its own laws in determining the manner in which a decedent's debts are to be allocated among the various assets of his estate.

The allocation of debts is relevant in determining the value of a decedent's property which is considered subject to death tax in a country where that country asserts a situs jurisdiction (i.e., where it taxes the property of the decedent solely on the basis that it was situated in that country). It is also relevant where a country asserts worldwide jurisdiction with respect to a decedent's estate in determining the amount of the estate which is considered situated outside of that country for purposes of determining the allowable credit for foreign death taxes. Under Dutch law, debts which relate to real property or business property are allocated solely to the property to which they relate. On the other hand, under the Internal Revenue Code a decedent's debts are allocated on a pro rata basis to all of the assets in his estate.

Insofar as it relates to the allocation of deductions, the proposed convention modifies the above general rule in the situation where a country allocates deductions on the basis of the situs of property to insure that there is proper allocation of deductions in two situations: (1) the determination of the net amount of a decedent's estate which is taxable in a country; and (2) the amount of the foreign tax credit a country will allow for death taxes imposed by the other country. First, it, in effect, is provided that in determining the amount of deductions to be allocated to a country (which accordingly will serve to reduce the net amount of the decedent's taxable estate in that country), property which that country may not tax under the terms of the proposed convention is not to be taken into account. In the absence of this rule, property which a country could tax under its domestic law, but not under the proposed convention, could be taken into account in determining the amount of deductions to be allocated to that country and thus would result in the allocation to that country of a disproportionately large amount of the deductions. In other words, it is not proper to allocate deductions to a country on the basis of property located in that country which it is prevented from taxing. Second, it is provided that in allocating deductions for purposes of determining the amount of a foreign death tax credit one country will allow for death taxes imposed by the other country, deductions are not to be allocated to property in the country, unless a credit is allowable under the terms of the proposed convention for the taxes imposed by the other country with respect to the property.

The proposed convention also preserves the existing reporting and recordkeeping requirements with respect to estates of persons which are taxable under the domestic law of a country but are exempt from that country's tax under the proposed convention. In effect, it is provided that the reporting and recordkeeping requirements of each country, and the sanctions imposed on failures to comply with these requirements (which often are imposed with reference to the amount of underpayment of tax), are to be applied without regard to the exemptions from tax provided by the proposed convention. Either country, however, may by regulations waive any of these requirements or sanctions if they are found to be unnecessary to prevent fraud or fiscal evasion.

The proposed convention also contains a provision somewhat similar to that found in our other estate tax treaties which provides

that the convention is not to have the effect of extending a country's jurisdiction to tax over that provided in its domestic law or of otherwise increasing the amount of death taxes imposed by a country (other than an increase which results from a reduction of the other country's tax under the proposed convention for which a credit is allowable).

*Article 6. Immovable property*

Under the proposed convention, a country may tax only that part of the estate of the decedent, who was neither a citizen nor a domiciliary of that country, which consists of immovable property (basically real property) situated in that country, and business assets attributable to a permanent establishment (or fixed base) of the decedent in that country (which are dealt with in article 7).

Under the proposed convention, the determination of whether an item of property is immovable property is to be made under the laws of the country in which the property is located. Although U.S. law does not define "immovable property," that term for U.S. purposes is to be considered to mean real property. It is further provided that immovable property does not include any security interests or ships or aircraft.

*Article 7. Business property of a permanent establishment and assets pertaining to a fixed base used for the performance of professional services*

The second type of property of a nonresident alien which a country may tax under the proposed convention consists of business assets of a permanent establishment of the decedent located in that country (other than ships and aircraft operated in international traffic and related movable property) and assets (other than immovable property) pertaining to a fixed base of the decedent situated in that country and used for the performance of professional services or other similar independent activities. As subsequently discussed (article 9), a country may not tax stock which a nonresident alien owns in a corporation of that country. Accordingly, the situs country jurisdiction allowed by this provision of the proposed convention is of limited significance, since a nonresident alien may carry on his business activities in the situs country through a domestic corporation, rather than a permanent establishment, and thereby not be subject to situs significance, since a nonresident alien may carry on his business activities in the situs country through a domestic corporation, rather than a permanent establishment, and thereby not be subject to situs country death taxes on the business assets because the situs country may not impose its death tax on his stock in the domestic corporation.

The proposed convention contains a definition of the term "permanent establishment" which is similar to the modern definition found in recent U.S. income tax treaties. Generally, any fixed place of business through which a decedent engaged in a trade or business is considered a permanent establishment. For this purpose, a decedent is considered engaged in a trade or business regardless of whether the business is carried on as a sole proprietorship or through a partnership or unincorporated association. In the case of a partnership or association, however, only the decedent's interest in the business entity will be taken into account for purposes of this provision.

A fixed place of business includes an office, factory, sales outlet, and any building site or construction, or assembly project which exists for more than 12 months. This general rule is modified by providing that a fixed place of business which is used for all or a number of specified activities will not be considered a permanent establishment. These activities include the warehousing of goods for purposes of storage, display, delivery, or processing by another person.

An additional activity included within this exempt category is the maintenance of a fixed place of business (by a person other than a dealer) for the purpose of investing or trading in stocks, securities, or commodities for the decedent's own account, whether directly or through a broker or an agent. The Internal Revenue Code contains a similar jurisdictional rule for purposes of determining whether a nonresident alien is considered engaged in business in the United States so as to be subject to U.S. income tax.

The proposed convention also provides that a decedent will be deemed to have a permanent establishment in a country if he had an agent in that country who had and habitually exercised a general contracting authority (other than for the purchase of goods or merchandise) in that country. This agency rule does not apply, however, if the agent is a broker, general commission agent, or any other agent of an independent status, provided the agent is acting in the ordinary course of his business.

*Articles 8 and 9. Taxation on the basis of domicile and citizenship*

Under the proposed convention, only the country of the decedent's domicile or citizenship at death may impose its death tax on the property of the decedent, except for real property, or business assets or a permanent establishment (or fixed base), situated in the other country which also may be taxed by that other country. In other words, if a decedent is neither a citizen nor a resident of a country, then that country may not impose its death tax on his property (or take that property into account in determining the rate of its tax), unless the property is real property or business assets of a permanent establishment (or fixed base) situated in that country. The principal effect of this provision is to exempt from a country's death taxes property of a nonresident alien of that country such as stocks, bonds, art objects, jewelry, and life insurance proceeds.

The exemption provided in this regard from the U.S. estate tax for stock of a U.S. corporation which is owned by a nonresident alien, who is a Dutch domiciliary or citizen, is not found in our other estate tax treaties or in the Internal Revenue Code. This exemption, however, will remove whatever impediments the existence of our estate tax imposes to investments by Dutch persons in the United States and thereby should help our balance-of-payments position. At the same time, this provision will not have the effect of totally exempting these assets from death taxation, inasmuch as the Netherlands imposes its death tax on domiciliaries at effective rates which are comparable to those in the United States, and thus property which is exempted from the U.S. estate tax under this provision will be subject to the comparable Dutch tax burden.

In the case where a decedent is domiciled in one country and is a citizen of the other country, both countries may impose their death taxes with respect to the worldwide estate of the decedent. Thus,

both the United States and the Netherlands may impose their death taxes on the worldwide estates of their citizens. Where, however, the decedent is not considered domiciled under the proposed convention in his country of citizenship, the tax jurisdiction allowed that country under the proposed convention generally is a secondary jurisdiction. In other words, although that country may exert its death tax with respect to the worldwide estate of the decedent, it must give a credit against that tax for the death taxes imposed by the country of domicile.

#### *Article 10. Exemptions*

Under the proposed convention, the Netherlands will allow a U.S. citizen or domiciliary (who is not also a Dutch citizen or domiciliary) a marital deduction which is somewhat similar to the marital deduction allowed U.S. citizens and residents under the Internal Revenue Code. In this type of case, the Netherlands' tax jurisdiction extends only to real property, or business assets of a permanent establishment (or fixed base), of the decedent which is situated in the Netherlands.

It is provided that if this property (other than community property) passes to the decedent's surviving spouse, the Netherlands will allow a deduction from the value of the decedent's estate subject to Dutch death taxes for the amount of the property passing to the spouse. The amount of the deduction, however, will be limited to 50 percent of the value of the decedent's property subject to tax in the Netherlands (determined after allowance of any applicable deductions, but before taking into account the \$30,000 exemption provided by the proposed convention).

If the United States changes its estate tax laws in such a manner as to make the treatment of nonresident aliens in relation to the treatment of U.S. citizens and domiciliaries substantially less favorable than it is at the present time, the Netherlands will cease to allow this marital deduction. It is understood that the Netherlands was willing to grant this marital deduction in view of the relatively favorable treatment provided by the United States pursuant to the Foreign Investors Tax Act of 1966 to estates of nonresident aliens. Accordingly, if that treatment should become substantially less favorable, the Netherlands is not willing to continue the allowance of the marital deduction.

To relieve small estates of situs country taxation, the proposed convention provides that where a country may tax real property or business property of a nonresident alien solely by reason of the property's situs in that country, it will exempt the property from its death tax if the value of the property (after reduction by the applicable deductions and the marital deduction) does not exceed \$30,000. If the value of the property does exceed \$30,000, the exemption, in effect, is phased out. It is provided that the tax imposed by the situs country in this case is to be the smaller of the amount of tax determined under its law or 50 percent of the value of the property in excess of \$30,000.

In view of the 6 percent tax rate which the Netherlands imposes on property of nonresident aliens, the effect of this provision in the case of estates of U.S. citizens or domiciliaries (who are not also citizens or domiciliaries of the Netherlands) is to exempt the assets of the estate located in the Netherlands from Dutch death tax, if the taxable value of the assets is \$30,000 or less, and to reduce the amount of Dutch death tax imposed on these assets where their value is between \$30,000

and \$34,000. This provision will not affect U.S. estate taxation of Dutch citizens or residents since the Internal Revenue Code presently allows the estates of nonresident aliens a \$30,000 exemption.

*Article 11. Credits*

The proposed convention provides a series of rules to determine the amount of tax credits which will be allowed by each country in cases where a decedent's property is taxed by both countries. These provisions constitute rules for determining the priority of the countries' rights to tax property of decedents in the sense that the country which grants a credit for the other country's tax, in effect, is exercising a secondary, rather than a primary, taxing jurisdiction. These credit rules, in conjunction with the limitations imposed by the proposed convention on situs country taxation and on the ability of a country to tax the worldwide estate of a decedent, constitute the approach employed by the proposed convention to avoid double taxation where both countries tax a decedent's property.

In general, the proposed convention provides for three types of credits: First, a credit against the tax of the country of domicile or citizenship for taxes imposed by the other country on property situated there; second, the allowance by the nondomiciliary country of an additional credit for taxes imposed by the country of domicile where both countries tax the worldwide estate of a decedent; and finally, the allowance by each country of a prorated credit for a portion of the other country's tax in cases not covered by the first two credit rules. The principal case falling within the third credit rule is that of a citizen of one country who was permanently living in the other country for a period of less than 7 years. Existing U.S. estate tax treaties generally only contain a credit provision similar to the third type described above.

Under the proposed convention, the first credit rule provides that the country in which a decedent was domiciled, or of which he was a citizen, will allow a credit for the taxes imposed by the other country on real property and business property of a permanent establishment (or fixed base) of the decedent situated in that other country. The country of domicile or citizenship will allow this credit whether the other country imposes its tax on the basis of situs jurisdiction or imposes it on the worldwide estate of the decedent on the basis of his citizenship or domicile in that country. In many cases, this credit rule in conjunction with the 7-out-of-10-year domicile rule will serve to eliminate double taxation. This is because a citizen of one country who is temporarily in the other country for less than 7 years, on the one hand, will not be considered domiciled in that other country and thus his estate will not be subject to death taxes in that country other than with respect to real property or business assets and, on the other hand, his estate will be allowed a credit by the country of citizenship for the taxes imposed by the other country on the real property or business property situated there.

In cases where both countries tax the estate of a decedent on a worldwide basis because the decedent was a citizen of both countries or a citizen of one and a domiciliary of the other, the second credit rule of the proposed convention provides for the allowance of an additional tax credit by the country in which the decedent was not domiciled. In the case where the decedent was a citizen of only one of

the countries at his death and had been domiciled for more than 7 out of the 10 years prior to his death in the other country, the country of citizenship will allow a credit for the tax imposed by the other country (i.e., the country of domicile). If the decedent was a citizen of both countries at his death, then the country in which he was not domiciled will allow a credit for the tax imposed by the country of domicile.

Under these credit rules, the nondomiciliary country yields priority of taxation of the decedent's estate to the domiciliary country. In the first situation, the nondomiciliary country which is the country of citizenship, in effect, yields priority of taxation to the country of domicile in view of the fact that during the first 7 years of the decedent's domicile in the other country, the country of citizenship has priority of taxation (since during that period it is considered the country of domicile under the proposed convention).

The third credit rule provides that in other cases where both countries tax the worldwide estate of a decedent, they are to allow a split or prorated credit; namely, each country will allow a credit with respect to property taxed by both countries equal to that percentage of its tax on the property (or the other country's tax on the same property, if smaller) which the amount of that country's tax is of the combined tax of both countries. Generally, this credit rule will have principal application in the case of a citizen of one country who had been permanently living in the other country for less than 7 years at the time of his death.

Under the proposed convention, the total amount of credits which one country will allow under the convention and under its laws or other treaties is limited to that portion of its tax which is attributable to all property for which a credit is allowable under the convention. In determining this limitation, properties are not to be considered on an individual basis, but rather are to be aggregated. This limitation does not apply to the split credit since that credit has a built-in limitation.

As is the case under our existing estate tax treaties, the proposed convention further provides that credits allowed by a country against its tax other than pursuant to the convention are to be subtracted from the gross tax imposed by that country in order to determine the tax imposed by it which is creditable against the other country's tax or against which the other country's tax may be credited.

A credit will not be finally allowed under the proposed convention until the tax for which the credit is claimed has been paid. In addition, any credit allowed under the proposed convention is to be in lieu of credits allowed by the domestic laws of each country with respect to taxes of the other country.

#### *Article 12. Limitation on claims for credit or refund*

Under the Internal Revenue Code, a claim for credit or refund of Federal estate taxes generally must be made within 4 years and 3 months after the date of the decedent's death (or 5 years and 3 months from the date of death where the claim is based on the allowance of a credit for foreign death taxes). The proposed convention provides a period of limitation during which claims for credit or refund of taxes based on the provisions of the convention may be made, which in some cases will be somewhat longer than that allowed by the Internal Revenue Code. It is provided that a claim for credit or refund of taxes based on the provisions of the convention must be

made before the expiration of the latest of (1) the period of limitations prescribed under the domestic law of the country to which the claim is made, (2) 5 years from the decedent's death, or (3) 1 year after final determination and payment of a tax for which a credit is claimed under the convention (provided these events occur within 10 years from the decedent's death).

The proposed convention follows the approach of other U.S. estate tax treaties and provides that any refund made pursuant to the convention is to be made without interest.

*Article 13 and 14. Administrative provisions*

The proposed convention contains various administrative provisions which are generally found in other U.S. tax treaties. In general, the proposed convention provides—

(1) For consultation and negotiation between the countries to resolve differences arising in the interpretation or application of the proposed convention and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the proposed convention; and

(2) For the exchange between the countries of legal information and of information pertinent to carrying out the provisions of the proposed convention, or the tax laws of one of the countries insofar as its taxation is in accordance with the proposed convention, or to preventing fraud or fiscal evasion with respect to the taxes covered by the proposed convention.

Article VIII of the protocol sets forth the understanding that the Netherlands cannot disclose information obtained from banks and certain similar institutions, including insurance companies, since this information is treated as confidential under Dutch law. The Netherlands will disclose information, however, where the bank or institution is the executor or administrator of the decedent's estate.

*Article 15. Diplomatic and consular officials*

The proposed convention provides that its provisions are not to affect the fiscal privileges which diplomatic and consular officials and officials of international organizations enjoy under the general rules of international law or the provisions of special agreements. It is further provided that the right to tax these persons will be reserved to the country for whom they perform their functions (or the country of citizenship in the case of international officials) and that these officials are not to be considered domiciled in the country where they were employed (the receiving country). This provision is designed to prevent diplomatic and consular officials of a third country from claiming domicile in either the United States or the Netherlands so as to bring themselves within the provisions of the convention.

*Article 16. Entry into force*

The proposed convention will enter into force upon the date the instruments of ratification are exchanged and will apply to estates of persons dying on or after that date.

*Article 17. Territorial extension*

The proposed convention contains a method similar to that found in some of our other tax treaties by which the convention may be extended to Surinam or the Netherland Antilles, or to any areas not

otherwise covered by the proposed convention for whose international relations the United States is responsible, if the country or area imposes taxes substantially similar to those covered by the convention. The convention may be extended pursuant to this provision either in its entirety or with the necessary modifications. The exchange is to be effected by an exchange of notes through diplomatic channels which then must be ratified.

*Article 18. Termination*

The proposed convention will continue in force indefinitely but either country may terminate it as of the close of any calendar year which ends at least 5 years after the convention enters into force.

*Protocol*

All but one of the provisions of the protocol to the proposed convention have been discussed in connection with the provisions of the convention to which they relate. The remaining provision, article IX of the protocol, provides that if either country changes its laws with the result that there is a substantial alteration of the effects of the proposed convention, the countries are to consult together with a view to making appropriate modifications in the proposed convention, if one of the countries requests consultations.

