

[JOINT COMMITTEE PRINT]

**EXPLANATION OF PROPOSED INCOME TAX  
TREATY (AND PROPOSED PROTOCOL)  
BETWEEN THE UNITED STATES  
AND JAMAICA**

PREPARED FOR THE USE OF THE  
COMMITTEE ON FOREIGN RELATIONS  
UNITED STATES SENATE

BY THE STAFF OF THE  
JOINT COMMITTEE ON TAXATION



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### INTRODUCTION

This pamphlet provides an explanation of the proposed income tax treaty as modified by the proposed protocol between the United States and Jamaica. The proposed treaty was signed on May 21, 1980, and was amplified by an Exchange of Notes signed the same day. The proposed protocol, together with a related exchange of notes, was signed on July 17, 1981. The proposed treaty would replace the 1959 extension to Jamaica of the 1945 income tax treaty between the United States and the United Kingdom, as subsequently modified. The proposed treaty has been scheduled for a public hearing on September 24, 1981, by the Senate Committee on Foreign Relations.

The proposed treaty is similar to other recent U.S. income tax treaties and to the model income tax treaty of the Organization for Economic Cooperation and Development (OECD) in many respects, but in a number of respects it accords greater jurisdiction to tax to the country of source, rather than to the country of residence. In that regard it reflects in part the United Nations model for income tax treaties between developing and developed countries.

The first part of the pamphlet is a summary of the principal provisions of the proposed tax treaty. The second part provides an overview of U.S. tax laws relating to international trade and investment and U.S. tax treaties in general. This is followed by a detailed, article-by-article explanation of the proposed treaty and protocol.



## I. SUMMARY

### *In General*

The principal purpose of the proposed income tax treaty between the United States and Jamaica is to reduce or eliminate potential double taxation of income earned by citizens and residents of either country from sources within the other country. The proposed treaty is intended to promote closer economic cooperation between the two countries and to eliminate possible barriers to trade caused by overlapping taxing jurisdiction of the two countries.

As in other U.S. tax treaties, these objectives are principally achieved by each country agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other. For example, the treaty contains the standard tax treaty provision that neither country will tax the business income derived from sources within that country by residents of the other unless the business activities in the taxing country are substantial enough to constitute a branch or other permanent establishment (Article 7). Similarly, the treaty contains the standard "commercial visitor" exemptions under which residents of one country performing personal services will not be required to file tax returns and pay tax in the other unless their contacts with the other exceed certain specified minimums (Articles 14 and 15). Also, the proposed treaty provides that capital gains derived by residents of either country from sources within the other are generally to be taxed only by the country of residence and not by the country of source (Article 13), and that dividends, interest and royalties received by residents of one country from sources within the other are to be taxed at reduced rates by the country of source (Articles 10, 11, and 12).

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the treaty generally provides for the relief by the country of residence of the potential double taxation through a foreign tax credit (Article 24).

The treaty contains the standard provision (the "savings clause") contained in U.S. tax treaties that each country retains the right to tax its citizens and residents as if the treaty had not come into effect (Article 1). In addition, it contains the standard provision that the treaty will not be applied to deny any taxpayer any benefits he would be entitled to under the domestic law of either country or under any other agreement between the two countries; that is, the treaty will generally be applied only to the benefit of taxpayers.

The treaty also contains standard nondiscrimination provisions and provides for exchanges of information and administrative cooperation between the tax authorities of the two countries to avoid double taxation and prevent fiscal evasion with respect to income taxes.

The proposed treaty contains a number of provisions that vary from the U.S. model and many U.S. income tax treaties. A number of these provisions generally reflect U.S. concessions to Jamaica because it is a developing country.

(1) The proposed treaty does not cover U.S. excise taxes on insurance premiums paid to foreign insurers and on private foundations. Thus, the U.S. will continue to impose those taxes.

(2) The definition of permanent establishment is somewhat broader than that in the U.S. model and many existing U.S. treaties. The principal areas in which the proposed treaty departs from the U.S. model are the inclusion as a permanent establishment of a place of management, a store or sales outlet, construction projects lasting more than 183 days in a 12-month period (rather than the model 12 months), performing services through personnel for more than 90 days, and the maintenance of substantial equipment for more than 120 consecutive days. Also, the proposed treaty includes connected supervisory services in the time period of a construction project.

(3) The tax on direct investment dividends is limited to 10 percent in contrast with the 5 percent in the U.S. model.

(4) The United States is prohibited from imposing its so-called second withholding tax on dividends paid by Jamaican corporations earning significant business profits in the United States.

(5) The U.S. accumulated earnings tax will not apply to certain income of a Jamaican company derived under Jamaican tax incentive legislation.

(6) The tax at source on gross interest is limited to 12.5 percent rather than the zero rate in the U.S. model. The zero rate is rarely obtained.

(7) Royalties, including movie royalties, may be taxed at 10 percent of gross rather than the zero rate in the U.S. model. The zero rate is rarely obtained.

(8) Independent personal service income may be taxed if the person is present in a country for more than 90 days, in contrast to the U.S. model which requires presence for more than 183 days.

(9) Both dependent and independent personal service income may be taxed at source if the income exceeds a dollar threshold. The U.S. model does not contain a dollar threshold.

(10) The proposed treaty, as amended by the proposed protocol, contains the tightest provision found in any U.S. treaty that prevents third country use of treaties.

(11) The proposed treaty, as amended by the proposed protocol, gives U.S. taxpayers a deduction for foreign conventions in Jamaica.

#### **Issues**

(1) **Less-developed country concessions.**—Jamaica is a less-developed country, and this treaty departs significantly from the United States and OECD models in providing for broad source basis taxation. A number of these departures reflect the influence of the United Nations model for income tax treaties between developing and developed countries. These departures could become precedent for negotiations with other developing countries. The relevant provisions include (i) higher than model limitations on withholding taxes on investment income, (ii) the expansion of the cases in which a business of one coun-

try will be considered to have a permanent establishment in the host country (and thus be taxable on its business profits in the host country), (iii) lower dollar limits for determining when income earned by a resident of one of the countries from the performance of personal services in the other country can be taxed by the host country. Another concession is the prohibition against the United States imposing its accumulated earnings tax on Jamaican companies deriving income subject to Jamaican tax incentive legislation.

These concessions are considered necessary in order to obtain treaties with developing countries. Treaties with developing countries can be in the interest of the United States because they provide tax relief for U.S. investors and a framework within which the taxation of those investors will take place. They also provide for an exchange of information which will enable the two countries to better administer their tax laws. See Article 27.

(2) **Foreign conventions.**—Under provisions (Code sec. 274(h)) adopted in 1976 and modified in 1980, U.S. taxpayers are generally not allowed deductions for attending business conventions outside the United States, its possessions, Canada and Mexico unless it is “as reasonable” to hold the convention outside that “North American” area as within it. The recently negotiated protocol to the pending treaty would expand the North American area exception to the U.S. foreign convention expense rules and would thus permit Americans to deduct expenses of attending a convention in Jamaica. This granting of a deduction otherwise denied represents an expansion of the general scope of treaties which usually seek only to minimize double taxation. It raises the issue of how far we will go in giving tax benefits to Americans under treaties. The Jamaican protocol does contain a quid pro quo in the form of the strongest anti-treaty shopping provision in any U.S. income tax treaty and a commitment from Jamaica to negotiate a mutual assistance treaty.

## II. OVERVIEW OF UNITED STATES TAXATION OF INTERNATIONAL TRADE AND INVESTMENT AND TAX TREATIES

### A. United States Tax Rules

The United States taxes U.S. citizens and residents and U.S. corporations on their worldwide income. The United States taxes nonresident alien individuals and foreign corporations on their U.S. source income which is not effectively connected with the conduct of a trade or business in the United States (sometimes referred to as "non-effectively connected income"). They are also taxed on their U.S. source income and certain limited classes of foreign source income which is effectively connected with the conduct of a trade or business in the United States (sometimes referred to as "effectively connected income.")

Income of a nonresident alien or foreign corporation which is effectively connected with the conduct of a trade or business in the United States is subject to tax at the normal graduated rates on the basis of net taxable income. Deductions are allowed in computing effectively connected taxable income, but only if and to the extent they are connected with income which is effectively connected.

United States source fixed or determinable, annual or periodical income (e.g. interest, dividends, rents, salaries, wages, premiums, annuities) which is non-effectively connected income and which is received by a nonresident alien or foreign corporation is subject to tax at a rate of 30 percent of the gross amount paid. This gross tax on fixed or determinable income is often reduced or eliminated in the case of payments to residents of countries with which the U.S. has an income tax treaty.

Certain exemptions from the gross tax are provided. Bank account interest is defined as foreign source interest and, therefore, is exempt. Exemptions are also provided for certain original issue discount and for income of a foreign government from investments in U.S. securities. Our treaties also provide for exemption from tax in certain cases.

The 30-percent (or lower treaty rate) tax imposed on U.S. source non-effectively connected income paid to foreign persons is collected by means of withholding (hence they are often called withholding taxes).

Net U.S. source capital gains are also subject to the 30 percent tax but only in the case of a nonresident alien who is present in the United States for at least 183 days during the taxable year. Otherwise foreign corporations and nonresident aliens are only subject to U.S. taxation (at the graduated rates) on those capital gains that are effectively connected with the conduct of a trade or business in the United States.

Prior to June 18, 1980, non-effectively connected capital gains from the sale of U.S. real estate were subject to U.S. taxation only if re-

ceived by a nonresident alien who was present in the United States for at least 183 days. However, in the Omnibus Reconciliation Act of 1980 a provision was added to the Internal Revenue Code that the sale, exchange or disposition of U.S. real estate by a foreign corporation or a nonresident alien would be taxed as effectively connected income. Also taxable under the legislation are dispositions by foreign investors of their interests in certain U.S. corporations and other entities whose assets include U.S. real property and associated personal property.

The source of income received by nonresident aliens and foreign corporations is determined under special rules contained in the Internal Revenue Code. Under these rules interest and dividends paid by a U.S. citizen or resident or by a U.S. corporation are considered U.S. source income. However, if the U.S. corporation derives more than 80 percent of its gross income from foreign sources, then dividends and interest paid by such corporation will be foreign source rather than U.S. source. Conversely, dividends and interest paid by a foreign corporation, which has at least 50 percent of its income as effectively connected income, are U.S. source to the extent of the ratio of its effectively connected income to total income.

Rents and royalties paid for the use of property in the United States is considered U.S. source income. The property use can be either tangible property or intangible property (e.g., patents, secret processes and formulas, franchises and other like property).

Since it taxes U.S. persons on their worldwide income, double taxation of income can arise because income earned abroad by a U.S. person will be taxed by the country in which the income is earned and also by the United States. The U.S. seeks to mitigate this double taxation by allowing U.S. taxpayers to credit their foreign income taxes against the U.S. tax imposed on their foreign source income. A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax on U.S. source income. Therefore, the foreign tax credit provisions contain a limitation that insures that the foreign tax credit only offset the U.S. tax on foreign source income. This limitation is computed on a world-wide consolidated basis. Hence, all income taxes paid to all foreign countries are combined to offset U.S. taxes on all foreign income.

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

Separate limitations on the foreign tax credit are provided for certain interest, DISC dividends, and oil income.

#### **B. United States Tax Treaties—In General**

The traditional objectives of U.S. tax treaties have been the avoidance of international double taxation and the prevention of tax avoidance and evasion. To a large extent, the treaty provisions designed to carry out these objectives supplement Code provisions having the same objectives, modifying the generally applicable statutory rules with provisions which take into account the particular tax system of the

treaty country. Given the diversity of tax systems in the world, it would be virtually impossible to develop in the Code rules which unilaterally would achieve these objectives for all countries.

Notwithstanding the unilateral relief measures of the United States and our treaty partners, double taxation might arise because of differences in source rules between the United States and the other country. Likewise, if both countries consider the same deduction allocable to foreign sources, double taxation can result. Significant problems arise in the determination of whether a foreign tax qualifies for the U.S. foreign tax credit. Also, double taxation may arise in those limited situations where a corporation or individual may be treated as a resident of both countries and be taxed on a worldwide basis by both.

In addition, there may be significant problems involving "excess" taxation—situations where either country taxes income received by nonresidents at rates which exceed the rates imposed on residents. This is most likely to occur in the case of income taxed at a flat rate on a gross income basis. (Most countries, like the United States, generally tax domestic source income on a gross income basis when it is received by nonresidents who are not engaged in business in the country.) In many situations the gross income tax is imposed at a rate which exceeds the tax which would have been paid under the net income tax system applicable to residents.

Another related objective of U.S. tax treaties is the removal of barriers to trade, capital flows, and commercial travel caused by overlapping tax jurisdictions and the burdens of complying with the tax laws of a jurisdiction where the contacts with, and income derived from, that jurisdiction are minimal.

The objective of limiting double taxation is generally accomplished in treaties by the agreement of each country to limit, in certain specified situations, its right to tax income earned from its territory by residents of the other country. For the most part, the various rate reductions and exemptions by the source country provided in the treaties are premised on the assumption that the country of residence will tax the income in any event at levels comparable to those imposed by the source country on its residents. The treaties also provide for the elimination of double taxation by requiring the residence country to allow a credit for taxes which the source country retains the right to impose under the treaty. In some cases, the treaties may provide for exemption by the residence country of income taxed by the source country pursuant to the treaty.

Treaties first seek to eliminate double taxation by defining the term "resident" so that an individual or corporation generally will not be subject to tax as a resident by each of the two countries. The treaty also provides that neither country will tax business income derived from sources within it by residents of the other country unless the business activities in the taxing jurisdiction are substantial enough to constitute a branch or other permanent establishment or fixed base. The treaties contain commercial visitation exemptions under which individual residents of one country performing personal services in the other will not be required to file tax returns and pay tax in that other country unless their contacts exceed certain specified minimums, normally presence for a set number of days or earnings of over a certain fixed dollar amount.

The treaties deal with passive income such as dividends, interest, or royalties, or capital gains, from sources within one country derived by residents of the other country by either providing that they are taxed only in the country of residence or by providing that the withholding tax generally imposed on those payments is reduced. As described above, the U.S. generally imposes a 30 percent tax and seeks to reduce this tax in some cases on some income to zero in its tax treaties.

In its treaties, the United States, as a matter of policy, retains the right to tax its citizens and residents on their worldwide income as if the treaty had not come into effect, and provides this in the treaties in the so-called "savings clause." Double taxation can therefore still arise. Double taxation can also still arise because most countries will not exempt passive income from tax at source.

This double taxation is further mitigated either by granting a credit for income taxes paid to the other country, or by, in the case of some of our treaty partners, by providing that income will be exempt from tax in the country of residence. The United States provides in its treaties that it will allow a credit against United States tax for income taxes paid to the treaty partners, subject to the limitations of U.S. law. An important function of the treaty is to define the taxes to which it applies and provide that they will be considered creditable income taxes for purposes of the treaty.

The treaties also provide for administrative cooperation between the countries. This cooperation includes a competent authority mechanism to resolve double taxation problems arising in individual cases, or more generally, by consultation between tax officials of the two governments.

Administrative cooperation also includes provision for an exchange of tax-related information to help the United States and its treaty partners administer their tax laws. The treaties generally provide for the exchange of information between the tax authorities of the two countries where such information is necessary for carrying out the provisions of the treaty or of their domestic tax laws. The obligation to exchange information under the treaties typically does not require either country to carry out measures contrary to its laws or administrative practices or to supply information not obtainable under its laws or in the normal course of its administration, or to supply information which would disclose trade secrets or other information the disclosure of which would be contrary to public policy.

The provisions generally result in an exchange of routine information, such as the names of U.S. residents receiving investment income. The IRS (and the treaty partner's tax authorities) also can request specific tax information from a treaty partner. This can include information to be used in a criminal investigation or prosecution.

### III. EXPLANATION OF PROPOSED TAX TREATY

Set forth below is an article-by-article explanation of the proposed income tax treaty between the United States and Jamaica, as modified by the proposed protocol.

#### *Article 1. Personal Scope*

The proposed treaty applies generally to residents of the United States and to residents of Jamaica, with specific exceptions designated in other articles. This follows other U.S. income tax treaties and the OECD model income tax treaty.

The proposed treaty also contains the customary rule that it may not be applied to restrict any benefits under domestic tax rules. This reflects the general rule that a treaty does not work to increase the tax burden of residents of either country beyond what it would be in the absence of the treaty—that is, the treaty only applies where it benefits taxpayers.

The proposed treaty contains the “saving clause” contained in all U.S. income tax treaties which provides, with specified exceptions, that the treaty is not to affect the taxation by the United States of its citizens and residents or the taxation by Jamaica of its citizens and residents. Residents for purposes of the treaty (and thus for purposes of the saving clause) include corporations and other entities as well as individuals (Article 4 (Residence)).

Under section 377, a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of U.S. income tax will, in certain cases, be subject to tax for a period of ten years following the loss of citizenship. The treaty, as amended by the proposed protocol, contains the standard provision found in the U.S. model, and most recent treaties, specifically retaining the right to tax former citizens. Even without this provision, the Internal Revenue Service reaches this result. See Rev. Rul. 79-152, 1979-1 C.B. 237. (See also Article 13(7), which denies capital gain benefits regardless of the reason for expatriation.)

Exceptions to the saving clause are provided for the benefits conferred by the articles dealing with certain public pensions and child support payments (Article 19), relief from double taxation (Article 24), nondiscrimination (Article 25), and mutual agreement procedures (Article 26); thus, the benefits of those articles will be conferred by each country on its own citizens and residents as well as the citizens and residents of the other. In addition, the benefits conferred by the articles dealing with the taxation of income received by government employees (Article 20), students and trainees (Article 21), teachers (Article 22), and diplomatic and consular officials (Article 28) are to be provided by each country to its residents provided those residents are neither citizens of, nor have immigrant status in, that country.

Consequently, except for the exceptions to the saving clause set forth above, U.S. citizens and residents generally benefit under the

treaty as the result of the agreement by Jamaica to reduce its rate of tax on their income or exempt their income from tax rather than as the result of reductions in tax or exemptions by the United States. Even in this situation, if the tax which is foregone by Jamaica could have otherwise been claimed in full by the U.S. taxpayers as a foreign tax credit, the real beneficiary of the reduction or elimination of the Jamaican tax would, as a practical matter, be the U.S. Treasury rather than the U.S. taxpayer. Similarly, except as noted above, Jamaican citizens and residents benefit under the treaty only to the extent that the United States agrees to reduce its tax on their income or to exempt their income from tax.

**Article 2. Taxes Covered**

In the case of the United States, the proposed treaty applies to the Federal income taxes imposed under the Internal Revenue Code. However, it does not generally apply to the accumulated earnings tax or the personal holding company tax. Unlike the U.S. model treaty, it does not apply to the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations. Thus, the United States will be able to continue to impose those taxes without restriction.

In the case of Jamaica, the treaty applies to the income tax, the company profits tax, and the transfer tax. These taxes are specifically designated as creditable income taxes for purposes of the U.S. foreign tax credit.

The proposed treaty also contains a provision generally found in U.S. income tax treaties to the effect that it will apply to substantially similar taxes which either country may subsequently impose. In particular, the treaty will apply to a tax imposed by Jamaica in lieu of the income tax or the company profits tax. As explained in the Exchange of Notes accompanying the proposed treaty, the Jamaican negotiators expressed concern about whether certain amounts received by Jamaica from companies extracting and refining bauxite in Jamaica would qualify for the United States foreign tax credit. The United States negotiators agreed that the Convention would cover amounts paid "in lieu of" the company profits tax (or income tax) of Jamaica, if the Government of Jamaica decides to impose such a tax in the future, as long as that tax meets the requirements of creditability under U.S. law (Code sec. 903).<sup>1</sup>

Each country is obligated under the treaty to notify the other of any changes it makes in its tax laws and of any official published material concerning the treaty, including explanations, regulations, rulings, and judicial determinations.

Additionally, the nondiscrimination provisions (Article 25) of the treaty apply to all taxes of every kind imposed at the national, state, or local level by the United States or Jamaica. The exchange of information and administrative assistance provisions (Article 27) of the proposed treaty will also apply to all taxes of every kind imposed by the two countries at the national level.

<sup>1</sup> U.S. law allows a foreign tax credit for foreign income taxes, and for taxes paid "in lieu of" an income tax otherwise generally imposed by the foreign country.

**Article 3. General Definitions**

Certain of the standard definitions found in most U.S. income tax treaties are contained in the proposed treaty.

Under the proposed treaty, the term "United States" means the United States of America and when used in a geographical sense includes the States and the District of Columbia, the territorial waters of the United States, and any area outside the States and the District of Columbia which in accordance with international law and the laws of the United States is an area within which the rights of the United States with respect to the natural resources of the seabed and subsoil may be exercised. This reference to the seabed and subsoil is not contained in the latest U.S. model definition. However, the United States reads the definition in the model as being no different than the definition in this proposed convention.

The term "Jamaica" means the island of Jamaica, the Morant Cays, the Pedro Cays and their Dependencies and when used in a geographical sense similarly includes the territorial waters of Jamaica and its natural resource jurisdiction.

A "national" of either country is defined to include both a citizen of that country and also any legal entity such as a corporation, trust, estate, partnership, or association which is established under the laws of that country. A "company" is defined as a corporation or other entity treated as a corporation for tax purposes. An "enterprise" of a country is defined as an enterprise or undertaking carried on by a resident of that country. Although the treaty does not define the term "enterprise," it would have the same meaning that it has in other U.S. tax treaties—the trade or business activities undertaken by an individual, partnership, corporation, or other entity.

The proposed treaty also contains the standard provision that, unless the context otherwise requires or the competent authorities of the two countries establish a common meaning, any terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty.

**Article 4. Residence**

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

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

Under the treaty, a person other than a company, is resident in a country for purposes of the treaty if it is resident in that country for purposes of that country's tax. However, in the case of a partnership, estate or trust, the entity is treated as a resident only to the extent that the income derived by the entity is subject to that country's tax as

the income of a resident either in its hands or in the hands of its partners or beneficiaries.

A company is treated as a resident of Jamaica if it is managed and controlled in Jamaica, and as a resident of the United States if it is created or organized under the laws of the United States or a political subdivision. A company which is managed and controlled in Jamaica but organized under U.S. law is a "dual resident." Such a company is considered to be outside the scope of the treaty except for purposes of paragraph 2 of Article 10 (Dividends), Article 25 (Non-discrimination), Article 26 (Mutual agreement procedure), Article 27 (Exchange of information and administrative assistance) and Article 29 (Entry into force). A company organized under Jamaican law but managed and controlled in the United States would not be a resident of either country.

A set of rules is provided to determine residence in the case of an individual who, under the basic treaty definition, would be considered to be a resident of both countries. In the case of a dual resident individual, the individual will be deemed for all purposes of the treaty to be a resident only of the country in which he has his permanent home (where an individual dwells with his family), his center of vital interests (his closest economic and personal relations), his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests, applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement. In the case of a dual resident person, other than an individual or a company (e.g., a dual resident partnership, trust, or estate), the residence of the person and the mode of application of the treaty will be determined by the competent authorities.

**Article 5. Permanent Establishment**

The proposed treaty contains a definition of permanent establishment which follows the pattern of other recent U.S. income tax treaties and the U.S. and OECD model tax treaties. However, in order to reflect Jamaica's status as a developing country, a number of concessions are made to the principle of taxation of income at the source. Some of these concessions reflect positions suggested by the United Nations model tax treaty between developed and developing countries. The permanent establishment concept 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. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties are applicable.

The principal areas in which the Jamaican treaty departs from the U.S. model are in its inclusion in the permanent establishment definition of a sales outlet, construction projects lasting more than 183 days (rather than 12 months), an individual performing services more than 90 days, and maintenance of equipment more than 120 days. Also, the inclusion in the time period of supervisory activity connected with construction or natural resource type activity is a departure from the U.S. model.

In general, a fixed place of business through which a resident of one country engages in business in the other country is considered a permanent establishment. This includes a place of management; a branch; an office; a factory; a workshop; a store or premises used as a sales outlet; a warehouse, in relation to a person providing storage facilities for others; or a mine, an oil or gas well, a quarry, or other place of extraction of natural resources. It also includes any building site, construction, assembly, installation, or dredging project, or drilling rig or ship used for the exploration or development of natural resources, but only if the site, project, etc., lasts for more than 183 days in any twelve-month period (including the period of any supervisory activity connected therewith). A permanent establishment will not exist in any taxable year in which such a site, project or activity is in that country for a period or periods aggregating less than 30 days.

An enterprise will also have a permanent establishment if it furnishes services, including consultancy, management and technical, and supervisory services in a country through employees or other personnel, but only if these continue within that country for more than 90 days in any twelve-month period. No permanent establishment will result, however, in any taxable year in which these services are performed less than 30 days. However, the 90-day minimum requirement does not apply, and a permanent establishment will result, if the services are performed for a related enterprise (Article 9(3)). Such a permanent establishment is not necessarily also a permanent establishment of the related enterprise (Article 5(7)).

Finally, an enterprise will have a permanent establishment if it maintains substantial equipment or machinery in a country but only if the equipment or machinery is maintained in that country for a period of more than 120 consecutive days. No permanent establishment will, however, exist in any taxable year in which the equipment or machinery is maintained within that country for less than 30 days.

This general rule is modified to provide that a fixed place of business which is only used for any or all of a number of specified activities will not constitute a permanent establishment. These activities include the use of facilities for storing, displaying, or delivering merchandise belonging to the enterprise and the maintenance of a stock of goods belonging to the enterprise for purposes of storage, display, or delivery, except where the goods or merchandise are held for sale by the enterprise in a store or premises used as a sales outlet. Also included are maintenance of goods for processing by another person, or the purchase of goods or merchandise, collection of information, or any other preparatory or auxiliary activities for the enterprise.

Even if an enterprise of one country does not have a permanent establishment in the other country under the foregoing rules, it may still be treated as having one to the extent that goods or merchandise are sold by or on behalf of the enterprise for use, consumption, or disposition in that other country. This special rule applies only if the goods or merchandise are either (a) subjected to processing in that other country by another person (whether or not purchased in that other country); or (b) purchased in that other country and not subjected to processing outside that other country.

If an enterprise of one country maintains an agent in the other country who has, and regularly exercises, the authority to enter into

contracts in that other country in the name of the enterprise, then the enterprise will be deemed to have a permanent establishment in the other country with respect to the activities which the agent undertakes on its behalf. This rule does not apply where the contracting authority is limited to those activities (described above) such as storage, display, or delivery of merchandise which are excepted from the definition of permanent establishment. However, the enterprise will be treated as having a permanent establishment if the agent habitually maintains in that other country a stock of goods or merchandise from which he regularly makes deliveries on behalf of the enterprise and additional activities conducted in that other country on behalf of the enterprise have contributed to the conclusion of the sale of the goods or merchandise.

The proposed treaty contains the usual provision that the agency rule will not apply if the agent is a broker, general commission agent, or other agent of independent status acting in the ordinary course of its business. However, this rule is modified to provide that when the activities of the agent are devoted wholly or almost wholly on behalf of that enterprise, he will not be considered an agent of independent status if the transactions between the agent and the enterprise were not made under arm's length conditions.

The fact that a company which is a resident of one country controls or is controlled by a company which is a resident of the other country or which carries on business in that other country (whether through a permanent establishment or otherwise) will not of itself constitute either company a permanent establishment of the other.

**Article 6. Income from Immovable Property (Real property)**

The proposed treaty provides that income from real property (including income from agriculture or forestry) may be taxed in the country where the real property or natural resources are located. For purposes of the treaty, real property will generally have the meaning provided under the laws of the country where the property is located, but will in any case include property which is accessory to real property, livestock and equipment used in agriculture and forestry, and rights to real property. Ships, boats, and aircraft will not be considered real property.

Income from real property includes income from the direct use or renting of the property. It also includes royalties and other payments in respect of the exploitation of natural resources (e.g., oil wells). It does not include interest on loans secured by real property. Under Article 13 (Capital Gains), gains on the sale, exchange, or other disposition of the property may also be taxed by the country where the property is located.

Generally, gain realized by a nonresident alien or a foreign corporation from the sale of a capital asset is not subject to U.S. tax unless the gain is effectively connected with the conduct of a U.S. trade or business or, in the case of a nonresident alien, he is physically present in the United States for at least 183 days in the taxable year. However, under the Foreign Investment in Real Property Tax Act of 1980, as amended, a nonresident alien or foreign corporation is taxed by the United States on gain from the sale of U.S. real estate, and gain from the sale of stock in U.S. real property holding corporations,

as if gain was effectively connected with a trade or business conducted in the U.S. The capital gain provision of Article 13 would not in any way restrict the right of the United States to tax the gain from the sale of U.S. real estate and stock of U.S. real property holding corporations under the provisions of the 1980 legislation or any similar but later enacted legislation. It also retains the right of the U.S. to impose relevant reporting or withholding requirements. This treaty permits the United States to tax such foreign investment under its domestic law.

The proposed treaty does not include a provision in the U.S. model which would allow an election to be taxed on real estate income on a net basis. Such a provision is already included in the Internal Revenue Code (secs. 871(d) and 882(d)).

**Article 7. Business Profits**

United States law separates the business and investment income of a nonresident alien or foreign corporation. A nonresident alien or foreign corporation is subject to a flat 30 percent (or lower treaty rate) rate of tax on its U.S. source income if that income is not effectively connected with the conduct of a trade or business within the United States. The regular individual or corporate rates apply to U.S. source income which is effectively connected with the conduct of a trade or business within the United States.

The taxation of income as business or investment income varies depending upon whether the income is U.S. or foreign. U.S. source periodic income, such as interest, dividends, rents, wages, and capital gains is effectively connected with the conduct of a trade or business within the United States only if the asset generating the income is used in or held for use in the conduct of the trade or business, or if the activities of the trade or business were a material factor in the realization of the income. All other U.S. source income is treated as effectively connected income.

Foreign source income is effectively connected income only if the foreign person has an office or other fixed place of business in the United States and the income is attributable to that place of business. Only three types of foreign source income can be effectively connected income: rents and royalties derived from the active conduct of a licensing business; dividends, interest, or gain from stock or debt derived in the active conduct of a banking, financing or similar business in the United States; and certain sales income attributable to a United States sales office.

Except in the case of a dealer, the trading in stocks, securities or commodities in the United States for one's own account does not constitute a trade or business in the United States and accordingly income from those activities is not taxed by the U.S. as business income. This concept includes trading through a U.S. based employee, a resident broker, commission agent, custodian or other agent or trading by a foreign person physically present in the United States.

The proposed treaty generally follows the U.S. model, other recent treaties, and the OECD model. Under the proposed treaty, business profits of an enterprise of one country are taxable in the other country only to the extent they are attributable to a permanent establishment in the other country through which the enterprise carries on business.

This is one of the basic limitations on a source country's right to tax income of a nonresident.

The taxation of business profits under the proposed treaty differs from United States rules for taxing business profits primarily in requiring more than merely being engaged in trade or business before a country can tax effectively connected business profits. Under the Internal Revenue Code, all that is necessary for business profits to be taxed is that a trade or business be carried on in the United States. Under the proposed treaty, on the other hand, some level of fixed place of business must be present.

Under the proposed treaty, business profits of an enterprise of one country are taxable in the other country only to the extent they are attributable to a permanent establishment in the other country through which the enterprise carries on business.

The business profits of a permanent establishment are determined on an arm's-length basis. Thus, there is to be attributed to it the business profits which would reasonably be expected to have been derived by it if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing at arm's-length with the resident of which it is a permanent establishment.

In computing taxable business profits, deductions are allowed for expenses, wherever incurred, which are reasonably allocable to the permanent establishment. Such deductions would include, for example, a reasonable allocation of executive and general administrative expenses, interest, research and development which are incurred for purposes of the enterprise as a whole, or for that part of the enterprise that includes the permanent establishment.

Business profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment for the account of the enterprise. Thus, where a permanent establishment purchases goods for its head office, the business profits attributed to the permanent establishment with respect to its other activities will not be increased by a profits element on its purchasing activities.

Where business profits include items of income which are dealt with separately in other articles of the treaty, those other articles, and not the business profits article, will govern the treatment of those items of income. Unlike the U.S. model treaty, the proposed treaty provides that film royalties are not business profits. Thus, those royalties may be subject to tax (Article 12) even though the recipient has no permanent establishment in the taxing country.

***Article 8. Shipping and Air Transport***

As a general rule, the United States would tax the U.S. source income of a foreign person from the operation of ships or aircraft to or from the United States. An exemption from U.S. tax is provided if the ship or aircraft is documented under the laws of a foreign country that grants an equivalent exemption to the U.S. citizens and corporations. The United States has entered into agreements with a number of countries under which that country grants an exemption which results in the United States exempting that country's shipping. Under the present treaty, U.S.-flag vessels operated by U.S. persons are exempt from Jamaican tax.

The proposed treaty provides that income which is derived by an enterprise of either country from the operation of ships and aircraft in international traffic shall be exempt from tax by the other country. International traffic means any transportation by ship or aircraft, except where the transportation is solely between places in the other country (Article 3(1)(d) (General definitions)). Unlike the present treaty, the exemption applies whether or not the ships or aircraft are registered in the first country. Thus, for example, Jamaica would not tax the income of a U.S. person operating a Liberian-flag vessel.

The exemption for shipping and air transport profits applies to profits from the rental of ships or aircraft if operated in international traffic by the lessee or if such rental profits are incidental to the actual operation of ships and aircraft in international traffic. Income from the operation in international traffic of ships or aircraft also includes income derived from the use, maintenance, or rental of containers, trailers for the inland transportation of containers, and other related equipment where the equipment is used to transport goods and merchandise in international traffic. The shipping and air transport provisions also apply to profits from participation in a pool, a joint business, or an international operating agency.

**Article 9. Associated Enterprises**

The proposed treaty provides that, if an enterprise subject to the taxing jurisdiction of a treaty country and any other enterprise are related and make arrangements or impose conditions between themselves which are different from those which would be made between independent persons, then any income, deductions, credits, or allowances which would, but for those arrangements or conditions, have been taken into account in computing the income (or loss) of, or the tax payable by, one of these enterprises, may be taken into account in computing the amount of income subject to tax and the taxes payable by that enterprise. An enterprise is related to another enterprise if either enterprise owns or controls directly or indirectly the other, or if any third person or persons own or control directly or indirectly both. For this purpose, the term "control" includes any kind of control, whether or not legally enforceable, and however exercised or exercisable. Thus, the treaty does not in any way limit the authority of the Internal Revenue Service to allocate or apportion income, deductions, credits, or allowances between related parties under section 482 of the Internal Revenue Code in situations where it determines that the allocation is necessary in order to prevent the evasion of taxes or clearly to reflect the income of the related parties.

Where an adjustment has been made by one treaty country in accordance with this provision and if necessary to prevent double taxation, the other country is, if it agrees with the adjustment, to make a corresponding adjustment to the income of the related enterprise in that other country. If the second country disagrees, however, the competent authorities will attempt to reach an agreement (Article 26).

**Article 10. Dividends**

As a general rule, the United States imposes a 30-percent tax ("withholding tax") on dividends paid to foreign persons by U.S. corporations and certain foreign corporations earning more than half of their

income from a U.S. business. Under the proposed treaty this tax, and Jamaica's similar tax, would be reduced.

Under the proposed treaty, each country may tax dividends paid by its companies to shareholders resident in the other (i.e., they may impose a dividend withholding tax on shareholders resident in the other country). The rate of tax is limited to 15 percent if the beneficial owner is a resident of the other country. However, it is limited to 10 percent (as contrasted with 5 percent in the U.S. model treaty) in the case of dividends paid to a company which directly or indirectly owns at least 10 percent of the voting stock of the company making the dividend distribution. This reduced withholding rate applies even in the case of a "dual resident" corporation.

Neither country can tax dividends paid by companies of the other except insofar as (a) the dividends are paid to residents of the country imposing the tax, or (b) the dividends are effectively connected with a permanent establishment or a fixed base in the taxing country. This provision waives the U.S. "second withholding tax" on dividends paid by foreign companies earning half of their income from U.S. business. The U.S. model would allow a tax where at least 50 percent of the company's gross income was attributable to a permanent establishment in the taxing country, to the extent the dividends are paid out of the profits derived from the permanent establishment.

The reduced rates of tax on dividends will apply unless the recipient has a permanent establishment (or fixed base in the case of an individual performing independent personal services) in the source country and the dividends are effectively connected with the permanent establishment (or fixed base). Dividends effectively connected with a permanent establishment are to be taxed as business profits (Article 7). Dividends effectively connected with a fixed base are to be taxed as income from the performance of independent personal services (Article 14).

The proposed treaty also provides that the income of a Jamaican company derived from the manufacture in Jamaica of approved products under the tax incentive legislation of Jamaica (as in effect on the date of signature of the treaty or as the competent authorities may agree pursuant to Article 26 (Mutual Agreement Procedure)) will not be subject to the United States accumulated earnings tax. In addition, a company which is a resident of Jamaica will be exempt from United States accumulated earnings tax if individuals (other than United States citizens) who are residents of Jamaica control, directly or indirectly, throughout the last half of the taxable year more than 75 percent of the entire voting power in that company.

#### **Article 11. Interest**

The U.S. imposes a 30-percent tax on U.S. source interest paid to foreign persons under the same rules that are applicable to dividends. U.S. source interest generally is interest on debt obligations of U.S. persons, but not interest on deposits in banks. Bank account interest of a foreign person is thus exempt from U.S. tax. U.S. source interest also includes interest paid by a foreign corporation if at least 50 percent of the gross income of the foreign corporation, in the prior three year period, was effectively connected with a U.S. trade or business of that corporation.

Each country may tax interest income of its residents arising in the other country. However, the interest may also be taxed in the country in which it arises at a rate not exceeding 12.5 percent. This contrasts with the U.S. position, rarely achieved, that interest should be exempt from tax at source.

However, in certain situations, interest income will be exempt from withholding. First, interest is exempt if derived by the government of one of the treaty countries or an instrumentality thereof (including the Bank of Jamaica, the Jamaica Development Bank, the Jamaica Mortgage Bank, the Export-Import Bank of the United States, the Overseas Private Investment Corporation, the Federal Reserve Banks of the United States, and such other institutions of either country as the competent authorities may agree pursuant to Article 26 (Mutual Agreement Procedure)). It is understood, however, that the competent authorities will not exercise this authority except in the case of institutions substantially similar to those enumerated. Also exempted is interest derived by a resident of one country on debt which is guaranteed or insured by the government of that country or its instrumentality.

Interest generally "arises" in a country when the payer is that country's government, a political subdivision, a local authority or a resident of that country. Where, however, the person paying the interest, whether he is a resident or not, has in a treaty country a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and the interest is borne by the permanent establishment or fixed base, then the interest will be deemed to arise in the country in which the permanent establishment or fixed base is situated.

The reduced withholding rate on interest will apply unless the recipient has a permanent establishment or fixed base in the source country and the interest is effectively connected with the permanent establishment or fixed base. In that event, the interest will be taxed as business profits (Article 7) or income from the performance of independent personal services (Article 14).

The proposed treaty defines interest as income from debt claims of every kind, whether or not secured and whether or not carrying a right to participate in profits. In particular, it includes income from government securities and from bonds or debentures, including premiums or prizes attaching to bonds or debentures.

**Article 12. Royalties**

Under the same system that applies to dividends and interest, the U.S. imposes a 30-percent tax on all U.S. source royalties paid to foreign persons. Royalties are from U.S. sources if they are from property located in the United States, including royalties for the use of or the right to use intangibles in the United States.

The proposed treaty provides for reduction of source basis taxation. Royalties that arise (see royalty source rule discussed below) in one country and are paid to a resident of the other country may be taxed by both countries. However, the withholding tax imposed in the source country may not exceed 10 percent of the gross royalty. The U.S. model calls for an exemption from tax at source.

Royalties are defined for this purpose as payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including films, radio or television tapes, any patents, trade marks, designs or models, plans, secret formulas or processes, or any other similar rights or property. Royalties also include payments for information concerning industrial, commercial, or scientific experience (e.g., "know-how"). Gains from the alienation of any such rights which are contingent on productivity, use or disposition are also covered by these rules. However, this article does not apply to mineral royalties (which are covered by Article 6) or to payments for the use of tangible personal property (which are covered by Article 7).

Royalties generally "arise" in a country when the payer is that country's government, a political subdivision or a local authority thereof, or a resident of that country. However, where the right or property for which the royalties are paid is used within the United States or Jamaica, the royalties will be deemed to arise in the country in which the right or property is used.

The reduced withholding rates do not apply where the recipient is an enterprise with a permanent establishment in the source country or an individual performing personal services in an independent capacity through a fixed base in the source country, and the royalties are effectively connected with the permanent establishment or fixed base. In that event the royalties will be taxed as business profits (Article 7) or income from the performance of independent personal services (Article 14).

#### **Article 13. Capital Gains**

The proposed treaty generally provides that capital gains derived by a resident of one country will be exempt from tax by the source country. This rule is generally the same as U.S. law under which capital gains derived from U.S. sources by foreign investors are generally exempt from U.S. tax.

The exemption does not apply in certain situations, and in those situations the gains may be taxed by both countries (with relief from double taxation provided pursuant to Article 24. First, gains from the sale or exchange of real property may be taxed in the country where the property is located. Also included in this exception are gains from the sale or exchange of shares of the capital stock of a corporation, or an interest in a partnership, trust or estate, the property of which consists principally of real property located in that country. For this purpose, an interest which an entity holds in a second entity is treated as a real property interest in a country if the second entity's property consists predominantly of real property in that country. These treaty provisions are generally consistent with the U.S. foreign investment in U.S. real property legislation which imposes a tax on the gains of foreign investors from sale of U.S. real property interests whether held directly or indirectly through real property holding organizations.

Second, gains on the sale or exchange of property which forms a part of the business property of a permanent establishment or a fixed base (including gains on the disposition of the permanent establishment

or the fixed base itself) may be taxed in the country where the permanent establishment or fixed base is located. This second exception does not apply to gains from the sale or exchange of ships, aircraft or containers operated by an enterprise of the other country in international traffic; such gains are only taxable by the country of residence.

Third, Jamaica may impose its transfer tax upon the alienation of property in accordance with the Transfer Tax Act as in effect on the date of signature of the treaty. Finally, nothing in the treaty is to prevent a country from levying, according to its domestic law, a tax on gains from the alienation of property derived by an individual who is a resident of the other country and who was a national of the first country at any time during the ten-year period immediately preceding the alienation of the property.

**Article 14. Independent Personal Services**

Income of a non-resident alien from the performance of personal services in the U.S. is not in the U.S. for at least 90 days, the compensation does not exceed \$3,000, and the services are performed as an employee of a foreign person not engaged in a trade or business in the U.S. or they are performed for a foreign permanent establishment of a U.S. person. The United States taxes the income of a nonresident alien at regular rates if the income is effectively connected with the conduct of a trade or business in the U.S. by the individual. (See discussion of U.S. taxation of business profits under Article 7. (Business Profits).) The performance of personal services within the United States can be a trade or business within the United States (sec. 864(b)).

Under the proposed treaty, income from the performance of independent personal services (i.e., services performed as an independent contractor, not as an employee) in one country by a resident of the other country is exempt from tax in the country where the services are performed, unless (1) the person performing the personal service is present in the country where the services are performed for more than 90 days during the taxable year, (2) the individual has a fixed base regularly available to him in that country for the purpose of performing the services, or (3) his net income from services in that country exceeds \$5,000 (or its Jamaican dollar equivalent) for the taxable year. If the second requirement (but not the first or third) is met, the source country can only tax that portion of the individual's income which is attributable to the fixed base.

In contrast, the U.S. model treaty would require presence for more than 183 days (rather than 90) under the first requirement. The model also contains no dollar limit on the amount which may be earned free of tax if the first and second requirements are not met.

**Article 15. Dependent Personal Services**

Under the proposed treaty, income from services performed as an employee in one country (the source country) by a resident of the other country will not be taxable in the source country if four requirements are met: (1) the individual is present in the source country for not more than 183 days during the taxable year; (2) his employer is not a resident of the source country; (3) the compensation is not borne by a permanent establishment or fixed base of the employer in the source country; and (4) the net income from services as an employee in that country for the taxable year does not exceed \$5,000 (or its equivalent

in Jamaican dollars). The fourth requirement is a departure from the U.S. model treaty, which contains no dollar limitation.

Compensation derived by an employee aboard a ship or aircraft operated by an enterprise of one country in international traffic is exempt from tax by the other country, provided that the compensation is in respect of employment as a member of the regular complement of the ship or aircraft.

This article is modified by the articles covering directors' fees (Article 16), pensions and social security payments (Article 19), and compensation as a government employee (Article 20).

**Article 16. Directors' Fees**

Directors' fees and similar payments derived by a resident of one country for services rendered in the other country as a member of the board of directors of a company which is a resident of the other country may be taxed in that other country. However, no tax may be imposed by that other country where the amount of the fees, not including reimbursed expenses, do not exceed \$400 (or its Jamaican dollar equivalent) per day for each day the resident is present in that other country for the purpose of performing those services.

**Article 17. Limitation of Benefits**

The proposed treaty, as amended by the proposed protocol, contains a provision which is intended to deny the benefits of the treaty to persons who are not entitled to those benefits by reason of their residence in the United States or Jamaica.

The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Jamaica as they apply to residents of the two countries. At times, however, residents of third countries attempt to use a treaty. Such use is known as treaty shopping, and refers to the situation where a person who is not a resident of either country seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, the nonresident is able to secure these benefits by establishing a corporation (or other entity) in one of the countries which, as a resident of that country, is entitled to the benefits of the treaty. Additionally, it may be possible for the third country resident to repatriate funds to that third country from the entity under favorable conditions (i.e., it may be possible to reduce or eliminate taxes on the repatriation either through relaxed tax provisions in the distributing country or by passing the funds through other treaty countries (essentially, continuing to treaty shop), until the funds can be repatriated under favorable terms.

The proposed treaty, as amended by the protocol, contains a provision that is intended to limit the use of the treaty to residents of the two countries. This is accomplished by providing that a business entity (a corporation, partnership, trust, or other business organization) is not entitled to the benefits of the convention unless more than 75 percent of the beneficial interest in that entity is owned by one or more individual residents of the country of which the entity is a resident and the income of the entity is not used in substantial part, directly or indirectly, to meet liabilities to persons who are not residents of Jamaica or the United States, other than any such persons who are individuals subject to tax in the United States or Jamaica on their

world-wide income by reason of citizenship. Liabilities include liabilities to pay interest or royalties to a resident of neither the United States nor Jamaica. This provision would, for example, deny the benefits of the reduced U.S. withholding tax rates on dividends, interest or royalties to a Jamaican company that is owned by residents of a third country.

A company that has substantial trading in its stock on a recognized exchange in the United States or Jamaica is presumed to be owned by individual residents of the contracting country in which the company is resident. Accordingly, a Jamaican company traded on the New York Stock Exchange would be considered owned by residents of Jamaica.

An exception is provided so that the denial of treaty benefits do not apply if it is determined that the acquisition, ownership or maintenance of the entity, and the conduct of its operation did not have as a principal purpose obtaining benefits under the proposed treaty. Accordingly, the provision will not apply if it can be shown that there was no treaty shopping motives for forming the company and if it is not in fact operated with the principal purposes of obtaining the treaty benefits. Thus the burden of overcoming the treaty shopping rule is on the taxpayer claiming treaty benefits.

A treaty shopping motive is not present, and accordingly the anti-abuse permission will not apply, to a Jamaican company, which is owned by individual residents of a country other than the United States or Jamaica, if that company does not use income subject to the convention to satisfy liabilities to residents of countries other than the United States and Jamaica, the company is actually engaged in business in Jamaica, and the income for which a treaty benefit is claimed is incidental to or derived in connection with the business operations in Jamaica. It also will not apply if the individual owners of the corporation are residents of countries that have income tax treaties with the United States and under those treaties those individuals would have gotten U.S. tax benefits that are the same or similar to those being claimed by the Jamaican company.

Similar rules are to apply to a U.S. company owned by residents of countries other than Jamaica or the United States when that company derives income and Jamaican tax benefits on that income are claimed under the proposed treaty.

**Article 18. Entertainers and Athletes**

The proposed treaty contains a set of rules which modify the taxation of income earned by entertainers (such as theater, motion picture, radio or television artistes and musicians) and athletes. The proposed treaty provides that, notwithstanding the other provisions dealing with the taxation of personal services (Articles 14 and 15), each country may tax nonresident entertainers or athletes on the income from their personal activities as such performed in that country if their gross receipts (not including reimbursed expenses or expenses borne on their behalf) exceed \$400 or its equivalent in Jamaican dollars per day, or \$5,000 or its equivalent in Jamaican dollars for the taxable year concerned. Thus, highly paid entertainers and athletes will be taxable by the country in which they perform, regardless of the period of time spent in that country. However, as in the case of the other

provisions dealing with personal services income, this provision does not bar the country of residence or citizenship from also taxing that income. In such a case, double taxation is avoided by the grant of a foreign tax credit (Article 24).

In addition, the proposed treaty provides that where income in respect of personal services performed by an entertainer or athlete is paid not to the entertainer or athlete but rather to another person, that income will be taxable by the country in which the services are performed in any situation where the entertainer or athlete shares directly or indirectly in the profits of the person receiving the income. For this purpose, participation in the profits of the recipient of the income includes the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions, or other distributions. The provision is intended to prevent performers and athletes from avoiding tax in the country in which they perform by routing the compensation for their services through a third person such as a personal holding company.

**Article 19. Pensions, Etc.**

Under the proposed treaty, pensions derived by a resident of one country may be taxed only by that country unless the services giving rise to the pension were performed in the other country while he was a resident of that other country, in which case that other country may also tax the pension. However, social security payments and other public pensions paid by one country to a resident of the other or a citizen of the United States will be taxable only in the paying country. Annuities beneficially derived by a resident of one country will be taxable only in that country unless the annuity was purchased in the other country while he was a resident of that other country, in which case the annuity may also be taxed in that other country.

Alimony paid by a resident of one country to a resident of the other will be exempt from tax in the recipient's country. Child support paid by a resident of one country to a resident of the other will be exempt from tax in both countries.

**Article 20. Government Service**

Under the proposed treaty, compensation paid by one country, its political subdivisions or local authorities, to an individual for services performed for the paying governmental entity is exempt from tax by the other country. However, this exemption does not apply if the services are performed in the other country and the individual is a resident and a national of that country. In that situation, the compensation is taxable only by the country where the services are performed. Thus, an individual performing services for a Jamaican governmental entity ordinarily will only be taxable by Jamaica. However, if he performs the services in the United States and is a U.S. citizen and resident, he will be taxable only by the United States.

Pensions paid for services to a governmental entity of either country will generally be taxable only by that country. However, if the recipient is a resident and national of the other country, and was a national of that country at the time the services were rendered, the pension will be taxable only by that other country.

The governmental service rules do not apply in situations where the compensation or pensions are paid in connection with any business carried on by any governmental entity of either country. In such situations, the provisions applicable to the private sector apply; Articles 14 (Independent personal services), 15 (Dependent personal services), 16 (Directors' fees), 18 (Entertainers and athletes) and 19 (Pensions, etc.).

**Article 21. Students and Trainees**

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

A resident of one treaty country at the time he becomes temporarily present in the other country as an employee of, or under contract with, a resident of his home country for the primary purpose of acquiring technical, professional, or business experience from a person other than a resident of his home country or other than a person related to such resident, or studying at a university or other recognized educational institution in that other country, is eligible for the trainee exemption. This applies for a period not exceeding 12 consecutive months with respect to his income from personal services in an aggregate amount not in excess of \$7,500 or its equivalent in Jamaican dollars.

A student or trainee covered by these provisions may instead elect under the treaty to be treated for tax purposes as a resident of the host country. The election applies for the entire period that the individual is covered one year for a trainee, and it may not be revoked except with the consent of the competent authority of the host country. The purpose of the election is to permit foreign students and trainees present in the United States to qualify for benefits such as the standard deduction (the zero bracket amount), and for the dependency deductions (if applicable). For example, for U.S. tax purposes nonresident aliens are limited to one personal deduction and they are not permitted to claim the standard deduction or the dependency deduction. By electing to be taxed as U.S. residents, they may claim these deductions but, as a consequence, they are subject to U.S. tax on their worldwide income. This election would generally be advantageous for those foreign students, apprentices, and business trainees who do not have any substantial income from sources the election, he and his spouse may, also elect for the spouse to be treated as a U.S. resident pursuant to section 6013(g) of the Code.

**Article 22. Teachers and Researchers**

A resident of one country who visits the other for the purpose of teaching or engaging in research at a university, college, or other recognized educational institution is eligible for exemption from tax by the host country on compensation from that teaching or research. The exemption does not apply, however, if the visit at its inception is expected to last more than two years, and the exemption is limited to the initial two years of the visit in any event. Also, the exemption applies to income from research only if the research is undertaken by the individual in the public interest and not primarily for the benefit of

some other private person or persons. The exemption for income from teaching and research may be used by an individual only once in his lifetime.

**Article 23. Other Income**

As a general rule, any item of income, regardless of its source, which is derived by a resident of either country and which is not dealt with in one of the other articles of the treaty will be taxable only by the country of residence. However, such an item of income which is received by a resident of one country who is a citizen of the other may be taxed by both countries (Articles 1 (Personal scope)), subject to a foreign tax credit for taxes paid to the other if the other country is the country of source (Article 24 (Relief from double taxation)).

However, this general rule does not apply if the recipient of the income is a resident of one country and carries on business in the other country through a permanent establishment or a fixed base, and the right or property in respect of which the income is paid is effectively connected with the permanent establishment or fixed base. In such a case the provisions of Article 7 (Business profits), Article 14 (Independent personal services), or Article 18 (Artistes and Athletes), as the case may be, will apply.

Moreover, notwithstanding either of these rules, if a resident of one country receives income which arises in the other, the income may be taxed by that other country.

**Article 24. Relief from Double Taxation**

*In general*

One of the principal purposes for entering into an income tax treaty is to limit double taxation of income earned by a resident of one of the countries that may be taxed by the other country. The United States seeks to unilaterally mitigate double taxation by allowing U.S. taxpayers to credit the foreign income taxes that they pay against the U.S. tax imposed on their foreign source income. A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax on U.S. source income. Therefore, the foreign tax credit provisions contain a limitation that insures that the foreign tax credit only offset the U.S. tax on foreign source income. This limitation is computed on world-wide consolidated basis. Hence, all income taxes paid to all foreign countries are combined to offset U.S. taxes on all foreign income.

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

Separate limitations on the foreign tax credit are provided for certain interest, DISC dividends, and oil income.

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

*United States*

Under the proposed treaty, the United States agrees to provide its citizens and residents with a foreign tax credit against their U.S. income tax for the appropriate amount of taxes paid to Jamaica. The credit allowed for U.S. tax purposes is in accordance with the provisions and subject to the limitations of U.S. law applicable to the year in question. Under present law, the United States only allows a credit for foreign income taxes (sec. 901 of the Internal Revenue Code), or foreign taxes imposed in lieu of income taxes (Code sec. 903), and the credit is limited to the amount of the pre-credit U.S. tax which is attributable to foreign source income (Code secs. 904 and 907).

The proposed treaty also provides that a deemed-paid foreign tax credit will be made available to a U.S. company with respect to dividends from a Jamaican company in which it owns, directly or indirectly, at least 10 percent of the voting power. In this case, a credit will be allowed for the Jamaican tax paid by the Jamaican company on the profits out of which the dividend is paid. A deemed-paid foreign tax credit satisfying the treaty requirements is presently provided under the Internal Revenue Code (sec. 902).

The treaty provides that the Jamaican taxes currently covered by the treaty, and similar subsequently-enacted taxes, will be treated as "income taxes" eligible, within the statutory limits, for the credit. In the Exchange of Notes accompanying the proposed treaty, the United States agrees that if Jamaica imposes a tax on extraction and refining of bauxite which is in lieu of the company profits tax, that new tax would be covered by the treaty (and eligible for the foreign tax credit), but only if it met the requirements of section 903 of the Internal Revenue Code.

*Jamaica*

The proposed treaty similarly provides that, in accordance with and subject to the limitations of Jamaican law for the taxable year, Jamaica will allow its citizens and residents a credit against their Jamaican tax for the appropriate amount of taxes paid to the United States. Jamaica also agrees to provide an indirect credit in the case of a dividend paid by a U.S. company in which a Jamaican company has at least 10 percent of the voting power. The amount of the credit is based on the U.S. tax on the profits out of which the dividend is paid.

For the purpose of applying both the U.S. and Jamaican credits under the treaty, the treaty prescribes rules for determining the source of income.

**Article 25. Nondiscrimination**

The proposed treaty contains a comprehensive nondiscrimination provision relating to all taxes of every kind imposed at the national, state, or local level. It is similar to provisions which have been embodied in other recent U.S. income tax treaties.

Under this provision, neither country can discriminate by imposing more burdensome taxes (or other requirements connected with taxes) on citizens of the other country than it imposes on its own citizens who are in the same circumstances. This provision does not, however, require either country to grant to residents of the other country the

personal allowances, reliefs, or credits for taxation purposes on account of personal status or family responsibilities which it grants to its own residents.

Similarly, neither country may tax a permanent establishment of an enterprise of the other country less favorably than it taxes its own enterprises carrying on the same activities. In determining the taxable income of an enterprise of either country, both countries are required to allow the enterprise to deduct interest, royalties, and other disbursements paid by the enterprise to residents of the other country under the same conditions that they allow deductions for such amounts paid to residents of the same country as the enterprise. The nondiscrimination provision also applies to corporations of one country which are owned by residents of the other country.

However, nothing in the nondiscrimination article is to prevent Jamaica from charging a higher rate of income tax under section 48(5) of the Income Tax Act of Jamaica on a life insurance company which is a resident of the United States than on a regionalized life insurance company. Also, in the Exchange of Notes accompanying the proposed treaty, it is observed that Jamaica requested that the nondiscrimination provisions not prevent Jamaica from imposing special taxes in pursuance of its economic development program, even if these taxes might otherwise violate those provisions. The United States explained that it could not agree to such a provision before having the opportunity to examine the specific aspects of such legislation. The United States delegation also believed that it would be inappropriate to grant to the competent authorities the power to expand in this way the scope of the treaty by administrative action. However, the United States agreed that if at some time in the future Jamaica should enact legislation which would contravene the nondiscrimination provisions, the United States would be prepared to reopen discussions with Jamaica to determine whether it would be appropriate to except the legislation from the scope of those provisions.

The provision is not intended to restrict the right of the United States to tax foreign corporations on their dispositions of a U.S. real property interest because of effect of the provisions imposing the tax is not discriminatory. Nor is the provision intended to permit a foreign corporation to claim the benefit of U.S. statutory provisions intended to eliminate U.S. double taxation, such as the dividends received exclusion provided by section 243.

The proposed treaty, as amended by the proposed protocol, contains a provision that permits U.S. taxpayers a deduction for attending a convention in Jamaica to the extent that the expenses would be deductible if the convention were held in the U.S. Under U.S. law (Sec. 274 (h)) a U.S. taxpayer is not permitted to deduct expenses of attending a convention outside of the United States, Canada, or Mexico unless the taxpayer can establish that the locality and the purpose, activities or residences of the active members of the sponsoring organization, justified the foreign location. Initially, the provision denied deductions for conventions outside the United States. However, in 1980 the deduction was extended to conventions held in Canada and Mexico.

The proposed treaty, as amended by the proposed protocol, would permit a deduction for attendance at a convention held in Jamaica provided that the normal U.S. rules (such as business purpose) for

attending conventions in the United States are met. The provision covers only the expenses incurred for meals, lodging, and the personal sustenance and comfort of the traveler, the registration fees, including fees for the cost of materials, and the ground and air transportation to and from the convention site. These expenses are allowed to the extent otherwise allowable under U.S. law. A similar provision is included in the proposed Canadian treaty.

**Article 26. Mutual Agreement Procedure**

The proposed treaty contains the standard mutual agreement provision which authorizes the competent authority of the United States and Jamaica to consult together to attempt to alleviate individual cases of double taxation or cases of taxation not in accordance with the proposed treaty.

Under the proposed article a resident or citizen of one country who considers that the action of the countries or either of them will cause him to pay a tax not in accordance with the treaty may present his case to the competent authority of the country of which he is a resident or citizen. A resident who has a permanent establishment or fixed base in the other country may present his case to either country. The competent authority then makes a determination as to whether or not the claim has merit. If it is determined that the claim does have merit, and if the competent authority cannot unilaterally solve the problem, that authority endeavors to come to an agreement with the competent authority of the other country to limit the taxation which is not in accordance with the provisions of the treaty.

Adjustments are to be made even if the statute of limitations has run. For Jamaica, however, the competent authority must be notified of a possible adjustment before the statutory period runs.

A second provision directs the competent authorities to resolve any difficulties or doubts arising as to the interpretation of application of the proposed treaty. Specifically, they are authorized to agree as to the attribution of income deductions or credits and the readjustment of taxes, the determination as to source of income, the characterization of items of income, and to the common meaning of terms. Under this authority, the Internal Revenue Service from time to time issues rulings defining terms in a treaty.

The competent authorities are authorized to eliminate double taxation in cases not provided for in the proposed treaty.

The treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of the mutual agreement provision. This would include meeting together for an oral exchange of opinions. These provisions make clear that it is not necessary to go through normal diplomatic channels in order to discuss problems arising in the application of the treaty and also removes any doubt as to restrictions that might otherwise arise by reason of the confidentiality rules of the United States or Jamaica.

**Article 27. Exchange of Information and Administrative Assistance**

This article forms the basis for cooperation between the two countries to attempt to deal with avoidance or evasion of their respective taxes and to enable them to obtain information so that they can prop-

erly administer the treaty. The proposed treaty provides for the exchange of information which is necessary to carry out the provisions of the proposed treaty or for the prevention of fraud or for the administration of statutory provisions concerning taxes to which the convention applies. However, the exchange of information is not limited to taxes covered by the proposed treaty.

The information exchanged may relate to tax compliance generally and not merely to avoidance or evasion of tax.

Information exchanged is to be treated as secret in the same manner as information obtained under the domestic laws of the receiving country, except that it may be disclosed to persons involved in the assessment, collection, enforcement, or prosecution concerning the taxes to which the treaty applies. The information may be used for such purposes only. Accordingly, it is not clear that Congress in the exercise of its oversight responsibilities could obtain the information.

The proposed treaty contains narrow limitations on the obligations of the countries to supply requested information. A country is not required to carry out administrative measures contrary to its law or administrative practice, to supply particulars not obtainable under its laws or in the normal course of administration, or to supply information that would disclose a trade secret or the disclosure of which would be contrary to public policy.

The proposed treaty provides that a country receiving a request will endeavor to obtain the information requested the same way as if its own taxation was involved. The country would be obligated to obtain the information even if it does not, at that time, need the information. A requested country will use its subpoena or summons powers and any other powers that it has under its own laws to collect information requested by the other country, even though it itself does not need that information for its own purposes. The requested competent authority will attempt to provide the information requested in the form requested. Specifically, the competent authority will attempt to provide depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts or writings) to the extent that they can be obtained under the laws and practices of the requested country in the enforcement of its own tax laws.

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

It is understood that in obtaining information a requested country will use the powers and procedures that it has available to it under its laws, even if the requesting country does not have similar powers and procedures for obtaining the information. Thus, it is not intended that provision be strictly reciprocal. For example, once the U.S. Internal Revenue Service has referred a case to the Justice Department for possible criminal prosecution, the United States investigators can no

longer use an administrative summons to obtain information. If, however, Jamaica could still use administrative process to obtain requested information, it would be expected to do so even though the U.S. cannot. The U.S. could not, however, tell Jamaica which of its procedures to use.

**Article 28. Diplomatic Agents and Consular Officials**

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the taxation privileges of diplomatic and consular officials under the general rules of international law or the provisions of special agreements.

**Article 29. Entry into Force**

The proposed treaty will enter into force upon the exchange of instruments of ratification. It will take effect with respect to income of taxable years beginning on or after the first day of January of the year after the year in which it enters into force and with respect to taxes payable at the source on or after the first day of the second month after the month in which it enters into force. As the provisions of the proposed treaty come into effect, the corresponding provisions of the extension to Jamaica of the 1945 treaty between the United States and the United Kingdom will terminate.

**Article 30. Termination**

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 months' prior notice through diplomatic channels. Such a termination will be effective with respect to income of taxable years beginning (or, in the case of withholding taxes, amounts paid or credited) on or after January 1 next following the expiration of the 6-month period.

**Exchange of Notes**

In notes exchanged at the time of the signing of the treaty, the United States offered assurances to Jamaica that, when circumstances permitted, the United States would be prepared to resume discussions with a view to incorporating provisions into the treaty, consistent with U.S. income tax policies regarding other developing countries, which will minimize the interference of the United States tax system with incentives offered by the Government of Jamaica.

The Notes also dealt with issues under the nondiscrimination provisions (discussed previously under Article 25 (Nondiscrimination)) and the status of a possible Jamaican tax on bauxite extraction and refining (discussed previously under Article 2 (Taxes covered) and Article 24 (Relief from double taxation)).

**Protocol**

**Explanation**

After the proposed treaty was signed, a proposed protocol modifying the proposed treaty as signed. Also, notes were exchanged in connection with the signing of the proposed protocol. The proposed protocol adds a new provision which would permit U.S. citizens to

educt expenses of attending business conventions in Jamaica. This provision is discussed in more detail under the discussion of Article 25 (Nondiscrimination). Also, the proposed protocol contains two provisions intended to limit potential abuse of the convention by denying treaty benefits in situations where those benefits were not intended. First, it makes it clear that the United States can continue to tax former citizens who reside in Jamaica under the Internal Revenue Code. Second, it contains a far-reaching provision denying treaty benefits to residents of third countries who establish a corporation or other entities in either Jamaica or the United States for the principal purpose of obtaining treaty benefits from the other countries. This provision is discussed in more detail in discussion of Article 17.

***Exchange of notes under the protocol***

The notes state that the antitreaty shopping provision contained in the protocol is not intended to impede the bona fide investment in Jamaica by residents of third countries. Also, the notes commit the two countries to enter into negotiation of new treaties on extradition and mutual assistance on criminal matters.

The protocol will enter into force upon the exchange of instruments of ratification and will become effective in accordance with the provisions of the proposed treaty.