[JOINT COMMITTEE PRINT]

EXPLANATION OF PROPOSED INCOME TAX TREATY AND PROPOSED PROTOCOL BETWEEN THE UNITED STATES AND THE REPUBLIC OF VENEZUELA

SCHEDULED FOR A HEARING

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INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, describes the proposed income tax treaty, as supplemented by the proposed protocol, between the United States of America and the Republic of Venezuela ("Venezuela"). The proposed treaty and proposed protocol were signed on January 25, 1999.[2] The Senate Committee on Foreign Relations has scheduled a public hearing on the proposed treaty and proposed protocol on October 13, 1999.

Part I of the pamphlet provides a summary with respect to the proposed treaty and proposed protocol. Part II provides a brief overview of U.S. tax laws relating to international trade and investment and of U.S. income tax treaties in general. Part III contains an article-by-article explanation of the proposed treaty and proposed protocol. Part IV contains a discussion of issues with respect to the proposed treaty and proposed protocol.

[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of Proposed Income Tax Treaty and Proposed Protocol Between the United States and the Republic of Venezuela* (JCS–10–99), October 8, 1999.

[2] For a copy of the proposed treaty and proposed protocol, see Senate Treaty Doc. 106–3, June 29, 1999.

I. SUMMARY

The principal purposes of the proposed income tax treaty between the United States and Venezuela are to reduce or eliminate double taxation of income earned by residents of either country from sources within the other country and to prevent avoidance or evasion of the taxes of the two countries. The proposed treaty also is intended to promote close economic cooperation between the two countries and to eliminate possible barriers to trade and investment caused by overlapping taxing jurisdictions of the two countries.

As in other U.S. tax treaties, these objectives principally are achieved through each country's agreement to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other country.

For example, the proposed treaty contains provisions under which each country generally agrees not to tax business income derived from sources within that country by residents of the other country unless the business activities in the taxing country are substantial enough to constitute a permanent establishment or fixed base (Articles 7 and 14). Similarly, the proposed treaty contains "commercial visitor" exemptions under which residents of one country performing personal services in the other country will not be required to pay tax in the other country unless their contact with the other country exceeds specified minimums (Articles 14, 15, 18 and 21). The proposed treaty provides that dividends, interest, royalties, and certain capital gains derived by a resident of either country from sources within the other country generally may be taxed by both countries (Articles 10, 11, 12 and 13); however, the rate of tax that the source country may impose on a resident of the other country on dividends, interest, and royalties generally will be limited by the proposed treaty (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 proposed treaty generally provides for relief from the potential double taxation through the allowance by the country of residence of a tax credit for certain foreign taxes paid to the other country, or alternatively, in the case of Venezuela, an exemption from Venezuelan income tax (Article 24).

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

The proposed treaty also contains a detailed limitation on benefits provision to prevent the inappropriate use of the treaty by third-country residents (Article 17).

No income tax treaty between the United States and Venezuela is in force at present. The proposed treaty is similar to other recent U.S. income tax treaties, the 1996 U.S. model income tax treaty ("U.S. model"), the model income tax treaty of the Organization for Economic Cooperation and Development ("OECD model"), and the United Nations Model Double Taxation Convention between Developed and Developing Countries (the "U.N. model"). However, the proposed treaty contains certain substantive deviations from those treaties and models.

II. OVERVIEW OF U.S. TAXATION OF INTERNATIONAL TRADE AND INVESTMENT AND U.S. TAX TREATIES

This overview briefly describes certain U.S. tax rules relating to foreign income and foreign persons that apply in the absence of a U.S. tax treaty. This overview also discusses the general objectives of U.S. tax treaties and describes some of the modifications to U.S. tax rules made by treaties.

A. U.S. Tax Rules

The United States taxes U.S. citizens, residents, and corporations on their worldwide income, whether derived in the United States or abroad. The United States generally taxes nonresident alien individuals and foreign corporations on all their income that is effectively connected with the conduct of a trade or business in the United States (sometimes referred to as "effectively connected income"). The United States also taxes nonresident alien individuals and foreign corporations on certain U.S.-source income that is not effectively connected with a U.S. trade or business.

Income of a nonresident alien individual or foreign corporation that is effectively connected with the conduct of a trade or business in the United States generally is subject to U.S. tax in the same manner and at the same rates as income of a U.S. person. Deductions are allowed to the extent that they are related to effectively connected income. A foreign corporation also is subject to a flat 30–percent branch profits tax on its "dividend equivalent amount," which is a measure of the effectively connected earnings and profits of the corporation that are removed in any year from the conduct of its U.S. trade or business. In addition, a foreign corporation is subject to a flat 30–percent branch-level excess interest tax on the excess of the amount of interest that is deducted by the foreign corporation in computing its effectively connected income over the amount of interest that is paid by its U.S. trade or business.

U.S.-source fixed or determinable annual or periodical income of a nonresident alien individual or foreign corporation (including, for example, interest, dividends, rents, royalties, salaries, and annuities) that is not effectively connected with the conduct of a U.S. trade or business is subject to U.S. tax at a rate of 30 percent of the gross amount paid. Certain insurance premiums earned by a nonresident alien individual or foreign corporation are subject to U.S. tax at a rate of 1 or 4 percent of the premiums. These taxes generally are collected by means of withholding.

Specific statutory exemptions from the 30–percent withholding tax are provided. For example, certain original issue discount and certain interest on deposits with banks or savings institutions are exempt from the 30–percent withholding tax. An exemption also is provided for certain interest paid on portfolio debt obligations. In

addition, income of a foreign government or international organization from investments in U.S. securities is exempt from U.S. tax.

U.S.-source capital gains of a nonresident alien individual or a foreign corporation that are not effectively connected with a U.S. trade or business generally are exempt from U.S. tax, with two exceptions: (1) gains realized by a nonresident alien individual who is present in the United States for at least 183 days during the taxable year, and (2) certain gains from the disposition of interests in U.S. real property.

Rules are provided for the determination of the source of income. For example, interest and dividends paid by a U.S. citizen or resident or by a U.S. corporation generally are considered U.S.-source income. Conversely, dividends and interest paid by a foreign corporation generally are treated as foreign-source income. Special rules apply to treat as foreign-source income (in whole or in part) interest and dividends paid by certain U.S. corporations with foreign businesses and to treat as U.S.-source income (in whole or in part) dividends paid by certain foreign corporations with U.S. businesses. Rents and royalties paid for the use of property in the United States are considered U.S.-source income.

Because the United States taxes U.S. citizens, residents, and corporations on their worldwide income, double taxation of income can arise when income earned abroad by a U.S. person is taxed by the country in which the income is earned and also by the United States. The United States seeks to mitigate this double taxation generally by allowing U.S. persons to credit foreign income taxes paid 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 liability on U.S.-source income. Therefore, the foreign tax credit provisions contain a limitation that ensures that the foreign tax credit offsets only the U.S. tax on foreign-source income. The foreign tax credit limitation generally is computed on a worldwide basis (as opposed to a "per-country" basis). The limitation is applied separately for certain classifications of income. In addition, a special limitation applies to the credit for foreign taxes imposed on foreign oil and gas extraction income.

For foreign tax credit purposes, a U.S. corporation that owns 10 percent or more of the voting stock of a foreign corporation and receives a dividend from the foreign corporation (or is otherwise required to include in its income earnings of the foreign corporation) is deemed to have paid a portion of the foreign income taxes paid by the foreign corporation on its accumulated earnings. The taxes deemed paid by the U.S. corporation are included in its total foreign taxes paid and its foreign tax credit limitation calculations for the year the dividend is received.

B. U.S. Tax Treaties

The traditional objectives of U.S. tax treaties have been the avoidance of international double taxation and the prevention of tax avoidance and evasion. Another related objective of U.S. tax treaties is the removal of the barriers to trade, capital flows, and commercial travel that may be caused by overlapping tax jurisdictions and by the burdens of complying with the tax laws of a jurisdiction when a person's contacts with, and income derived from,

that jurisdiction are minimal. To a large extent, the treaty provisions designed to carry out these objectives supplement U.S. tax law provisions having the same objectives; treaty provisions modify the generally applicable statutory rules with provisions that take into account the particular tax system of the treaty partner.

The objective of limiting double taxation generally is accomplished in treaties through the agreement of each country to limit, in 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 agreed to by the source country in treaties are premised on the assumption that the country of residence will tax the income at levels comparable to those imposed by the source country on its residents. Treaties also provide for the elimination of double taxation by requiring the residence country to allow a credit for taxes that the source country retains the right to impose under the treaty. In addition, in the case of certain types of income, treaties may provide for exemption by the residence country of income taxed by the source country.

Treaties define the term "resident" so that an individual or corporation generally will not be subject to tax as a resident by both the countries. Treaties generally provide that neither country will tax business income derived by residents of the other country unless the business activities in the taxing jurisdiction are substantial enough to constitute a permanent establishment or fixed base in that jurisdiction. Treaties also contain commercial visitation exemptions under which individual residents of one country performing personal services in the other will not be required to pay tax in that other country unless their contacts exceed certain specified minimums (*e.g.*, presence for a set number of days or earnings in excess of a specified amount). Treaties address passive income such as dividends, interest, and royalties from sources within one country derived by residents of the other country either by providing that such income is taxed only in the recipient's country of residence or by reducing the rate of the source country's withholding tax imposed on such income. In this regard, the United States agrees in its tax treaties to reduce its 30–percent withholding tax (or, in the case of some income, to eliminate it entirely) in return for reciprocal treatment by its treaty partner.

In its treaties, the United States, as a matter of policy, generally retains the right to tax its citizens and residents on their worldwide income as if the treaty had not come into effect. The United States also provides in its treaties that it will allow a credit against U.S. tax for income taxes paid to the treaty partners, subject to the various limitations of U.S. law.

The objective of preventing tax avoidance and evasion generally is accomplished in treaties by the agreement of each country to exchange tax-related information. Treaties generally provide for the exchange of information between the tax authorities of the two countries when such information is necessary for carrying out 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 that is not obtainable under its laws or in the normal course of its administration

or that would reveal trade secrets or other information the disclosure of which would be contrary to public policy. The Internal Revenue Service (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.

Administrative cooperation between countries is enhanced further under treaties by the inclusion of a "competent authority" mechanism to resolve double taxation problems arising in individual cases and, more generally, to facilitate consultation between tax officials of the two governments.

Treaties generally provide that neither country may subject nationals of the other country (or permanent establishments of enterprises of the other country) to taxation more burdensome than that it imposes on its own nationals (or on its own enterprises). Similarly, in general, neither treaty country may discriminate against enterprises owned by residents of the other country.

At times, residents of countries that do not have income tax treaties with the United States attempt to use a treaty between the United States and another country to avoid U.S. tax. To prevent third-country residents from obtaining treaty benefits intended for treaty country residents only, treaties generally contain an "anti-treaty shopping" provision that is designed to limit treaty benefits to bona fide residents of the two countries.

III. EXPLANATION OF PROPOSED TREATY AND PROPOSED PROTOCOL

A detailed, article-by-article explanation of the proposed income tax treaty between the United States and Venezuela, as supplemented by the proposed protocol, is set forth below.

Article 1. General Scope

The general scope article describes the persons who may claim the benefits of the proposed treaty. The proposed treaty generally applies to residents of the United States and to residents of Venezuela, with specific modifications to such scope provided in other articles (*e.g.*, Article 20 (Government Service), Article 25 (Non-Discrimination) and Article 27 (Exchange of Information)). The determination of whether a person is a resident of the United States or Venezuela is made under the provisions of Article 4 (Residence).

The proposed treaty provides that it does not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance accorded by internal law or by any other agreement between the United States and Venezuela. Thus, the proposed treaty will not apply to increase the tax burden of a resident of either the United States or Venezuela. According to the Treasury Department's Technical Explanation (hereinafter referred to as the "Technical Explanation"), the fact that the proposed treaty only applies to a taxpayer's benefit does not mean that a taxpayer may select inconsistently among treaty and internal law provisions in order to minimize its overall tax burden. In this regard, the Technical Explanation sets forth the following example. Assume a resident of Venezuela has three separate businesses in the United States. One business is profitable and constitutes a U.S. permanent establishment. The other two businesses generate effectively connected income as determined under the Internal Revenue Code (the "Code"), but do not constitute permanent establishments as determined under the proposed treaty; one business is profitable and the other business generates a net loss. Under the Code, all three businesses would be subject to U.S. income tax, in which case the losses from the unprofitable business could offset the taxable income from the other businesses. On the other hand, only the income of the business which gives rise to a permanent establishment is taxable by the United States under the proposed treaty. The Technical Explanation makes clear that the taxpayer may not invoke the proposed treaty to exclude the profits of the profitable business that does not constitute a permanent establishment and invoke U.S. internal law to claim the loss of the unprofitable business that does not constitute a permanent establishment to offset the taxable income of the permanent establishment.[3]

[3] See Rev. Rul. 84–17, 1984–1 C.B. 308.

The proposed treaty provides that the dispute resolution procedures under its mutual agreement procedure article (Article 26) (and not the corresponding provisions of any other agreement to which the United States and Venezuela are parties) exclusively apply in determining whether a measure is within the scope of the proposed treaty. Unless the competent authorities agree that a taxation measure is outside the scope of the proposed treaty, only the proposed treaty's nondiscrimination rules, and not the nondiscrimination rules of any other agreement in effect between the United States and Venezuela, generally apply to that law or other measure. The only exception to this general rule is such national treatment or most favored nation obligations as may apply to trade in goods under the General Agreement on Tariffs and Trade. For purposes of this provision, the term "measure" means a law, regulation, rule, procedure, decision, administrative action, or any other similar provision or action.

Like all U.S. income tax treaties and the U.S. model, the proposed treaty includes a "saving clause." Under this clause, with specific exceptions described below, the proposed treaty does not affect the taxation by either treaty country of its residents or its citizens. By reason of this saving clause, unless otherwise specifically provided in the proposed treaty, the United States will continue to tax its citizens who are residents of Venezuela as if the treaty were not in force. "Residents" for purposes of the proposed treaty (and, thus, for purposes of the saving clause) includes persons defined as such in Article 4 (Residence), including corporations and other entities as well as individuals.

The proposed protocol contains a provision under which the saving clause (and therefore the U.S. jurisdiction to tax) applies for U.S. tax purposes to a former U.S. citizen whose loss of citizenship status had as one of its principal purposes the avoidance of U.S. tax; such application is limited to the ten-year period following the loss of citizenship status. The proposed treaty also contains a provision under Article 17 (Limitation on Benefits) which denies treaty benefits to former long-term residents of the United States for ten years following the loss of such residence status if such loss of status had as one of its principal purposes the avoidance of U.S. tax. Section 877 of the Code provides special rules for the imposition of U.S. income tax on former U.S. citizens and long-term residents for a period of ten years following the loss of citizenship or resident; these special tax rules apply to a former citizen or long-term resident only if his or her loss of U.S. citizenship or resident status had as one of its principal purposes the avoidance of U.S. income, estate or gift taxes. For purposes of applying the special tax rules to former citizens and long-term residents, individuals who meet a specified income tax liability threshold or a specified net worth threshold generally are considered to have lost citizenship or resident status for a principal purpose of U.S. tax avoidance.

Exceptions to the saving clause are provided for the following benefits conferred by a treaty country: the allowance of corresponding adjustments when the profits of an associated enterprise are adjusted by the other country (Article 9, paragraph 2); relief from double taxation through the provision of a foreign tax credit or, in the case of Venezuela, an exemption of income from

tax (Article 24); protection from discriminatory tax treatment (Article 25); and benefits under the mutual agreement procedures (Article 26). These exceptions to the saving clause permit residents and citizens of the United States or Venezuela to obtain such benefits of the proposed treaty with respect to their country of residence or citizenship.

In addition, the saving clause does not apply to the following benefits conferred by one of the countries upon individuals who neither are citizens of that country nor have immigrant status in that country. Under this set of exceptions to the saving clause, the specified treaty benefits are available to, for example, a Venezuelan citizen who spends enough time in the United States to be taxed as a U.S. resident but who has not acquired U.S. immigrant status (*i.e.*, does not hold a "green card"). The benefits that are covered under this set of exceptions are the exemptions from host country tax for certain government service salaries and pensions (Article 20), certain income received by visiting students, trainees, teachers and researchers (Article 21), and certain income of diplomats and consular officers (Article 28).

Article 2. Taxes Covered

The proposed treaty generally applies to the income taxes of the United States and Venezuela. However, Article 27 (Exchange of Information) generally is applicable to all taxes imposed by the United States and by Venezuela.

In the case of the United States, the proposed treaty applies to the Federal income taxes imposed by the Code, but excludes social security taxes. Unlike many U.S. income tax treaties in force, but like the U.S. model, the proposed treaty applies to the accumulated earnings tax and the personal holding company tax. The proposed treaty generally does not apply to any U.S. State or local income taxes; however, Article 25 (Non-Discrimination) applies to all taxes, including those imposed by state or local governments.

In the case of Venezuela, the proposed treaty generally applies to the income tax and the business assets tax. Under Article 24 (Relief from Double Taxation), however, the United States is not required under the proposed treaty to grant a U.S. foreign tax credit for business assets taxes paid to Venezuela.

The proposed treaty also contains a rule generally found in U.S. income tax treaties and the U.S., OECD and U.N. models which provides that the proposed treaty applies to any identical or substantially similar taxes that are imposed subsequently in addition to or in place of the taxes covered. The proposed treaty obligates the competent authority of each country to notify the competent authority of the other country of any significant changes in its internal tax laws, and of any official published material concerning the application of the proposed treaty. The Technical Explanation states that the term "significant" means that changes must be reported that are significant to the operation of the proposed treaty.

Article 3. General Definitions

The proposed treaty provides definitions of a number of terms for purposes of the proposed treaty. Certain of the standard definitions

found in most U.S. income tax treaties are included in the proposed treaty.

The term "Venezuela" means the Republic of Venezuela.

The term "United States" means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam, or any other U.S. possession or territory. The Technical Explanation states that the term "United States" includes the territorial seas of the United States.

The proposed protocol provides that when referred to in the geographical sense, "Venezuela" and "United States" include the areas of the seabed and subsoil adjacent to their respective territorial seas in which they may exercises rights in accordance with domestic legislation and international laws. The Technical Explanation states that the extension of these terms to areas adjacent to the territorial seas of the United States and Venezuela (as the case may be) applies to the extent that the United States or Venezuela exercises sovereignty in accordance with domestic legislation and international law for the purpose of natural resource exploration and exploitation of such areas. The Technical Explanation further states that the extension of such terms applies only if the person, property or activity to which the proposed treaty is being applied is connected with such natural resource exploration or exploitation.

The terms "a Contracting State" and "the other Contracting State" mean the United States or Venezuela, according to the context in which such terms are used.

The term "person" includes an individual, an estate, a trust, a partnership, a company, and any other body of persons. The Technical Explanation states that the term "person" includes Venezuelan "entidades" or "colectividades," which are not legal persons under Venezuelan law, but are taxable persons for Venezuelan tax purposes.

A "company" under the proposed treaty is any body corporate or any entity which is treated as a body corporate for tax purposes.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean, respectively, an enterprise carried on by a resident of a treaty country and an enterprise carried on by a resident of the other treaty country. The terms also include an enterprise carried on by a resident of a treaty country through an entity (such as a partnership) that is treated as fiscally transparent in that country. The Technical Explanation states that the definition in the proposed treaty is intended to make clear that an enterprise conducted by a fiscally transparent entity will be treated as carried on by a resident of a treaty country to the extent its partners or other owners are residents. The proposed treaty does not define the term "enterprise." The Technical Explanation states that the term "enterprise" generally is understood to refer to any activity or set of activities that constitutes a trade or business.

The proposed treaty provides that the term "national" means any individual possessing the nationality of the United States or Venezuela, and any legal person, association or other entities (including a Venezuelan "entidad" or "colectividad") deriving their status as such from the laws in force in the United States or Venezuela.

The term “international operation of ships or aircraft” means any transport by a ship or aircraft, except when such transport is solely between places within a country. This definition principally applies in the context of Article 8 (Shipping and Air Transport), which refers to the term “operation of ships or aircraft in international traffic.” The Technical Explanation states that such terms are understood to have the same meaning. The Technical Explanation also states that transport that constitutes international traffic includes any portion of the transport that is between two points within a country, even if the internal portion of the transport involves a transfer to a land vehicle or is handled by an independent contractor (provided that the original bills of lading include such portion of the transport).

The U.S. “competent authority” is the Secretary of the Treasury or his delegate. The U.S. competent authority function has been delegated to the Commissioner of Internal Revenue, who has redelegated the authority to the Assistant Commissioner (International). On interpretative issues, the latter acts with the concurrence of the Associate Chief Counsel (International) of the IRS. The Venezuelan “competent authority” is the Integrated National Service of Tax Administration (Servicio Nacional Integrado de Administracion Tributaria—SENIAT), its authorized representative or the authority which is designated by the Ministry of Finance as a competent authority.

The proposed treaty also contains the standard provision that, unless the context otherwise requires or the competent authorities agree to a common meaning pursuant to the provisions of the mutual agreement procedures of the proposed treaty (Article 26), all terms not defined in the proposed treaty have the meaning that they have under the laws of the country concerning the taxes to which the proposed treaty applies.

Article 4. Residence

The assignment of a country of residence is important because the benefits of the proposed treaty generally are available only to a resident of one of the treaty countries as that term is defined in the proposed treaty. Furthermore, issues arising because of dual residency, including situations of double taxation, may be avoided by the assignment of one treaty country as the country of residence when under the internal laws of the treaty countries a person is a resident of both countries.

Internal taxation rules

United States

Under U.S. law, the residence of an individual is important because a resident alien, like a U.S. citizen, is taxed on his or her worldwide income, while a nonresident alien is taxed only on certain U.S.-source income and on income that is effectively connected with a U.S. trade or business. An individual who spends sufficient time in the United States in any year or over a three-year period generally is treated as a U.S. resident. A permanent resident for immigration purposes (*i.e.*, a “green card” holder) also is treated as a U.S. resident.

Under U.S. law, a company is taxed on its worldwide income if it is a "domestic corporation." A domestic corporation is one that is created or organized in the United States or under the laws of the United States, a State, or the District of Columbia.

Venezuela

Under Venezuelan law, individuals and corporations generally are taxed under a territorial-based system, that is, based on income from sources in Venezuela. The sourcing rules of Venezuela's territorial system generally apply to residents and nonresidents. However, the tax rates imposed on Venezuelan source income, as well as the manner in which the income is taxed (*e.g.*, on a net or gross basis), differ for Venezuelan residents and nonresidents. Individuals are considered to be residents of Venezuela if they are present in Venezuela for more than 180 days in the current or preceding calendar year. A Venezuelan corporation is one that is registered under a commercial registry in Venezuela (*i.e.*, incorporated in Venezuela).

Proposed treaty rules

The proposed treaty provides rules to determine whether a person is a resident of the United States or Venezuela for purposes of the proposed treaty.

The proposed treaty generally defines "resident of a Contracting State" separately in the case of the United States and Venezuela, respectively, to determine whether a person is a resident of the United States or a resident of Venezuela for purposes of the proposed treaty. The Technical Explanation states that these separate definitions are provided due to differences in the structure of the U.S. and Venezuelan tax systems.

Under the proposed treaty, a resident of the United States means any person who, under the laws of the United States, is liable to tax in the United States by reason of the person's domicile, residence, citizenship, place of incorporation, or any other criterion of a similar nature. The proposed treaty provides that a U.S. citizen or an alien admitted lawfully to the United States for permanent residence (a "green card" holder), who is not a resident of Venezuela under the basic residence rules, will be treated as a U.S. resident only if such individual has a permanent home or habitual abode in the United States. If such individual is a resident of Venezuela under the basic residence rules, he or she is considered to be a resident of both countries and his or her residence for purposes of the proposed treaty is determined under the tie-breaker rules described below.

Under the proposed treaty, a resident of Venezuela means any resident individual ("domiciliado"), any legal person that is created or organized under the laws of Venezuela, and any entity or collectivity ("entidad o colectividad") formed under the laws of Venezuela which is not a legal person but is subject to the taxation applicable to corporations in Venezuela. The Technical Explanation states that those entidades and colectividades that are not taxed as corporations in Venezuela are treated as fiscally transparent entities under Venezuelan law and, thus, are subject to the special rules for such fiscally transparent entities described below.

The proposed protocol provides that the term "resident of a Contracting State" also includes the United States or Venezuela and any of its political subdivisions or local authorities.

The proposed protocol also provides a special rule to treat as residents of a treaty country certain organizations that generally are exempt from tax in that country. Under this rule, pension trusts and any other organizations that are constituted and operated exclusively to provide pension benefits, or for religious, charitable, scientific, artistic, cultural, or educational purposes and that are residents of that country according to its laws, are treated as residents of such country notwithstanding that all or part of its income may be exempt from tax under the domestic law of that country.

The proposed treaty provides a special rule for fiscally transparent entities. Under this rule, an item of income, profit or gain derived through an entity that is fiscally transparent under the laws of either country will be considered to be derived by a resident of a country to the extent that the item is treated, for purposes of the tax laws of such country, as the income, profit, or gain of a resident of such country. The Technical Explanation states that in the case of the United States, such fiscally transparent entities include partnerships, common investment trusts under section 584 of the Code, grantor trusts and U.S. limited liability companies treated as partnerships for U.S. tax purposes. For example, if a corporation resident in Venezuela distributes a dividend to an entity treated as fiscally transparent for U.S. tax purposes, the dividend will be considered to be derived by a resident of the United States only to the extent that U.S. tax laws treat one or more U.S. residents (whose status as U.S. residents is determined under U.S. tax laws) as deriving the dividend income for U.S. tax purposes.

The Technical Explanation states that these rules for income derived through fiscally transparent entities apply regardless of where the entity is organized (*i.e.*, in the United States, Venezuela, or a third country). The Technical Explanation also states that these rules apply even if the entity is viewed differently under the tax laws of the other country. As an example, the Technical Explanation states that income from Venezuelan sources received by an entity organized under the laws of Venezuela, which is treated for U.S. tax purposes as a corporation and is owned by a U.S. shareholder who is a U.S. resident for U.S. tax purposes, is not considered derived by the shareholder of that corporation, even if under the tax laws of Venezuela the entity is treated as fiscally transparent. Rather, for purposes of the proposed treaty, the income is treated as derived by the Venezuelan entity.

Dual residents

Individuals

A set of "tie-breaker" rules is provided to determine residence in the case of an individual who, under the basic residence rules, would be considered to be a resident of both countries. Under these rules, an individual is deemed to be a resident of the country in which he or she has a permanent home available. If the individual has a permanent home in both countries, the individual's residence is deemed to be the country with which his or her personal and eco-

nomic relations are closer (*i.e.*, his or her "center of vital interests"). If the country in which the individual has his or her center of vital interests cannot be determined, or if he or she does not have a permanent home available in either country, he or she is deemed to be a resident of the country in which he or she has an habitual abode. If the individual has an habitual abode in both countries or in neither country, he or she is deemed to be a resident of the country of which he or she is a national. If the individual is a national of both countries or neither country, the competent authorities of the countries will settle the question of residence by mutual agreement.

Entities

In the case of any person other than an individual that is a resident of both countries under the basis residence rules, the proposed treaty requires the competent authorities to settle the issue of residence by mutual agreement and to determine the mode of application of the proposed treaty to such person. Under the proposed treaty, if the competent authorities are unable to make such a determination, the person will not be considered a resident of either country and, thus, will not be granted benefits under the proposed treaty.

Article 5. Permanent Establishment

The proposed treaty contains a definition of the term "permanent establishment" that generally follows the pattern of other recent U.S. income tax treaties, the U.S. model, the OECD model and the U.N. model.

The permanent establishment concept is one of the basic devices used in income tax treaties to limit the taxing jurisdiction of the host country and, thus, to mitigate double taxation. Generally, an enterprise that is a resident of one country is not taxable by the other country on its business profits 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 apply, or whether those items of income will be taxed as business profits.

In general, under the proposed treaty, a permanent establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on. A permanent establishment includes a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources. It also includes a building site or construction or installation project, or an installation or drilling rig or ship used for the exploration of natural resources, but only if such site, project, or activities continue for more than 183 days within any 12–month period beginning or ending in the taxable year concerned. The Technical Explanation states that the 183–day test applies separately to each individual site or project, with a series of contracts or projects that are interdependent both commercially and geographically treated as a single project. The Technical Explanation further states that if the 183–day threshold is exceeded, the site or project constitutes a per-

manent establishment as of the first day of activity. The 183–day period for establishing a permanent establishment in connection with a site, project, rig, or ship is significantly shorter than the twelve-month period provided in the corresponding rule of the U.S. and OECD models, but is the same as the periods contained in the U.N. model and U.S. treaties with some other countries.

The proposed protocol provides that it is understood that if an enterprise which is a general contractor undertakes the performance of a comprehensive project and subcontracts parts of such project to a subcontractor, the time spent by such subcontractor is considered to be time spent by the general contractor for purposes of the 183–day test. The subcontractor will have a permanent establishment only if its activities satisfy the 183–day test. The proposed protocol provides that the 183–day period begins as of the date on which the construction activity itself begins, and does not take into account time spent solely on preparatory activities such as obtaining permits.

The proposed treaty further provides that a permanent establishment includes the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if the activities of that nature continue (for the same or a connected project) within that country for a period or periods aggregating more than 183 days within any 12–month period beginning or ending in the taxable year concerned. This rule regarding the performance of services as constituting a permanent establishment is not contained in the U.S. or OECD models. A similar rule is contained in the U.N. model.

Under the proposed treaty, the following activities are deemed not to constitute a permanent establishment: the use of facilities solely for storing, displaying, or delivering goods or merchandise belonging to the enterprise; the maintenance of a stock of goods or merchandise belonging to the enterprise solely for storage, display, or delivery, or solely for processing by another enterprise; the maintenance of a fixed place of business solely for the purchase of goods or merchandise or for the collection of information for the enterprise; the maintenance of a fixed place of business solely for the purpose of carrying on for the enterprise any other activity of a preparatory or auxiliary character; and the maintenance of a fixed place of business solely for the purpose of any combination of the forgoing activities described above, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character. The proposed protocol provides that it is understood that in order for these rules to apply, the activities described above that are conducted by a resident of a country must each be of a preparatory or auxiliary character. Thus, maintaining sales personnel in a country would not be an activity excepted from treatment as a permanent establishment under these rules, and, if other requirements of the permanent establishment article are satisfied, would constitute a permanent establishment. The Technical Explanation gives advertising and supplying information as examples of preparatory and auxiliary activities that would not give rise to a permanent establishment. The rules in the proposed treaty are similar to the rule in the OECD

model. Unlike the proposed treaty and the OECD model, the U.S. model provides that the maintenance of a fixed place of business solely for any combination of the above-listed activities does not constitute a permanent establishment, without requiring that the overall combination of activities be of a preparatory or auxiliary character.

If a person, other than an independent agent, is acting on behalf of an enterprise and has and habitually exercises in a country the authority to conclude contracts in the name of the enterprise, the enterprise generally will be deemed to have a permanent establishment in that country in respect of any activities that person undertakes for the enterprise. This rule does not apply where the activities of such person are limited to those activities specified above, such as storage or display of merchandise, which do not constitute a permanent establishment.

Under the proposed treaty, no permanent establishment is deemed to arise merely because the enterprise carries on business in a country through a broker, general commission agent, or any other agent of independent status, provided that such persons are acting in the ordinary course of their business. Unlike the U.S. model, but similar to the U.N. model, the proposed treaty provides that when the activities of such agent are devoted wholly or almost wholly on behalf of that enterprise and the transactions between the agent and the enterprise are not made under arm's length conditions, such agent will not be considered to be an independent agent for purposes of the foregoing rule.

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

Article 6. Income from Immovable Property (Real Property)

This article covers income from real property. The rules in Article 13 (Gains) cover gains from the sale of real property.

Under the proposed treaty, income derived by a resident of one country from immovable property (real property), including income from agriculture or forestry, situated in the other country may be taxed in the country where the property is located. This rule is consistent with the rules in the U.S., OECD and U.N. models.

The term "immovable property (real property)" has the meaning which it has under the law of the country in which the property in question is situated.[4] The proposed treaty specifies that the term in any case includes property accessory to immovable property (real property); livestock and equipment used in agriculture and forestry; rights to which the provisions of general law respecting landed property apply; usufruct of immovable property (real property); and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources. Ships, boats, and aircraft are not considered to be immovable property (real property).

[4] In the case of the United States, the term is defined in Treas. Reg. sec. 1.897–1(b).

The proposed treaty specifies that the country in which the property is situated may tax income derived from the direct use, letting, or use in any other form of immovable property (real property). The proposed treaty further provides that the rules of this article permitting source-country taxation apply to the income from immovable property (real property) of an enterprise and to income from immovable property (real property) used for the performance of independent personal services.

Similar to the U.S. model and other U.S. income tax treaties, the proposed treaty provides residents of a country with an election to be taxed by the other country on a net basis on income from real property in that country, as if such income were business profits attributable to a permanent establishment in such other country (where such treatment is not otherwise allowed). Such election is binding for the taxable year and all subsequent taxable years unless the competent authority of the country in which the property is situated agrees to terminate the election. U.S. internal law provides such a net-basis election in the case of income of a foreign person from U.S. real property (Code secs. 871(d) and 882(d)).

Article 7. Business Profits

U.S. internal law

U.S. law distinguishes between the U.S. business income and the other U.S. income of a nonresident alien or foreign corporation. A nonresident alien or foreign corporation is subject to a flat 30–percent rate (or lower treaty rate) of tax on certain 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 income (from any source) which is effectively connected with the conduct of a trade or business within the United States.

The treatment of income as effectively connected with a U.S. trade or business depends upon whether the source of the income is U.S. or foreign. In general, U.S.-source periodic income (such as interest, dividends, rents, and wages) and U.S.-source capital gains are effectively connected with the conduct of a trade or business within the United States 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 of a person engaged in a trade or business in the United States is treated as effectively connected with the conduct of a trade or business in the United States (under what is referred to as the “force of attraction” rule).

Foreign-source income generally 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 are considered to be effectively connected income: rents and royalties for the use of certain intangible property derived from the active conduct of a U.S. business; certain dividends and interest either derived in the active conduct of a banking, financing, or similar business in the United States or received by a corporation the principal

business of which is trading in stocks or securities for its own account; and certain sales income attributable to a U.S. sales office. Special rules apply for purposes of determining the foreign-source income that is effectively connected with a U.S. business of an insurance company.

Any income or gain of a foreign person for any taxable year that is attributable to a transaction in another year is treated as effectively connected with the conduct of a U.S. trade or business if it would have been so treated had it been taken into account in that other year (Code sec. 864(c)(6)). In addition, if any property ceases to be used or held for use in connection with the conduct of a trade or business within the United States, the determination of whether any income or gain attributable to a sale or exchange of that property occurring within ten years after the cessation of business is effectively connected with the conduct of a trade or business within the United States is made as if the sale or exchange occurred immediately before the cessation of business (Code sec. 864(c)(7)).

Proposed treaty limitations on internal law

Business profits subject to host country tax

Under the proposed treaty, the business profits of an enterprise of one of the countries are taxable in the other country if the enterprise carries on business through a permanent establishment within the other country, but only so much of the business profits that is attributable to that permanent establishment.

The taxation of business profits under the proposed treaty differs from U.S. internal law rules for taxing business profits primarily by requiring more than merely being engaged in a trade or business before a country can tax business profits and by substituting an "attributable to" standard for the Code's "effectively connected" standard. Under the proposed treaty, some level of fixed place of business would have to be present and the business profits generally would have to be attributable to that fixed place of business.

The proposed treaty provides that there will be attributed to a permanent establishment the business profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions. The Technical Explanation states that amounts may be attributed to the permanent establishment whether or not they are from sources within the country in which the permanent establishment is located.

Nothing in this article will affect the application of any law of a country relating to the determination of the tax liability of a person in cases where the information available to the competent authority of that country is inadequate to determine the profits to be attributed to a permanent establishment. In such cases, the determination of the profits of the permanent establishment must be consistent with the principles stated in this article (*i.e.*, to reflect arm's length pricing and appropriate deductions of expenses).

Treatment of expenses

In computing taxable business profits, the proposed treaty provides that deductions are allowed for expenses, wherever incurred,

which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred. However, no deductions are allowed for amounts paid by the permanent establishment to its head office or other offices of the enterprise (other than reimbursement for actual expenses) by way of royalties, fees, or other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or by way of interest for loans to the permanent establishment. The Technical Explanation states that there should be no profit element in such intra-company transfers. Similarly, no account is taken for amounts charged by the permanent establishment to its head office or other offices of the enterprise (other than reimbursement for actual expenses) by way of royalties, fees, or other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or by way of interest for loans to the head office of the enterprise or any other of its offices. The Technical Explanation states that a permanent establishment may not increase its business profits by the amount of any notional fees for ancillary services performed for another unit of the enterprise, and also may not deduct expenses in providing such services, because those expenses would be incurred for purposes of a business unit other than the permanent establishment.

A country may, consistent with its law, impose limitations on deductions taken by the permanent establishment so long as these limitations are consistent with the concept of net income. The Technical Explanation states that this rule would not permit the countries to deny a deduction for wages and interest expenses because such expenses are so fundamental that denial of such deductions would be inconsistent with the concept of net income.

The proposed protocol provides that expenses allowed as a deduction include a reasonable allocation of expenses, including executive and general administrative expenses, research and development expenses, interest, and other expenses incurred in the taxable year for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), regardless of where incurred. However, such expenses are allowed as deductions only to the extent that such expenses have not been deducted by such enterprise and are not reflected in other deductions allowed to the permanent establishment, such as the deduction for cost of goods sold or the value of the purchases. The proposed protocol provides that the allocation of expenses must be accomplished in a manner that reflects to a reasonably close extent the factual relationship between the deduction and the permanent establishment and the enterprise. The proposed protocol provides examples of bases and factors which may be considered, including but not limited to: (1) comparison of units sold; (2) comparison of the amount of gross sales or receipts; (3) comparison of cost of goods sold; (4) comparison of profit contribution; (5) comparison of expenses incurred, assets used, salaries paid, space utilized, and time spent that are attributable to the activities of the permanent establish-

ment; and (6) comparison of gross income.[5] The Technical Explanation states that these rules permit (but do not require) each country to apply the type of expense allocation rules provided by U.S. law, such as in Treas. Reg. secs. 1.861–8 and 1.882–5.

The proposed protocol provides that research and development expenses incurred with respect to the same product line may be allocated to a permanent establishment based on gross receipts (*i.e.*, the ratio of gross receipts of the permanent establishment to the total gross receipts of the enterprise with respect to that product line). The proposed protocol further provides that Venezuela will not allow a deduction with respect to any expenses allocable to income not subject to tax in Venezuela under its territorial system of taxation.

Other rules

Business profits are not attributed to a permanent establishment merely by reason of the mere purchase of goods or merchandise by the permanent establishment for 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 are not increased by a profit element in its purchasing activities.

The business profits attributable to a permanent establishment must be determined under the same method each year unless there is a good and sufficient reason to the contrary. The Technical Explanation states that this rule does not restrict a treaty country from imposing additional requirements, such as the rules under Code section 481, to prevent amounts from being duplicated or omitted following a change in accounting method.

The proposed treaty provides that business profits attributable to a permanent establishment include only the profits or losses derived from the assets or activities of the permanent establishment. The proposed treaty does not incorporate the limited force of attraction rule of Code section 864(c)(3). The proposed treaty is consistent with the U.S. model and other existing U.S. treaties in this regard.

Where business profits include items of income that are dealt with separately in other articles of the proposed treaty, those other articles, and not the business profits article, govern the treatment of those items of income (except where such other articles specifically provide to the contrary). Thus, for example, dividends are taxed under the provisions of Article 10 (Dividends), and not as business profits, except as specifically provided in Article 10.

The proposed treaty incorporates the rule of Code section 864(c)(6) and provides that any income or gain attributable to a permanent establishment or a fixed base during its existence is taxable in the country where the permanent establishment or fixed base is located even though payments are deferred until after the permanent establishment or fixed base has ceased to exist. This rule applies with respect to business profits (Article 7, paragraphs 1 and 2), dividends (Article 10, paragraph 6), interest (Article 11, paragraph 6), royalties (Article 12, paragraph 4), gains (Article 13,

[5] These bases and factors are taken from those described in Temp. Treas. Reg. sec. 1.861–8T(c)(1).

paragraph 3), independent personal services income (Article 14), and other income (Article 22, paragraph 2).

Article 8. Shipping and Air Transport

Article 8 of the proposed treaty covers income from the operation or rental of ships, aircraft, and containers in international traffic. The rules governing income from the disposition of ships, aircraft, and containers are contained in Article 13 (Gains).

The United States generally taxes 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 income is earned by a corporation that is organized in, or an alien individual who is resident in, a foreign country that grants an equivalent exemption to U.S. corporations and residents. The United States has entered into agreements with a number of countries providing such reciprocal exemptions.

The proposed treaty provides that profits which are derived by an enterprise of one country from the operation in international traffic of ships or aircraft are taxable only in that country, regardless of the existence of a permanent establishment in the other country. International traffic means any transport by a ship or aircraft, except where the transport is solely between places in the other country.

The proposed treaty provides that profits from the rental of ships or aircraft on a full (time or voyage) basis constitute profits from the operation of ships or aircraft. Thus, such profits from the rental of ships or aircraft for use in international traffic are exempt from tax in the other country. In addition, the proposed treaty provides that profits from the operation of ships or aircraft include profits derived from the rental of ships or aircraft on a bareboat basis if such ships or aircraft are operated in international traffic by the lessee or if such rental profits are incidental to profits from the operation of ships or aircraft in international traffic. The proposed treaty further provides that profits derived by an enterprise from the inland transport of property or passengers within either country is treated as profits from the operation of ships or aircraft in international traffic if such transport is undertaken as part of international traffic.

Like the U.S. model, the proposed treaty provides that profits derived by an enterprise of a country from the use, maintenance, or rental of containers (including trailers, barges, and related equipment for the transport of containers) used in international traffic are taxable only in that country.

Like the U.S. model, the shipping and air transport provisions of the proposed treaty also apply to profits from participation in a pool, joint business, or international operating agency. This rule covers profits derived pursuant to an arrangement for international cooperation between carriers in shipping and air transport.

The proposed protocol provides that this article will not affect the provisions of the December 29, 1987, agreement between the United States and Venezuela for the avoidance of double taxation with respect to shipping and air transport.

Article 9. Associated Enterprises

The proposed treaty, like most other U.S. tax treaties, contains an arm's-length pricing provision. The proposed treaty recognizes the right of each country to make an allocation of profits to an enterprise of that country in the case of transactions between related enterprises, if conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises. In such a case, a country may allocate to such an enterprise the profits which it would have accrued but for the conditions so imposed. This treatment is consistent with the U.S. model.

For purposes of the proposed treaty, an enterprise of one country is related to an enterprise of the other country if one of the enterprises participates directly or indirectly in the management, control, or capital of the other enterprise. Enterprises are also related if the same persons participate directly or indirectly in their management, control, or capital.

Under the proposed treaty, when a redetermination of tax liability has been made by one country under the provisions of this article, the other country will make a corresponding adjustment to the amount of tax paid in that country on the redetermined income if it agrees that the adjustment was correct. In making such adjustment, due regard is to be given to other provisions of the proposed treaty, and the competent authorities of the two countries are to consult with each other if necessary. The proposed treaty's saving clause retaining full taxing jurisdiction in the country of residence or citizenship does not apply in the case of such adjustments. Accordingly, internal statute of limitations provisions do not prevent the allowance of appropriate correlative adjustments.

This article does not replace the internal law provisions that permit this type of adjustment. Under the proposed treaty, this article does not limit any law provisions of either country that permit the distribution, apportionment, or allocation of income, deductions, credits, or allowances between persons (whether or not residents of one of the treaty countries) that are owned or controlled directly or indirectly by the same interests when necessary in order to prevent evasion of taxes or to clearly reflect income. The Technical Explanation states that adjustments are permitted under internal law provisions even if such adjustments are different from, or go beyond, the adjustments authorized by this article, provided that such adjustments are consistent with the general principles of this article permitting adjustments to reflect arm's-length terms. The Technical Explanation states that this article also permits the tax authorities of the countries to address thin capitalization issues.

Article 10. Dividends

Internal taxation rules

United States

The United States generally imposes a 30–percent tax on the gross amount of U.S.-source dividends paid to nonresident alien individuals and foreign corporations. The 30–percent tax does not apply if the foreign recipient is engaged in a trade or business in

the United States and the dividends are effectively connected with that trade or business. In such a case, the foreign recipient is subject to U.S. tax on such dividends on a net basis at graduated rates in the same manner that a U.S. person would be taxed.

Under U.S. law, the term "dividend" generally means any distribution of property made by a corporation to its shareholders, either from accumulated earnings and profits or current earnings and profits. However, liquidating distributions generally are treated as payments in exchange for stock and, thus, are not subject to the 30–percent withholding tax described above (see discussion of gains in connection with Article 13 below).

Dividends paid by a U.S. corporation generally are U.S.-source income. Also treated as U.S.-source dividends for this purpose are portions of certain dividends paid by a foreign corporation that conducts a U.S. trade or business. The U.S. 30–percent withholding tax imposed on the U.S.-source portion of the dividends paid by a foreign corporation is referred to as the "second-level" withholding tax. This second-level withholding tax is imposed only if a treaty prevents application of the statutory branch profits tax.

In general, corporations are not entitled under U.S. law to a deduction for dividends paid. Thus, the withholding tax on dividends theoretically represents imposition of a second level of tax on corporate taxable income. Treaty reductions of this tax reflect the view that where the United States already imposes corporate-level tax on the earnings of a U.S. corporation, a 30–percent withholding rate may represent an excessive level of source-country taxation. Moreover, the reduced rate of tax often applied by treaty to dividends paid to direct investors reflects the view that the source-country tax on payments of profits to a substantial foreign corporate shareholder may properly be reduced further to avoid double corporate-level taxation and to facilitate international investment.

A real estate investment trust ("REIT") is a corporation, trust, or association that is subject to the regular corporate income tax, but that receives a deduction for dividends paid to its shareholders if certain conditions are met. In order to qualify for the deduction for dividends paid, a REIT must distribute most of its income. Thus, a REIT is treated, in essence, as a conduit for federal income tax purposes. Because a REIT is taxable as a U.S. corporation, a distribution of its earnings is treated as a dividend rather than income of the same type as the underlying earnings. Such distributions are subject to the U.S. 30–percent withholding tax when paid to foreign owners.

A REIT is organized to allow persons to diversify ownership in primarily passive real estate investments. As such, the principal income of a REIT often is rentals from real estate holdings. Like dividends, U.S.-source rental income of foreign persons generally is subject to the 30–percent withholding tax (unless the recipient makes an election to have such rental income taxed in the United States on a net basis at the regular graduated rates). Unlike the withholding tax on dividends, however, the withholding tax on rental income generally is not reduced in U.S. income tax treaties.

U.S. internal law also generally treats a regulated investment company ("RIC") as both a corporation and a conduit for income tax purposes. The purpose of a RIC is to allow investors to hold a di-

versified portfolio of securities. Thus, the holder of stock in a RIC may be characterized as a portfolio investor in the stock held by the RIC, regardless of the proportion of the RIC's stock owned by the dividend recipient.

Venezuela

Venezuela generally does not impose a withholding tax on dividends.

Proposed treaty limitations on internal law

Under the proposed treaty, dividends paid by a company that is a resident of a treaty country to a resident of the other country may be taxed in such other country. Such dividends may also be taxed by the country in which the payor company is resident, and according to the laws of that country, but the rate of such tax is limited. Under the proposed treaty, source-country taxation (*i.e.*, taxation by the country in which the payor company is resident) generally is limited to 5 percent of the gross amount of the dividend if the beneficial owner of the dividend is a resident of the other country and is a company which owns at least 10 percent of the voting stock of the payor company. The source-country dividend withholding tax generally is limited to 15 percent of the gross amount of the dividends beneficially owned by residents of the other country in all other cases.

The Technical Explanation states that the term "beneficial owner" is not defined in the proposed treaty and, thus, is defined under the internal law of the source country. The Technical Explanation further states that the beneficial owner of a dividend for purposes of this article is the person to which the dividend income is attributable for tax purposes under the laws of the source country.

The rates of source-country dividend withholding tax permitted under the proposed treaty are consistent with those provided for in the U.S. model, the OECD model, and most other U.S. income tax treaties. The proposed treaty provides that these rules do not affect the taxation of the paying company on the profits out of which the dividends are paid.

The proposed treaty allows the United States to impose a 15–percent tax on a U.S.-source dividend paid by a RIC to a Venezuelan person. The proposed treaty allows the United States to impose a 15–percent tax on a U.S.-source dividend paid by a REIT to a Venezuelan person if: (1) the beneficial owner of the dividend is an individual holding an interest of not more than 10 percent of the REIT; (2) the dividend is paid with respect to a class of stock that is publicly traded and the beneficial owner of the dividend is a person holding an interest of not more than 5 percent of any class of the REIT's stock; or (3) the beneficial owner of the dividend is a person holding an interest of not more than 10 percent of the REIT and the REIT is diversified. There is no limitation in the proposed treaty on the tax that may be imposed by the United States with respect to a REIT dividend that does not satisfy at least one of these requirements. Thus, such a dividend is taxable at the 30–percent U.S. statutory withholding rate. For purposes of this provision, the Technical Explanation states that a REIT will be considered to

be diversified if the value of no single interest in the REIT's real property exceeds 10 percent of the REIT's total interests in real property.

The proposed treaty provides that dividends may not be taxed by the source country if the beneficial owner of the dividends is (1) the other country or a political subdivision or local authority thereof, or (2) a governmental entity constituted and operated exclusively to administer or provide pension benefits. This rule does not apply if the dividends are derived from carrying on a trade or business or from an associated enterprise. For these purposes, the proposed protocol provides that it is understood that a "governmental entity constituted and operated exclusively to administer or provide pension benefits" includes, in the case of Venezuela, private, public or mixed entities operating under or pursuant to the *Ley del Subsistema de Pensiones* (Law of the Pension System), enacted under the *Ley Organica del Sistema de Seguridad Social Integral* (Organic Law of the Integrated Social Security System).

The Technical Explanation states that Venezuela is currently considering ways of reforming its government-run social security system. *The Ley del Subsistema de Pensiones* currently is proposed legislation that would replace Venezuela's existing regime with a system of privatized funds that would be permitted to invest in equities. The Technical Explanation states that the inclusion of the proposed funds within the exemption for dividend payments was judged warranted because the system under the proposed legislation is similar to a government-run social security system (as opposed to a private pension plan system).

The Technical Explanation states that because the *Ley del Subsistema de Pensiones* has not been enacted, additional general requirements are listed in the proposed protocol to ensure that the exemption for dividend payments will apply only to entities that operate under or pursuant to a final version of the law that includes the significant features of the proposed law. In order to satisfy these requirements, the version of the *Ley del Subsistema de Pensiones* that is enacted must: (1) provide universal coverage; (2) require mandatory contributions by both employers and employees; (3) limit the discretion of employers or employees to direct investment; (4) restrict distributions or borrowings, directly or indirectly, except upon death, retirement or disability; and (5) require that accounts be maintained at only one such qualifying entity at a time. The proposed protocol further provides that such entities also must be operated, and their investment parameters established, pursuant to governmental oversight and regulation. For purposes of the rules described above, the term "governmental entity constituted and operated exclusively to administer or provide pension benefits" also includes any equivalent entities in the United States.

The proposed treaty defines "dividends" as income from shares or other rights, which are not debt claims and which participate in profits. The term also includes income from other corporate rights if such income is subjected to the same tax treatment as income from shares by the country in which the distributing corporation is resident. Furthermore, dividends include income from arrangements, including debt obligations, that carry the right to participate in, or determined with reference to, profits to the extent such

income is so characterized under the laws of the country in which the income arises.

The proposed treaty's reduced rates of tax on dividends do not apply if the dividend recipient carries on business through a permanent establishment in the source country, or performs in the source country independent personal services from a fixed base located in that country, and the dividend is attributable to such permanent establishment or fixed base. In such cases, the dividend attributable to the permanent establishment or the fixed base is taxed as business profits (Article 7) or as income from the performance of independent personal services (Article 14), as the case may be. Under the proposed treaty, these rules also apply if the permanent establishment or fixed base no longer exists when the dividends are paid but such dividends are attributable to the former permanent establishment or fixed base.

The proposed treaty provides that a country may not impose any tax on dividends paid by a company that is a resident of the other country, except to the extent that the dividends are paid to a resident of the first country or the dividends are attributable to a permanent establishment or fixed base situated in that first country. Thus, this provision generally overrides the ability of the United States to impose its second-level withholding tax on the U.S.-source portion of dividends paid by a Venezuelan corporation.

Article 11. Interest

Internal taxation rules

United States

Subject to several exceptions (such as those for portfolio interest, bank deposit interest, and short-term original issue discount), the United States imposes a 30–percent withholding tax on U.S.-source interest paid to foreign persons under the same rules that apply to dividends. U.S.-source interest, for purposes of the 30–percent tax, generally is interest on the debt obligations of a U.S. person, other than a U.S. person that meets specified foreign business requirements. Also subject to the 30–percent tax is interest paid by the U.S. trade or business of a foreign corporation.

Portfolio interest generally is defined as any U.S.-source interest that is not effectively connected with the conduct of a trade or business if such interest (1) is paid on an obligation that satisfies certain registration requirements or specified exceptions thereto and (2) is not received by a 10–percent owner of the issuer of the obligation, taking into account shares owned by attribution. However, the portfolio interest exemption does not apply to certain contingent interest income.

If an investor holds an interest in a fixed pool of real estate mortgages that is a real estate mortgage interest conduit ("REMIC"), the REMIC generally is treated for U.S. tax purposes as a pass-through entity and the investor is subject to U.S. tax on a portion of the REMIC's income (which, generally is interest income). If the investor holds a so-called "residual interest" in the REMIC, the Code provides that a portion of the net income of the REMIC that is taxed in the hands of the investor—referred to as the investor's "excess inclusion"—may not be offset by any net op-

erating losses of the investor, must be treated as unrelated business income if the investor is an organization subject to the unrelated business income tax, and is not eligible for any reduction in the 30–percent rate of withholding tax (by treaty or otherwise) that would apply if the investor were otherwise eligible for such a rate reduction.

Venezuela

Venezuela generally imposes a withholding tax on interest paid to nonresidents at a rate of 34 percent on 95 percent of the gross payment (*i.e.*, an effective rate of 32.3 percent). However, interest paid to nonresident financial institutions is subject to withholding tax at a rate of 4.95 percent.

Proposed treaty limitations on internal law

The proposed treaty provides that interest arising in one of the countries and derived by a resident of the other country generally may be taxed in both countries. This is contrary to the position of the U.S. model which provides for an exemption from source-country tax for interest beneficially owned by a resident of the other country.

The proposed treaty limits the rate of source-country tax that may be imposed on interest income if the beneficial owner of the interest is a resident of the other country. The source-country tax on such interest may not exceed 4.95 percent of the gross amount of the interest if it is beneficially owned by any financial institution, including an insurance company. The Technical Explanation states that this rate is based on the Venezuelan statutory rate of interest withholding for payments made to financial institutions. In all other cases, the rate of source-country tax on interest generally may not exceed 10 percent of the gross amount of such interest. These rates are higher than the rates permitted under the U.S. model and many U.S. income tax treaties.

The proposed treaty provides for a complete exemption from source-country withholding tax in the case of certain categories of interest arising in a country and earned by residents of the other country. Interest that is paid by a treaty country (or a political subdivision or local authority thereof) is exempt from source-country tax. In addition, exemptions from source-country tax apply to cases in which the beneficial owner of the interest is (1) the other country (or a political subdivision or local authority thereof) or an instrumentality wholly owned by the other country), or (2) a resident of that other country and the interest is paid with respect to debt obligations made, guaranteed, or insured (directly or indirectly) by that country or an instrumentality wholly owned by that country. The proposed protocol states that instrumentalities, referred to above, include the U.S. Export-Import Bank, the Federal Reserve Banks and the Overseas Private Investment Corporation, the Venezuelan Banco de Comercio Exterior, the Banco Central de Venezuela and the Fondo de Inversiones de Venezuela, and such other instrumentalities as the competent authorities may agree upon.

The proposed treaty provides two anti-abuse exceptions to the general source-country reduction in tax discussed above. The first exception relates to "contingent interest" payments. If interest is

paid by a source-country resident to a resident of the other country and is determined with reference (1) to receipts, sales, income, profits, or other cash flow of the debtor or a related person, (2) to any change in the value of any property of the debtor or a related person, or (3) to any dividend, partnership distribution, or similar payment made by the debtor to a related person, such interest may be taxed in the source country in accordance with its internal laws. However, if the beneficial owner is a resident of the other country, such interest may not be taxed at a rate exceeding 15 percent (*i.e.,* the rate prescribed in subparagraph (b) of paragraph 2 of Article 10 (Dividends)). The second anti-abuse exception provides that the reductions in and exemption from source country tax do not apply to excess inclusions with respect to a residual interest in a REMIC. Such income may be taxed in accordance with each country's internal law.

The proposed treaty defines the term "interest" as income from debt claims of every kind, whether or not secured by a mortgage and whether or not carrying a right to participate in the debtor's profits. In particular, it includes income from government securities and from bonds or debentures, including premiums or prizes attaching to such securities, bonds, or debentures. Furthermore, interest includes any other income that is treated as interest by the tax law of the country in which the income arises. The proposed treaty provides that the term "interest" does not include amounts treated as dividends under Article 10 (Dividends) or penalty charges for late payment.

The proposed treaty's reductions in source country tax on interest do not apply if (1) the beneficial owner of the interest carries on business in the source country through a permanent establishment located in that country, or performs independent personal services in the source country from a fixed base located in that country, and (2) the interest paid is attributable to such permanent establishment or fixed base. In such events, the interest is taxed as business profits (Article 7) or as independent personal services income (Article 14), as the case may be. These rules also apply if the permanent establishment or fixed base no longer exists when the interest is paid but such interest is attributable to the former permanent establishment or fixed base.

The proposed treaty provides that interest is treated as arising in a country if the payor is that country, including its political subdivisions and local authorities, or if the payor is a resident of that country.[6] If, however, the payor of the interest has a permanent establishment or a fixed base in a country and such interest is borne by the permanent establishment or fixed base, then such interest is sourced to the country in which the permanent establishment or fixed base is situated. In addition, if a person derives profits that are taxable on a net basis in such country under paragraph 5 of Article 6 (Income From Immovable Property (Real Property)) or paragraph 1 of Article 13 (Gains), and the interest is allocable to such profits, then such interest is sourced to the country in which such profits are derived. Thus, for example, if a French resident

[6] This is consistent with the source rules of U.S. law, which provide as a general rule that interest income has as its source the country in which the payor is resident.

has a permanent establishment in Venezuela and that French resident incurs indebtedness to a U.S. person, the interest on which is borne by the Venezuelan permanent establishment, the interest would be treated as having its source in Venezuela.

The proposed treaty addresses the issue of non-arm's-length interest charges between related parties (or parties otherwise having a special relationship) by providing that the amount of interest for purposes of applying this article is the amount of interest that would have been agreed upon by the payor and the beneficial owner in the absence of the special relationship. Any amount of interest paid in excess of such amount is taxable according to the internal laws of each country, taking into account the other provisions of the proposed treaty. For example, excess interest paid by a subsidiary corporation to its parent corporation may be treated as a dividend under internal law and thus subject to the provisions of Article 10 (Dividends).

Article 11A. Branch Tax

Internal taxation rules

United States

A foreign corporation engaged in the conduct of a trade or business in the United States is subject to a flat 30–percent branch profits tax on its "dividend equivalent amount," which is a measure of the accumulated U.S. effectively connected earnings of the corporation that are removed in any year from its U.S. trade or business. The dividend equivalent amount is limited by (among other things) the foreign corporation's aggregate earnings and profits accumulated in taxable years beginning after December 31, 1986. The Code provides that no U.S. treaty shall exempt any foreign corporation from the branch profits tax (or reduce the amount thereof) unless the foreign corporation is a "qualified resident" of the treaty country. The definition of a "qualified resident" under U.S. internal law is somewhat similar to the definition of a corporation eligible for benefits under the proposed treaty (discussed below in connection with Article 17 (Limitation on Benefits)).

A foreign corporation is subject to a branch-level excess interest tax with respect to certain "excess interest" of a U.S. trade or business of such corporation; under this rule an amount equal to the excess of the interest deduction allowed with respect to the U.S. business over the interest paid by such business is treated as if paid by a U.S. corporation to a foreign parent and therefore is subject to a withholding tax.

Venezuela

Venezuela does not impose tax on the dividend equivalent amount of branch profits or on excess interest.

Proposed treaty limitations on internal law

The proposed treaty provides that a company that is a resident of a country may be subject in the other country to a tax in addition to the tax on profits.

The proposed treaty permits the United States to impose its branch profits tax, but limits the rate of such tax to 5 percent. In

this regard, the proposed treaty permits the United States to impose a tax on the "dividend equivalent amount" of the business profits of a Venezuelan corporation which are attributable to a U.S. permanent establishment or that are subject to tax on a net basis as income or gains from real property. The proposed protocol provides that in the case of the United States, the term "dividend equivalent amount" has the meaning it has under U.S. laws, as it may be amended from time to time without changing the general principle thereof. The Technical Explanation states that the term "dividend equivalent amount" has the same meaning it has under Code section 884, as it may be amended, provided that the amendments are consistent with the purposes of the branch profits tax.

The proposed treaty permits the imposition of the U.S. tax on excess interest, but limits the rate of source-country tax. In this regard, the proposed protocol provides that for these purposes, excess interest means the excess, if any of (1) interest deductible in one or more years in computing the profits of a corporation that are either attributable to a permanent establishment or that are subject to tax on a net basis as income or gains from real property, over (2) the interest paid by or from such permanent establishment or trade or business. The proposed treaty provides that the rate of tax imposed on such excess interest may not exceed the specified rates in the interest article (*i.e.,* 4.95 or 10 percent, as the case may be, under Article 11(2)). Thus, for example, if the enterprise is a financial institution, the excess interest tax would be imposed at a 4.95 percent rate.

This article is drafted reciprocally to apply to both the United States and Venezuela. Although Venezuela currently does not impose branch taxes under its internal law, the Technical Explanation states that if in the future Venezuela should adopt such branch taxes, it may apply them to U.S. companies subject to the limitations of this article.

Article 12. Royalties

Internal taxation rules

United States

Under the same system that applies to dividends and interest, the United States imposes a 30–percent withholding tax on U.S.-source royalties paid to foreign persons. U.S.-source royalties include royalties for the use of or the right to use intangible property in the United States.

Venezuela

Venezuela generally imposes a withholding tax on royalties paid to nonresidents at a rate of 34 percent. The 34 percent rate is applied to 90 percent of notional income (*i.e.,* an effective rate of 30.6 percent) in the case of certain turnover-based royalties, and to 50 percent of notional income (*i.e.,* an effective rate of 17 percent) in the case of certain lump-sum royalties.

Proposed treaty limitations on internal law

The proposed treaty provides that royalties arising in a treaty country and derived by a resident of the other country may be

taxed by that other country. In addition, the proposed treaty allows the country where the royalties arise (the "source country") to tax such royalties according to its laws. However, if the beneficial owner of the royalties is a resident of the other country, the source country tax is limited.

The proposed treaty provides that the rate of source-country tax on certain royalties may not exceed 5 percent of the gross royalties. The 5–percent limitation applies to payments of any kind for the use of, or the right to use, industrial, commercial or scientific equipment. Unlike the proposed treaty, the U.S. model treats such income as business profits, and not as royalties.

The proposed treaty further provides that the rate of source-country tax on certain royalties may not exceed 10 percent of the gross royalties. The 10–percent limitation applies to payments of any kind received in consideration for the use of, or the right to use, any copyright of literary, dramatic, musical, artistic, or scientific work, including cinematographic films, tapes, and other means of image or sound reproduction, any patent, trademark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience. The proposed treaty also treats as royalties subject to the 10–percent limitation gains derived from the alienation of such right or property to the extent that such gains are contingent on the productivity, use or disposition thereof.

According to the Technical Explanation, payments with respect to computer software are treated as royalties or as business profits, depending on the facts and circumstances of the particular transaction. The Technical Explanation also states that it is understood that payments with respect to transfers of "shrink wrap" computer software will be treated as business profits, and not as royalties. The Technical Explanation also states that the term "industrial, commercial or scientific experience" includes information that is ancillary to a right otherwise giving rise to royalties, such as a patent or secret process.

The proposed treaty's reductions in source country tax on royalties do not apply if (1) the beneficial owner of the royalties carries on business in the source country through a permanent establishment located in that country, or performs in the source country independent personal services from a fixed base located in that country, and (2) the royalties are attributable to such permanent establishment or fixed base. In such cases, the interest is taxed as business profits (Article 7) or as independent personal services income (Article 14), as the case may be. These rules also apply if the permanent establishment or fixed base no longer exists when the royalties are paid but such royalties are attributable to the former permanent establishment or fixed base.

The proposed treaty provides that royalties are deemed to arise in a country when they are in consideration for the use of, or the right to use, property, information or experience in that country. This source rule generally is consistent with the place of use source rules under U.S. law.

The proposed protocol provides that payments received as consideration for technical services or assistance, including studies or surveys of a scientific, geological or technical nature, for engineer-

ing works including the plans related thereto, or for consultancy or supervisory services or assistance are not considered royalties, but are treated as either business profits under Article 7 or as independent personal services income under Article 14.

The proposed treaty addresses the issue of non-arm's-length royalties between related parties (or parties otherwise having a special relationship) by providing that the amount of royalties for purposes of applying this article is the amount that would have been agreed upon by the payor and the beneficial owner in the absence of the special relationship. Any amount of royalties paid in excess of such amount is taxable according to the laws of each country, taking into account the other provisions of the proposed treaty. For example, excess royalties paid by a subsidiary corporation to its parent corporation may be treated as a dividend under local law and thus subject to the provisions of Article 10 (Dividends).

Article 13. Gains

Internal taxation rules

United States

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 or she is physically present in the United States for at least 183 days in the taxable year. A nonresident alien or foreign corporation is subject to U.S. tax on gain from the sale of a U.S. real property interest as if the gain were effectively connected with a trade or business conducted in the United States. "U.S. real property interests" include interests in certain corporations if at least 50 percent of the assets of the corporation consist of U.S. real property.

Venezuela

Capital gains generally are subject to a withholding tax of 34 percent. However, the sale of shares of a publicly traded Venezuelan company are subject to a withholding tax of 1 percent of the sales price.

Proposed treaty limitations on internal law

Under the proposed treaty, gains or income derived by a treaty country resident from the alienation of immovable property (real property) situated in the other country may be taxed in the other country. Immovable property (real property) situated in the other country for purposes of this article includes immovable property (real property) referred to in Article 6 (Income from Immovable Property (Real Property)) that is situated in the other country, an interest in a partnership, trust or estate to the extent that its assets consist of immovable property (real property) situated in the other country, and a United States real property interest and an equivalent interest in Venezuelan immovable property (real property). The Technical Explanation states that distributions by a REIT that are attributable to gains derived from the alienation of real property are taxable under this article (and are not taxable under the dividends article (Article 10)).

The proposed treaty contains a standard provision which permits a country to tax the gain or income from the alienation of personal (movable) property that is attributable to a permanent establishment that an enterprise of a country has in the other country, or that is attributable to a fixed base that is available to a resident of a country in the other country for purposes of performing independent personal services. This rule also applies to gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or such fixed base. This rule also applies if the permanent establishment or fixed base no longer exists when the gains are recognized but such gains are attributable to the former permanent establishment or fixed base.

The proposed treaty provides that gains or income derived by an enterprise of a country from the alienation of ships, aircraft, or containers operated in international traffic are taxable only in that country. This rule also applies to personal property pertaining to the operation or use of such ships, aircraft, or containers. This rule applies even if such gain is attributable to a permanent establishment in the other country.

The proposed treaty provides that gains from the alienation of any property other than that discussed above are taxable under the proposed treaty only in the country where the alienator is a resident.

Article 14. Independent Personal Services

Internal taxation rules

United States

The United States taxes the income of a nonresident alien individual at the regular graduated rates if the income is effectively connected with the conduct of a trade or business in the United States by the individual. The performance of personal services within the United States may constitute a trade or business within the United States.

Under the Code, the income of a nonresident alien individual from the performance of personal services in the United States is excluded from U.S.-source income, and therefore is not taxed by the United States in the absence of a U.S. trade or business, if the following criteria are met: (1) the individual is not in the United States for over 90 days during the taxable year, (2) the compensation does not exceed $3,000, and (3) the services are performed as an employee of, or under a contract with, a foreign person not engaged in a trade or business in the United States, or are performed for a foreign office or place of business of a U.S. person.

Venezuela

Nonresident individuals generally are subject to a withholding tax on income with respect to the performance of professional services in Venezuela at a rate of 34 percent on 90 percent of notional income (*i.e.,* an effective rate of 30.6 percent).

Proposed treaty limitations on internal law

Under the proposed treaty, income in respect of professional services or other activities of an independent character derived by

a resident of a country is taxable only in that country. However, such income also may be taxed by the other country (the source country) if the individual has a fixed base regularly available to him or her in the other country for the purpose of performing the activities. In that case, the source country is permitted to tax only that portion of the individual's income which is attributable to that fixed base. This rule also applies where the income is received after the fixed base is no longer in existence, but the income is attributable to the former fixed base. The Technical Explanation states that the term "fixed base" is understood to be similar, but not identical, to the term "permanent establishment," as defined in the permanent establishment article (Article 5).

The proposed treaty provides that the term "professional services" includes especially independent scientific, literary, artistic, educational, or teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

The proposed treaty provides that the rules for taxing independent personal services income is subject to the provisions of the business profits article (Article 7). The Technical Explanation states that this rule ensures that in cases where the source country taxes income from independent personal services, it will do so only on a net basis. The proposed protocol provides that this article is to be interpreted according to the Commentary to Article 14 (Independent Personal Services) of the OECD Model, and of any guidelines which, for the application of such article, may be developed in the future. Thus, it is understood that the tax on such independent personal services income will be imposed on net income as if the income were attributable to a permanent establishment and taxable under Article 7 (Business Profits).

Article 15. Dependent Personal Services

Under the proposed treaty, salaries, wages, and other similar remuneration derived from services performed as an employee in one country (the source country) by a resident of the other country are taxable only by the country of residence if three requirements are met: (1) the individual must be present in the source country for not more than 183 days in any twelve-month period commencing or ending in the taxable year concerned; (2) his or her employer must not be a resident of the source country; and (3) the compensation must not be borne by a permanent establishment or fixed base of the employer in the source country. These limitations on source-country taxation generally are consistent with the U.S. and OECD models. The proposed protocol provides that the term "similar remuneration" includes benefits in kind received in respect of an employment and any other benefits, whether or not considered as salaries under the domestic laws of both countries. The proposed protocol gives a non-exhaustive list of examples of compensation that would be considered to be "similar remuneration." The list includes, but is not limited to, the use of a residence or automobile, health or life insurance coverage and club memberships, provision of meals, food and groceries, child care, reimbursement of medical, pharmaceutical and dental care expenses, provision of work cloth-

ing, toys and school supplies, scholarships, reimbursement of training course expenses, and mortuary and burial expenses.

The proposed treaty, similar to the U.S. model, provides that remuneration derived in respect of employment as a member of the crew of a ship or aircraft, or as other personnel regularly employed to serve aboard a ship or aircraft, operated in international traffic is taxable only in the employee's country of residence.

This article is subject to the provisions of the separate articles covering directors' fees (Article 16), pensions, social security, annuities, and child support (Article 19), government service income (Article 20), and income of students, trainees, teachers and researchers (Article 21).

Article 16. Directors' Fees

Under the proposed treaty, directors' fees and other similar payments derived by a resident of one country for services performed in the other country in his or her capacity as a member of the board of directors of a company which is a resident of that other country may be taxed in that other country. This rule is similar to the corresponding rule in the U.S. model. This rule applies notwithstanding the provisions of Article 14 (Independent Personal Services) and Article 15 (Dependent Personal Services).

The proposed protocol provides that for these purposes the term "similar payments" includes benefits in kind received in respect of an employment and any other benefits, whether or not considered as salaries under the domestic laws of both countries. The proposed protocol gives a non-exhaustive list of examples of compensation that would be considered to be "similar payments." The list includes, but is not limited to, the use of a residence or automobile, health or life insurance coverage and club memberships, provision of meals, food and groceries, child care, reimbursement of medical, pharmaceutical and dental care expenses, provision of work clothing, toys and school supplies, scholarships, reimbursement of training course expenses, and mortuary and burial expenses.

Article 17. Limitation on Benefits

In general

The proposed treaty contains a provision generally intended to limit the indirect use of the proposed treaty by persons who are not entitled to its benefits by reason of residence in the United States or Venezuela. The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Venezuela as they apply to residents of the two countries. At times, however, residents of third countries attempt to use a treaty. This use is known as "treaty shopping," which refers to the situation where a person who is not a resident of either treaty country seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, and without appropriate safeguards, the third-country resident may be able to secure these benefits indirectly by establishing a corporation or other entity in one of the treaty countries, which entity, 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 reduce the income

base of the treaty country resident by having the latter pay out interest, royalties, or other amounts under favorable conditions either through relaxed tax provisions in the distributing country or by passing the funds through other treaty countries until the funds can be repatriated under favorable terms.

The proposed anti-treaty shopping article provides that a person that is a resident of either Venezuela or the United States and that derives income from the other treaty country is entitled to the benefits of the proposed treaty in that other country only if such person:

(1) is an individual not treated as a resident of a third country;

(2) is one of the treaty countries or their political subdivisions or local authorities, or instrumentalities or companies wholly-owned by one of the treaty countries or their political subdivisions or local authorities;

(3) is an entity that is a not for profit organization that satisfies an ownership test;

(4) meets an active business test with respect to a particular item of income;

(5) is a company that satisfies a public company test;

(6) is a company that is owned by certain public companies; or

(7) is an entity that satisfies an ownership and base erosion test.

In addition, a person that does not satisfy any of the above requirements may be granted the benefits of the proposed treaty if the source country's competent authority so determines.

Individuals

An individual resident of a treaty country is entitled to the benefits of the proposed treaty provided that the individual is not treated as a resident of another country under the principles of the tie-breaker rules under subparagraph 3(a) and 3(b) of Article 4 (Residence). The Technical Explanation states that this provision is intended to prevent a third-country resident individual from using Venezuela's broad residency concept ("domiciliado") to treaty-shop into the United States.

Governments

Under the proposed treaty, the two countries, their political subdivisions or local authorities, or instrumentalities or companies wholly-owned by one of the countries or their political subdivisions or local authorities, are entitled to all treaty benefits.

Tax exempt entities

An entity is entitled to the benefits under the proposed treaty if it is a not for profit organization (including a pension fund or private foundation) that, by virtue of that status, generally is exempt from income tax in its country of residence, provided that more than half of the beneficiaries, members, or participants (if any) in such organization are entitled to the benefits of the proposed treaty.

Active business test

In general

Under the active business test, treaty benefits are available under the proposed treaty to a person that is engaged in the active conduct of a trade or business in its residence country if (1) the income derived in the other country is derived in connection with, or is incidental to, that trade or business, and (2) that trade or business is substantial in relation to the income-generating activity in the other country giving rise to the income in respect of which treaty benefits are being claimed in that other country.

This active trade or business test is applied separately to each item of income. Accordingly, an entity may be eligible for treaty benefits with respect to some but not all of the income derived in the source country. In contrast, satisfaction of the requirements for any one of the other specified categories allows treaty benefits for all income derived in the source country.

The term "trade or business" is not specifically defined in the proposed treaty. However, as provided in Article 3 (General Definitions), undefined terms are to have the meaning which they have under the laws of the country applying the proposed treaty. In this regard, the Technical Explanation states that the U.S. competent authority will refer to the regulations issued under Code section 367(a) to define an active trade or business. Under the proposed treaty, the active business test does not apply (and benefits therefore may be denied) to the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company. The Technical Explanation states these rules do not apply to a headquarters company, because the company would not be considered to be engaged in an active trade or business.

Income derived in connection with, or incidental to, a trade or business that is substantial

The Technical Explanation states that an item of income is derived in connection with a trade or business if the income-producing activity in the source country is a line of business which forms a part of, or is complementary to, the trade or business conducted in the residence country.[7] This rule is similar to the rule in the U.S. model. The Technical Explanation states that it is intended that a business activity generally will be considered to "form a part of" a business activity conducted in the other country if the two activities involve the design, manufacture or sale of the same products or type of products, or the provision of similar services. The Technical Explanation further states that in order for activities to be "complementary," the activities need not relate to the same types of products or services, but they should be part of the same overall industry and be related in the sense that success or failure of one activity will tend to result in the success or failure

[7] Cf. Treas. Reg. sec. 1.884–5(e)(1). (To satisfy the active business test, the activities that give rise to the U.S. income must be part of a U.S. business and that business must be an integral part of an active trade or business conducted by the foreign corporation in its residence country.)

of the other activity. The Technical Explanation provides several examples illustrating these principles.

The Technical Explanation states that whether a trade or business of a resident is substantial is determined based on all the facts and circumstances. According to the Technical Explanation, the factors to be considered include the relative scale of the activities conducted in the two countries, and the relative contributions made to the conduct of the trade or business in both countries.[8]

The Technical Explanation states that it is understood that income is incidental to a trade or business conducted in the other country if the production of such income facilitates the conduct of a trade or business in the other country. This rule is the same as the rule in the U.S. model. As an example, the Technical Explanation states that incidental income includes the temporary investment of working capital derived from a trade or business.

Public company tests

Under the public company tests, a company that is a resident of Venezuela or the United States is entitled to the benefits of the proposed treaty if there is substantial and regular trading in its principal class of shares on a recognized securities exchange. This test is similar to the rule contained in the U.S. model. The Technical Explanation states that the term "principal class of shares" is to be interpreted as the class of shares that represents the majority of the voting power and value of the company. The term "substantial and regular trading," although not defined in the proposed treaty, is to be defined by reference to the domestic laws of the country from which treaty benefits are being sought. In the case of the United States, this term is understood to have the meaning given "regularly traded" in Treas. Reg. sec. 1.884–5(d)(4)(i)(B), relating to the branch tax provisions of the Code.

Similarly, treaty benefits are available to a company that is a resident of Venezuela or the United States if at least 50 percent of each class of shares of the company is owned (directly or indirectly) by five or fewer companies that satisfy the public company test just described, provided that in the case of indirect ownership, each intermediate owner is a person entitled to the benefits of the proposed treaty under one of the various alternative tests.

The term "recognized securities exchange" means: (1) the Caracas and Maracaibo stock exchanges, the Bolsa Electronica and any stock exchange registered with the Comision Nacional de Valores in accordance with the Ley de Mercado de Capitales; (2) the NASDAQ System owned by the National Association of Securities Dealers, Inc., and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934; and (3) any other stock exchange agreed upon by the competent authorities of the two countries.

[8] Cf. Treas. Reg. sec. 1.884–5(e)(3). (A foreign corporation engaged in business in its residence country has a substantial presence in that country if certain of the attributes of that business, physically located in its residence country, equal at least a threshold percentage of its worldwide attributes.)

Ownership and base erosion tests

Under the proposed treaty, a person that is resident in one of the treaty countries is entitled to treaty benefits if it satisfies an ownership test and a base erosion test. Under the ownership test, more than 50 percent of the beneficial interest in a person (or, in the case of a company, more than 50 percent of the number of shares of each class of the company's shares) must be owned, directly or indirectly, by one or more individual residents of Venezuela or the United States, U.S. citizens, the countries themselves, political subdivisions or local authorities of the countries or instrumentalities or companies wholly-owned by such entities, certain tax-exempt organizations (as described in the discussion of tax-exempt entities above), or certain publicly traded companies and subsidiaries of publicly traded companies (as described in the discussion of the public company tests above) (so-called "qualified residents"). This rule could, for example, deny the benefits of the reduced U.S. withholding tax rates on dividends and royalties paid to a Venezuelan company that is controlled by individual residents of a third country. This rule is similar to a corresponding rule in the U.S. model. The Technical Explanation states that trusts may be entitled to treaty benefits under this provision if they are treated as residents under Article 4 (Residence) and otherwise satisfy these requirements.

In addition, the base erosion test is met only if less than 50 percent of the gross income of the person is used, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons or entities other than those referred to in the preceding paragraph. This rule is intended to prevent a corporation, for example, from distributing most of its income, in the form of deductible items such as interest, royalties, service fees, or other amounts) to persons not entitled to benefits under the proposed treaty. This treatment is similar to the corresponding rule in the U.S. model. For purposes of the base erosion test, the proposed treaty provides that the term "gross income" generally means gross receipts. In the case of an enterprise that is engaged in a business which includes the manufacture or production of goods, gross income means gross receipts reduced by the direct costs of labor and materials attributable to such manufacture or production and paid or payable out of such receipts.

Venezuelan entidad or colectividad

Under the proposed treaty, an entidad or colectividad formed under the laws of Venezuela (and otherwise entitled to treaty benefits under the objective tests described above) is not entitled to treaty benefits if such entidad or colectividad (or another entidad or colectividad or other person that controls such entity) has outstanding a class of interests: (1) that is "disproportionate," and (2) in which 50 percent or more of the vote or value of such entity is owned by certain persons or entities who are not qualified residents (as described above) of either Venezuela or the United States. A class of interests is disproportionate for these purposes if the terms of such interests, or the arrangements with respect to such interests, entitle its holders to a portion of the income of the entidad or colectividad derived from the United States that is larg-

er than the portion such holders would receive absent such terms or arrangements.

Former U.S. long-term residents

Notwithstanding the objective tests described above, a former long-term resident of the United States is not entitled to the benefits of the proposed treaty for the ten-year period following loss of such long-term resident status, if such loss of status had as one of its principal purposes the avoidance of U.S. tax, determined in accordance with U.S. law applicable to former U.S. citizens and long-term residents. Section 877 of the Code provides special rules for the imposition of U.S. income tax on former U.S. citizens and long-term residents for a period of ten years following the loss of citizenship or resident status; these special tax rules apply to a former citizen or long-term resident only if his or her loss of U.S. citizenship or resident status had as one of its principal purposes the avoidance of U.S. income, estate or gift taxes. For purposes of applying the special tax rules to former citizens and long-term residents, individuals who meet a specified income tax liability threshold or a specified net worth threshold generally are considered to have lost citizenship or resident status for a principal purpose of U.S. tax avoidance. The proposed protocol provides that a "long-term resident" means any individual who is a lawful permanent resident of the United States in 8 or more taxable years during the preceding 15 taxable years. In determining whether this threshold is met, the proposed protocol provides that there is not taken into account any year in which the individual is treated as a resident of Venezuela under the proposed treaty, or as a resident of any other country other than the United States under the provisions of any other U.S. tax treaty and, in either case, the individual does not waive the benefits of such treaty applicable to residents of the other country.

Grant of treaty benefits by the competent authority

The proposed treaty provides a "safety-valve" for a person that has not established that it meets one of the other more objective tests, but for which the allowance of treaty benefits would not give rise to abuse or otherwise be contrary to the purposes of the treaty. Under this provision, such a person may be granted treaty benefits if the competent authority of the source country so determines. The corresponding article in the U.S. model contains a similar rule. For this purpose, one of the factors the competent authorities must take into account is whether the establishment, acquisition, and maintenance of the person, and the conduct of its operations, did not have as one of its principal purposes the obtaining of treaty benefits.

Article 18. Artistes and Sportsmen

Like the U.S., OECD and U.N. models, the proposed treaty contains a separate set of rules that apply to the taxation of income earned by entertainers (such as theater, motion picture, radio, or television artistes or musicians) and sportsmen. These rules apply notwithstanding the other provisions dealing with the taxation of income from personal services (Articles 14 (Independent Personal

Services) and Article 15 (Dependent Personal Services)) and are intended, in part, to prevent entertainers and sportsmen from using the proposed treaty to avoid paying any tax on their income earned in one of the countries.

Under the proposed treaty, income derived by an entertainer or sportsman who is a resident of one country from his or her personal activities as such in the other country may be taxed in the other country if the amount of the compensation derived by him or her from such activities (including expenses reimbursed to him or her or borne on his or her behalf) exceeds $6,000 or its Venezuelan currency equivalent for the entire taxable year concerned. Under this rule, if a Venezuelan entertainer or sportsman maintains no fixed base in the United States and performs (as an independent contractor) for one day of a taxable year in the United States for total compensation of $10,000, the full amount would be subject to U.S. tax.

The proposed treaty provides that where income in respect of activities exercised by an entertainer or sportsman in his or her capacity as such accrues not to the entertainer or sportsman but to another person, that income of that other person is taxable by the country in which the activities are exercised, unless it is established that neither the entertainer or sportsman nor persons related to him or her participated directly or indirectly in the profits of that other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions, or other distributions. This provision applies notwithstanding the business profits and independent personal services articles (Articles 7 and 14).) This provision prevents highly-paid entertainers and sportsmen from avoiding tax in the country in which they perform by, for example, routing the compensation for their services through a third entity such as a personal holding company or a trust located in a country that would not tax the income.

The proposed treaty provides that these rules do not apply to income derived from activities performed in a country as an entertainer or sportsman if the visit to that country is wholly or mainly supported by public funds of one or both of the treaty countries or any of its political subdivisions or local authorities. In such a case, the income is taxable only in the entertainer's or sportsman's country of residence. This rule is not contained in the U.S., OECD or U.N. models, but is contained in some other U.S. treaties.

Article 19. Pensions, Social Security, Annuities, and Child Support

Under the proposed treaty, pensions and other similar remuneration derived and beneficially owned by a resident of either country in consideration of past employment is taxable only in the recipient's country of residence. The Technical Explanation states that, for purposes of this rule, the pension may be paid periodically or in a lump sum. The Technical Explanation also states that the provision is intended to encompass payments made by private retirement plans and arrangements in consideration of past employment. This provision is subject to the provisions of Article 20 (Government Service) with respect to pensions.

The proposed treaty provides that social security benefits paid by a country to a resident of the other country or to a U.S. citizen may be taxable by the payor's (*i.e.,* the source) country. This provision represents a departure from the U.S. model, which provides that social security benefits paid by a country to a resident of the other country or to a U.S. citizen are taxable only in the source country. The proposed treaty would allow such social security benefits to be taxed by both the residence and source country.[9] The proposed protocol provides that for these purposes the term "social security benefits" is intended to include United States tier 1 Railroad Retirement benefits.

The proposed treaty also provides that annuities (other than those covered under the pension rule described above) that are derived from a country and beneficially owned by an individual resident of the other country are taxable only in the country from which they are derived. This rule is different from the corresponding rule in the U.S. model, which provides that annuities are taxable only in the individual recipient's country of residence. The term "annuities" is defined for purposes of this provision as a stated sum paid periodically at stated times during a specific time period, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

The proposed treaty provides that child support payments made by a resident of a country to a resident of the other country are taxable only in the recipient's country of residence. This rule is different from the rule in the U.S. model, which provides that child support payments are exempt from tax in both countries. For these purposes, child support payments are periodic payments for the support of a minor child made pursuant to a written separation agreement, or a decree of divorce, separate maintenance or compulsory support.

Unlike many U.S. tax treaties, the proposed treaty does not contain a rule for alimony payments. Thus, such payments fall under the rules of Article 22 (Other Income), which generally allow such payments to be taxed both by the payor's country of residence and the recipient's country of residence. This approach generally is inconsistent with the U.S. model, which provides that alimony paid by a resident of a country and deductible in such country to a resident of the other country is taxable exclusively by the recipient's country of residence.

Article 20. Government Service

The proposed treaty provides rules with respect to the tax treatment of income (including pensions) from governmental employment. The provisions generally follow the corresponding provisions in the U.S., OECD and U.N. models.

Under the proposed treaty, remuneration, other than a pension, paid by one of the countries (or a political subdivision or local authority thereof) to an individual in respect of services rendered to

[9] Under Venezuelan law, U.S. social security benefits paid to a Venezuelan resident generally would not be taxable by Venezuela under its territorial tax system. In addition, social security benefits paid by Venezuela to a U.S. resident generally would be taxed by both Venezuela and the United States under each country's tax laws. The United States generally would provide a foreign tax credit for Venezuelan taxes paid with respect to such income.

that country (or subdivision or authority) generally is taxable only by that country. Such remuneration is taxable only in the other country, however, if the services are rendered in that other country by an individual who is a resident of that country and who (1) is also a national of that country or (2) did not become a resident of that country solely for the purpose of rendering the services.

The proposed treaty further provides that any pension paid by, or out of funds created by, one of the countries (or a political subdivision or local authority thereof) to an individual in respect of services rendered to that country (or subdivision or authority) is taxable only by that country. Such a pension is taxable only by the other country, however, if the individual is a national and resident of that other country. This provision is subject to paragraph 2 of Article 19 (Pensions, Social Security, Annuities, and Child Support), which provide that social security benefits paid by a country to a resident of the other country or a U.S. citizen may be taxed by the payor country.

The provisions described in the foregoing paragraphs are exceptions to the proposed treaty's saving clause for individuals who are neither citizens nor permanent residents of the country where the services are performed. Thus, for example, payments by the government of Venezuela to its employees in the United States are exempt from U.S. tax if the employees are not U.S. citizens or green card holders and were not residents of the United States at the time they became employed by the Venezuelan government.

The proposed treaty provides that if a country or one of its political subdivisions or local authorities is carrying on business (as opposed to functions of a governmental nature), the provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 16 (Directors' Fees), 18 (Artistes and Sportsmen), and 19 (Pensions, Social Security, Annuities, and Child Support) apply to remuneration and pensions paid for services rendered in connection with the business.

Article 21. Students, Trainees, Teachers and Researchers

The proposed treaty provides rules with respect to the taxation of income of students, trainees, teachers, and researchers.

Under the proposed treaty, an individual who is a resident of a country (the residence country) at the time he or she becomes temporarily present in the other country (the host country) will be exempt from tax by the host country for certain amounts received by the individual, if the individual's visit in the host country was for the primary purpose of (1) studying at a university or other recognized educational institution in the host country, (2) securing training required to qualify such individual to practice a profession or professional specialty, or (3) studying or doing research as a recipient of a grant, allowance or award from a government, religious, charitable, scientific, literary or educational organization. In such cases, the individual will be exempt from host country tax for a period not exceeding five taxable years from the date of the individual's arrival in the host country (and such additional period as is necessary to complete, as a full time student, educational requirements for a postgraduate or professional degree from a recognized educational institution). The exemptions from host country tax

apply to (1) payments from abroad, other than compensation for personal services, for the purpose of maintenance, education, study, research, or training, (2) a grant, allowance or award, and (3) income from personal services performed in the host country in an amount not to exceed $5,000 or its Venezuelan currency equivalent for any taxable year.

Under the proposed treaty, an individual who is a resident of one country (the residence country) at the time he or she becomes temporarily present in the other country (the host country) as an employee of, or under contract with, a resident of the first country, will be exempt from tax by the host country for certain amounts received by the individual, if the individual's visit in the host country was for the primary purpose of (1) acquiring technical, professional, or business experience from a person other than that resident of the residence country, or (2) studying at a university or other recognized educational institution in the host country. In such cases, the individual will be exempt from tax by the host country for a period not exceeding 12 months with respect to his or her income from personal services in an aggregate amount which does not exceed $8,000 or its Venezuelan currency equivalent.

The proposed protocol provides that the exemption amounts from host country tax described in the above paragraphs (*i.e.,* $5,000 and $8,000, respectively) are in addition to (and not in lieu of) any personal exemptions otherwise allowed under the domestic laws of the host country. Thus, an unmarried resident of Venezuela who is temporarily present in the United States for the primary purpose of studying at a university would be entitled to exclude from U.S. tax $5,000 of personal services income, and in addition, would be entitled to personal exemption amounts allowed by the Code.

The proposed treaty provides rules with respect to the taxation of income earned by teachers. The U.S., OECD and U.N. models do not contain similar provisions.

Under the proposed treaty, an individual who is a resident of a country (the residence country) at the time he or she becomes temporarily present in the other country (the host country) will be exempt from tax by the host country for certain amounts received by the individual, if the individual's visit in the host country was for the purpose of teaching or carrying on research at a recognized educational institution. In such cases, the individual will be exempt from tax by the host country for a period not exceeding two years from the date he or she visits the host country for such purposes with respect to his or her income from personal services for training or research at such institution. The proposed treaty provides that in no event will any individual have the benefits of this provision for more than five taxable years.

The proposed treaty provides that this article does not apply to income from research if such research is not undertaken by the individual in the public interest but primarily for the private benefit of a specific person or persons.

The provisions described in the foregoing paragraphs are exceptions to the proposed treaty's saving clause for individuals who are neither citizens nor permanent residents of the host country. Thus, for example, a person who is not a U.S. citizen, and who visits the

United States as a student and remains long enough to become a resident under U.S. law, but does not become a permanent resident, will be entitled to the full benefits of this article.

Article 22. Other Income

This article is a catch-all provision intended to cover items of income not specifically covered in other articles, and to assign the right to tax income from third countries to either the United States or Venezuela. As a general rule, items of income not otherwise dealt with in the proposed treaty which are derived by residents of one of the countries are taxable only in the country of residence.

This rule, for example, gives the United States the sole right under the proposed treaty to tax income derived from sources in a third country and paid to a U.S. resident. This article is subject to the saving clause, so U.S. citizens who are residents of Venezuela will continue to be taxable by the United States on their third-country income.

The general rule just stated does not apply to income (other than income from immovable property (real property) as defined in Article 6) 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 performs independent personal services in the other country from a fixed base, and the right or property in respect of which the income is paid is attributable to such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, will apply. This rule also applies where the income is received after the permanent establishment or fixed base is no longer in existence, but the income is attributable to the former permanent establishment or fixed base.

The proposed treaty provides that notwithstanding the foregoing rules, items of income of a resident of a country not dealt with in the other articles of the proposed treaty and arising in the other country, may also be taxed by that other country. This rule, which is not contained in the U.S. and OECD models, is similar to the corresponding rule in the U.N. model.

Article 23. Capital

Venezuela imposes a 1–percent capital tax on the value of business assets. Income taxes imposed by Venezuela may be credited against the capital tax.

The proposed treaty specifies the circumstances in which either treaty country may impose tax on capital owned by a resident of the other country. Since the United States does not impose taxes on capital, the only capital taxes covered by the proposed treaty are those imposed by Venezuela (*i.e.,* Venezuela's business assets tax). Thus, although the article is drafted in a reciprocal manner, its provisions are relevant only for the imposition of the Venezuelan tax.

The proposed treaty describes two situations under which Venezuela may tax the capital of a U.S. resident. First, capital represented by immovable property (real property) (as defined in Article 6) that is owned by a U.S. resident and located in Venezuela. Second, capital represented by personal (movable) property forming

part of the business property of a permanent establishment which a U.S. resident has in Venezuela or pertaining to a fixed base available to a U.S. resident for the purpose of performing independent personal services may be taxed by Venezuela.

The proposed treaty provides that capital represented by ships, aircraft, or containers that are owned by a U.S. resident and used in international operations, and other personal (movable) property pertaining to the operation of such ships, aircraft, and containers is taxable only in the residence country of the enterprise. All other elements of capital of a resident of either country are taxable only by that country. Thus, except as provided above, Venezuela generally cannot tax a U.S. resident on capital owned by that resident.

Article 24. Relief from Double Taxation

Internal taxation rules

United States

The United States taxes the worldwide income of its citizens and residents. It attempts unilaterally to mitigate double taxation generally by allowing taxpayers to credit the foreign income taxes that they pay against U.S. tax imposed on their foreign-source income. An indirect or "deemed-paid" credit is also provided. Under this rule, a U.S. corporation that owns 10 percent or more of the voting stock of a foreign corporation and that receives a dividend from the foreign corporation (or an inclusion of the foreign corporation's income) is deemed to have paid a portion of the foreign income taxes paid (or deemed paid) by the foreign corporation on its earnings. The taxes deemed paid by the U.S. corporation are included in its total foreign taxes paid for the year the dividend is received.

Venezuela

Under Venezuelan law, the primary method of avoiding double taxation is an exemption from foreign source income under its territorial-based tax system. Thus, generally no specific foreign tax credit relief is provided under Venezuelan law.

Proposed treaty limitations on internal law

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. 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.

The double tax issue is addressed in part in other articles of the proposed treaty that limit the right of a source country to tax income. This article provides further relief where both Venezuela and the United States otherwise still tax the same item of income. This article is not subject to the saving clause, so that the country of citizenship or residence will waive its overriding taxing jurisdiction to the extent that this article applies.

The proposed treaty provides that it is understood that double taxation will be avoided in accordance with the other paragraphs of this article (as described below).

In the case of Venezuela, the proposed treaty generally provides that when a resident of Venezuela derives income that, in accordance with the provisions of the proposed treaty, may be taxed by the United States, Venezuela will allow relief to such resident. Such relief may consist alternatively of (1) an exemption of such income from Venezuelan tax, or (2) a credit against Venezuelan tax on income. The proposed treaty provides that such relief will be allowed in accordance with the provisions and subject to the limitations of Venezuelan laws, as they may be amended from time to time without changing the principle of the proposed treaty provisions.

In the case of the United States, the proposed treaty generally provides that the United States will allow a U.S. citizen or resident a foreign tax credit for the income taxes paid to Venezuela by or on behalf of such U.S. citizen or resident. The proposed treaty also requires the United States to allow a deemed-paid credit, with respect to Venezuelan income tax, to any U.S. company that receives dividends from a Venezuelan company if the U.S. company owns 10 percent or more of the voting stock of such Venezuelan company. The credit generally is to be computed in accordance with the provisions and subject to the conditions and limitations of U.S. law (as such law may be amended from time to time without changing the general principles of the proposed treaty provisions).

Article 25. Non-Discrimination

The proposed treaty contains a non-discrimination article that is generally similar to the non-discrimination article in the U.S. model and to provisions that have been included in other recent U.S. income tax treaties. Like the U.S. model, non-discrimination protection is provided with respect to all taxes imposed by a country or its political subdivisions or local authorities, and not just to taxes covered by the proposed treaty under Article 2 (Taxes Covered).

In general, under the proposed treaty, one country may not discriminate by imposing other or more burdensome taxes (or requirements connected with taxes) on nationals of the other country than it would impose on its nationals in the same circumstances. The proposed protocol provides that it is understood that a nonresident of a country who is subject to tax by that country on his or her worldwide income by reason of being a national there is not in the same circumstances as a nonresident of that country who is subject to tax on income only from sources in that country. This provision applies, notwithstanding the provisions of Article 1 (General Scope), whether or not the nationals in question are residents of the United States or Venezuela.

Under the proposed treaty, 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. Consistent with the U.S., OECD and U.N. models, however, a country is not obligated to grant residents of the other country any personal allowances, reliefs, or reductions for tax purposes on account

of civil status or family responsibilities which it grants to its own residents.

The proposed treaty provides that nothing in the non-discrimination article is to be construed as preventing either of the countries from imposing the branch taxes described in Article 11A (Branch Tax).

Each country is required (subject to the arm's-length pricing rules of Articles 9 (Associated Enterprises), 11 (Interest), and 12 (Royalties)) to allow an enterprise of a country to deduct interest, royalties, and other disbursements paid by such enterprise to residents of the other country under the same conditions that it allows deductions for such amounts paid to residents of the same country as the payor. Similarly, each country is required to allow a resident of a country to deduct any debts of such resident to a resident of the other country, for purposes of determining the taxable capital of the resident of the first country, under the same conditions that it allows deductions for debts contracted to a resident of the first country. The Technical Explanation states that the term "other disbursements" is understood to include a reasonable allocation of executive and general administrative expenses, research and development expenses, and other expenses incurred for the benefit of a group of related persons.

The non-discrimination rules also apply to enterprises of one country that are owned in whole or in part by residents of the other country. Enterprises of one country, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other country, will not be subjected in the first country to any taxation or any connected requirement which is other or more burdensome than the taxation and connected requirements that the first country imposes or may impose on its similarly situated enterprises. The Technical Explanation includes examples of Code provisions that are understood by the two countries not to violate this provision of the proposed treaty. Those examples cover the rules that impose a withholding tax on non-U.S. partners of a partnership and the rules that prevent foreign persons from owning stock in Subchapter S corporations.

The saving clause (which allows the country of residence or citizenship to impose tax notwithstanding certain treaty provisions) does not apply to the non-discrimination article.

Article 26. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision, with some variation, that authorizes the competent authorities of the two countries to consult together to attempt to alleviate individual cases of double taxation not in accordance with the proposed treaty. The saving clause of the proposed treaty does not apply to this article, so that the application of this article might result in a waiver (otherwise mandated by the proposed treaty) of taxing jurisdiction by the country of citizenship or residence.

Under this article, a resident of one country who considers that the action of one or both of the countries result or will result in taxation which is not in accordance with the proposed treaty may present his or her case to the competent authority of either country. The proposed treaty provides that the case may be presented

to the competent authorities irrespective of the remedies provided by the domestic laws of the countries and the time limits prescribed in such laws for claiming a refund.

The competent authority then makes a determination as to whether the objection appears justified. If the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, that competent authority is to endeavor to resolve the case by mutual agreement with the competent authority of the other country, with a view to the avoidance of taxation which is not in accordance with the proposed treaty. The proposed protocol provides that the competent authorities are to endeavor to resolve such cases as promptly as possible. Provided that the statute of limitations has been interrupted in accordance with the steps designated by domestic law, any agreement reached is to be implemented notwithstanding any time limits or other procedural limitations under the domestic laws of the countries.

The competent authorities of the countries must endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the proposed treaty. The proposed treaty provides a non-exhaustive list of items that the competent authorities may agree to, including: (1) the same allocation of income, deductions, credits, or allowances of an enterprise of a country to its permanent establishment situated in the other country; (2) the same allocation of income, deductions, credits, or allowances between persons; (3) the same characterization of particular items of income; (4) the same application of source rules with respect to particular items of income; (5) the common meaning of a term; (6) increases in any specific amounts referred to in the proposed treaty to reflect economic or monetary developments; and (7) the application of the provisions of domestic law regarding penalties, fines, and interest in a manner consistent with the purposes of the proposed treaty. The competent authorities may also consult together for the elimination of double taxation in cases not provided for in the proposed treaty.

The proposed treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of this mutual agreement article. The Technical Explanation states that this provision makes clear that it is not necessary to go through diplomatic channels in order to discuss problems arising in the application of the proposed treaty.

Article 27. Exchange of Information

This article provides for the exchange of information between the two countries. Notwithstanding the provisions of Article 2 (Taxes Covered), the proposed treaty's information exchange provisions apply to all taxes imposed at the national level by the United States and Venezuela.

The proposed treaty provides that the two competent authorities will exchange such information as is necessary to carry out the provisions of the proposed treaty or the provisions of the domestic laws of the two countries concerning taxes covered by the proposed treaty (insofar as the taxation thereunder is not contrary to the proposed treaty). This exchange of information is not restricted by Ar-

ticle 1 (General Scope). Therefore, information with respect to third-country residents is covered by these procedures.

Any information exchanged under the proposed treaty will be treated as secret in the same manner as information obtained under the domestic laws of the country receiving the information. The exchanged information may be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection, or administration, enforcement, or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the proposed treaty or the oversight of the above. Such persons or authorities may use the information for such purposes only.[10] The Technical Explanation states that persons involved in the administration of taxes include legislative bodies with oversight roles with respect to the administration of the tax laws, such as, for example, the tax-writing committees of Congress and the General Accounting Office. Information received by these bodies must be for use in the performance of their role in overseeing the administration of U.S. tax laws. Exchanged information may be disclosed in public court proceedings or in judicial decisions.

As is true under the U.S., OECD and U.N. models, under the proposed treaty, a country is not required to carry out administrative measures at variance with the laws and administrative practice of either country, to supply information that is not obtainable under the laws or in the normal course of the administration of either country, or to supply information that would disclose any trade, business, industrial, commercial, or professional secret or trade process or information the disclosure of which would be contrary to public policy.

The proposed treaty provides that if information is requested by a country in accordance with the exchange of information article, the requested country will obtain the information to which the request relates in the same manner and to the same extent as if the tax were its own tax. The Technical Explanation states that this rule applies even if the requested country has no direct tax interest in the case to which the tax relates.

If specifically requested by the competent authority of a country, the competent authority of the other country must provide information under this article in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, and writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of the other country with respect to its own taxes.

The proposed protocol provides that it is understood that in order to comply with this exchange of information article, the competent authorities of the countries are empowered by their respective domestic laws to obtain information held by persons other than taxpayers, including information held by financial institutions, agents and trustees. The Technical Explanation states that although the proposed treaty does not include the provision in the U.S. model

[10] Code section 6103 provides that otherwise confidential tax information may be utilized for a number of specifically enumerated non-tax purposes. Information obtained by the United States pursuant to the proposed treaty could not be used for these non-tax purposes.

dealing with bank secrecy rules, the proposed protocol clarifies that the competent authorities of both countries have the necessary authority to comply with the provisions of this article (including obtaining information held by banks).

Article 28. Diplomatic Agents and Consular Officers

The proposed treaty contains the rule found in the U.S. model and other U.S. tax treaties that its provisions do not affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or the provisions of special agreements. Accordingly, the proposed treaty will not defeat the exemption from tax which a host country may grant to the salary of diplomatic officials of the other country. The saving clause does not apply in the application of this article to host country residents who are neither citizens nor lawful permanent residents of that country. Thus, for example, U.S. diplomats who are considered Venezuelan residents generally may be protected from Venezuelan tax.

Article 29. Entry Into Force

This article provides that the proposed treaty will be subject to ratification in accordance with the applicable procedures of each country. Each country is required to notify the other through diplomatic channels, accompanied by an instrument of ratification, when it has completed the required procedures.

The proposed treaty will enter into force on the date on which the second of the two notifications of the completion of ratification requirements and accompanying instrument of ratification has been received. With respect to taxes withheld at source, the proposed treaty will be effective for amounts paid or credited on or after the first day of January following the date on which the proposed treaty enters into force. With respect to other taxes, the proposed treaty will be effective for taxable periods beginning on or after the first day of January following the date on which the proposed treaty enters into force.

Article 30. Termination

The proposed treaty will continue in force until terminated by either country. Either country may terminate the proposed treaty at any time after the expiration of the five-year period from the date of its entry into force, provided that at least six months prior notice of termination has been given through diplomatic channels. A termination is effective, with respect to taxes imposed in accordance with Article 10 (Dividends), Article 11 (Interest), and Article 12 (Royalties) for amounts paid or credited on or after the first day of January following the date on which notice of expiration is given. In the case of other taxes, a termination is effective for taxable periods beginning on or after the first day of January following the date on which such notice of expiration is given.

The proposed treaty includes a provision with respect to the effect of changes in the law of either country. The appropriate authority of each country may request consultations with the appropriate authority of the other country to determine whether an amendment to the proposed treaty is appropriate to address a

change in the law or policy of either country. If, as a result of these consultations, a determination is made that the effect or application of the proposed treaty has been changed unilaterally by reason of domestic legislation enacted by a country such that the balance of benefits provided by the proposed treaty has been altered significantly, such authorities will consult with a view toward amending the treaty to restore an appropriate balance of benefits. The Technical Explanation notes that any such amendment would be subject to Senate advice and consent to ratification.

IV. ISSUES

The proposed treaty and proposed protocol with Venezuela presents the following specific issues.

A. Developing Country Concessions

The proposed treaty contains a number of developing country concessions, some of which are found in other U.S. income tax treaties with developing countries. The most significant of these concessions are described below.

Definition of permanent establishment

The proposed treaty departs from the U.S. and OECD models by providing for broader source-basis taxation with respect to business activities. The proposed treaty's permanent establishment article, for example, permits the country in which business activities are carried on to tax the activities in circumstances where it would not be able to do so under the U.S. or OECD models. Under the proposed treaty, a building site or construction or installation project, or an installation or drilling rig or ship used for the exploration of natural resources, constitutes a permanent establishment if the site, project or activities continue in a country for more than 183 days within any 12–month period. For example, under the proposed treaty, a U.S. enterprise's business profits that are attributable to a construction project in Venezuela will be taxable by Venezuela if the project lasts for more than 183 days within a 12–month period. Under the U.S. and OECD models, such a site or project must last for more than one year in order to constitute a permanent establishment. Under the U.N. model and other U.S. treaties with developing countries, the site or project must last for more than six months in order to constitute a permanent establishment. Thus, the proposed treaty's 183–day period for establishing a permanent establishment is significantly shorter than the corresponding periods in the U.S. and OECD models but is similar to the six-month period provided in U.S. treaties with developing countries.

The proposed treaty contains a provision, not present in either the U.S. model or the OECD model, which deems a permanent establishment to exist where an enterprise provides services through its employees in a country if the activities continue for a period or periods aggregating more than 183 days within any 12–month period. The U.N. model contains a similar rule.

Taxation of certain equipment leasing

The proposed treaty treats as royalties payments for the use of, or the right to use, industrial, commercial, or scientific equipment. In most other treaties, these payments are considered rental income; as such, the payments are subject to the business profits rules, which generally permit the source country to tax such

amounts only if they are attributable to a permanent establishment located in that country, and the payments are taxed, if at all, on a net basis. By contrast, the proposed treaty permits gross-basis source country taxation of these payments, at a rate not to exceed 5 percent, if the payments are not attributable to a permanent establishment situated in that country. If the payments are attributable to such a permanent establishment, the business profits article of the proposed treaty is applicable.

Other taxation by source country

The proposed treaty includes additional concessions with respect to source-based taxation of amounts earned by residents of the other treaty country.

The proposed treaty allows a maximum rate of source country tax on royalties of 5 or 10 percent, depending on the type of property involved. The 5–percent limitation applies to payments for the use of, or the right to use, industrial, commercial or scientific equipment. The 10–percent limitation applies to payments for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic films, tapes and other means of image or sound reproduction, and payments for the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience. The 10–percent limitation also applies to gains derived from the alienation of such right or property to the extent that such gains are contingent on the productivity, use, or disposition thereof. By contrast, both the U.S. model and the OECD model generally would not permit source-country taxation of royalties.

The proposed treaty generally permits source-country taxation of artistes and sportsmen if the amount of compensation derived by the individual in the source country exceeds $6,000 (including reimbursed expenses) for the taxable year concerned. By contrast, the U.S. model generally would permit source country taxation of artistes and sportsmen only if the gross receipts (including reimbursed expenses) exceed $20,000.

The proposed treaty permits residence-country taxation under Article 22 (Other Income) for income of a resident of a country that is not dealt with in other articles of the proposed treaty. Under the proposed treaty, such income that arises in a treaty country may also be taxed by the source country. By contrast, the U.S. and OECD models generally would permit only a recipient's country of residence to tax such other income.

Issue

One purpose of the proposed treaty is to reduce tax barriers to direct investment by U.S. firms in Venezuela. The practical effect of these developing country concessions could be greater Venezuelan taxation of future activities of U.S. firms in Venezuela than would be the case under rules that were comparable to those of either the U.S. model or the OECD model.

The issue is whether these developing country concessions represent appropriate U.S. treaty policy and, if so, whether Venezuela is an appropriate recipient of these concessions. There is a risk that

the inclusion of these concessions in the proposed treaty could result in additional pressure on the United States to include such concessions in future treaties negotiated with developing countries. However, a number of existing U.S. income tax treaties with developing countries already include similar concessions. Such concessions arguably are necessary in order to enter into treaties with developing countries. Tax treaties with developing countries can be in the interest of the United States because they provide reductions in the taxation by such countries of U.S. investors and a clearer framework for the taxation of U.S. investors. Such treaties also provide dispute resolution and nondiscrimination rules that benefit U.S. investors and exchange of information procedures that benefit the tax authorities.

B. Treaty Shopping

The proposed treaty, like a number of U.S. income tax treaties, generally limits treaty benefits for treaty country residents so that only those residents with a sufficient nexus to a treaty country will receive treaty benefits. Although the proposed treaty generally is intended to benefit only residents of Venezuela and the United States, residents of third countries sometimes attempt to use a treaty to obtain treaty benefits. This is known as treaty shopping. Investors from countries that do not have tax treaties with the United States, or from countries that have not agreed in their tax treaties with the United States to limit source country taxation to the same extent that it is limited in another treaty may, for example, attempt to reduce the tax on interest on a loan to a U.S. person by lending money to the U.S. person indirectly through a country whose treaty with the United States provides for a lower rate of withholding tax on interest. The third-country investor may attempt to do this by establishing in that treaty country a subsidiary, trust, or other entity which then makes the loan to the U.S. person and claims the treaty reduction for the interest it receives.

The anti-treaty shopping provision of the proposed treaty is similar to anti-treaty shopping provisions in the Code (as interpreted by Treasury regulations) and in the U.S. model. The provision also is similar to the anti-treaty shopping provision in several recent treaties. The degree of detail included in these provisions is notable in itself. The proliferation of detail may reflect, in part, a diminution in the scope afforded the IRS and the courts to resolve interpretive issues adversely to a person attempting to claim the benefits of a treaty; this diminution represents a bilateral commitment, not alterable by developing internal U.S. tax policies, rules, and procedures, unless enacted as legislation that would override the treaty. (In contrast, the IRS generally is not limited under the proposed treaty in its discretion to *allow* treaty benefits under the anti-treaty shopping rules.) The detail in the proposed treaty does represent added guidance and certainty for taxpayers that may be absent under treaties that may have somewhat simpler and more flexible provisions.

One provision of the anti-treaty shopping article differs from the comparable rule of some earlier U.S. treaties, but the effect of the change is not clear. The general test applied by those treaties to allow benefits to an entity that does not meet the bright-line own-

ership and base erosion tests is a broadly subjective one, looking to whether the acquisition, maintenance, operation of an entity did not have "as a principal purpose obtaining benefits under" the treaty. By contrast, the proposed treaty contains a more precise test that allows denial of benefits only with respect to income not derived in connection with (or incidental to) the active conduct of a substantial trade or business. (However, this active trade or business test does not apply with respect to a business of making or managing investments carried on by a person other than a bank or insurance company, so benefits may be denied with respect to such a business regardless of how actively it is conducted). In addition, the proposed treaty (like all recent treaties) gives the competent authority of the country in which the income arises the authority to determine that the benefits of the treaty will be granted to a person even if the specified tests are not satisfied.

The practical difference between the proposed treaty tests and the corresponding tests in other treaties will depend upon how they are interpreted and applied. Given the relatively bright line rules provided in the proposed treaty, the range of interpretation under it may be fairly narrow.

The Committee has in the past expressed its belief that the United States should maintain its policy of limiting treaty-shopping opportunities whenever possible. The Committee has further expressed its belief that, in exercising any latitude Treasury has with respect to the operation of a treaty, the treaty rules should be applied to deter treaty-shopping abuses. The proposed treaty's ownership test may be effective in preventing third-country investors from obtaining treaty benefits by establishing investing entities in Venezuela because third-country investors may be unwilling to allow more than 50 percent of such investing entities to be owned by U.S. or Venezuelan residents or other qualified owners in order to meet the ownership test of the anti-treaty shopping provision. The base erosion test contained in the proposed treaty will provide protection from certain potential abuses of a Venezuelan conduit. On the other hand, implementation of the tests for treaty shopping set forth in the proposed treaty raise factual, administrative, and other issues. The Committee may wish to satisfy itself that the anti-treaty-shopping rules in the proposed treaty are adequate under the circumstances.

C. Venezuelan Territorial Tax System

The proposed treaty raises unique issues because Venezuela has a territorial tax system. Under this system, Venezuela taxes income of residents or nonresidents only with respect to income from Venezuelan sources. Foreign source income is not subject to Venezuelan tax.

Some argue that it is inappropriate to forego U.S. tax when, because of the territorial tax system of the treaty partner, the result would be total elimination of any tax paid by the foreign investor on U.S. source income. In general, Venezuela does not tax the foreign source business income of a Venezuelan resident doing business in the United States. Under the proposed treaty, a Venezuelan resident engaged in business in the United States but not at a level that gives rise to a permanent establishment would not pay U.S.

tax, and would not pay any tax to Venezuela under its territorial system (assuming that the income was treated as not being from Venezuelan sources). In the absence of the proposed treaty, that person would be considered to be engaged in a U.S. trade or business and would be subject to U.S. tax on such income. Similarly, under the proposed treaty, a Venezuelan individual performing independent personal services in the United States would not be taxable in the United States on income earned from such services if not attributable to a fixed base. Assuming Venezuela did not tax such income under its territorial tax system, the result would be a complete exemption from tax. In addition, under the proposed treaty, the reduced rates of U.S. withholding tax on certain payments to Venezuelan persons (*e.g.,* for dividends, interest and royalties) would provide additional relief for such persons from taxation by both countries.

One of the principal purposes of a tax treaty is to eliminate double taxation of income (by both the source country and residence country). One way this goal is achieved is for the source country to cede its jurisdiction to tax the income to the residence country. This concept is less relevant where the residence country exempts the income from taxation. Some argue that it is not appropriate to enter into a treaty that results in a double exemption from taxation. In other U.S. treaties with countries that do not tax certain types of income earned abroad by its taxpayers until repatriated (*i.e.,* a remittance-based tax system), the United States has included provisions denying U.S. rate reductions and exemptions for income which is not remitted to and, thus, not subject to tax by the treaty partner.[11] Some might argue that a similar limitation might be appropriate here.

On the other hand, the proposed treaty would provide benefits for U.S. persons.[12] The proposed treaty generally would provide relief from potential double taxation for U.S. persons. A U.S. person is taxable by the United States on its worldwide income. Such income could also be subject to Venezuelan tax if treated as being from Venezuelan sources under its territorial tax system. Venezuelan sourcing rules relating to income and deductions may vary and be inconsistent with corresponding U.S. sourcing rules. Double taxation could result in cases where the income earned by such person is treated as being from U.S. sources under U.S. rules and from Venezuelan sources under Venezuelan rules. For example, absent the proposed treaty, Venezuela levies withholding tax on payments for certain services performed in the United States. Because the United States would treat this payment as being from U.S. sources, the U.S. foreign tax credit limitation in many cases would prevent the U.S. recipient of such income from claiming a credit against U.S. taxes for the Venezuelan taxes. The proposed treaty generally would address such potential cases of double taxation by preventing Venezuela from imposing tax on income from the per-

[11] Such provisions are included in the U.S. treaties with Jamaica and the United Kingdom.

[12] Venezuela has entered into tax treaties with the Czech Republic, Germany, Italy, the Netherlands, Portugal, Switzerland, Trinidad and Tobago, and the United Kingdom. Venezuela also has entered into a tax treaty with France that covers income taxes and air and shipping activities.

formance of services except when the income is attributable to a fixed base or permanent establishment in Venezuela.

The proposed treaty would also prevent double taxation which would result from the calculation of net income under Venezuela's statutory rules. Because Venezuela generally does not tax foreign source income, it does not permit foreign source deductions in calculating taxable income. This would prohibit a Venezuelan permanent establishment from deducting its share of the entity's home office expenses incurred for the benefit of the entire entity. Moreover, Venezuela generally would not permit its residents to deduct payments to foreign persons even if such payments would be deductible if paid to a Venezuelan person. Under the business profits (Article 7) and non-discrimination (Article 25) articles of the proposed treaty, these deductions would be permitted.

In addition, the exchange of information and mutual agreement provisions of the proposed treaty will provide additional benefits. These provisions are useful for purposes of preventing fiscal evasion, as well as addressing cases of potential double taxation (not otherwise specifically addressed under the treaty). In addition, the reduced rates of source country tax under the proposed treaty would provide U.S. investors with relief, for example, from Venezuelan statutory withholding taxes (*e.g.,* on interest and royalties). This would have the effect of encouraging additional trade with, and investment in, Venezuela.

The Committee may wish to consider whether entering into a treaty with a country that has a territorial tax system like that of Venezuela is appropriate as a matter of U.S. treaty policy.

D. Stability of Venezuelan Law

In the past the Treasury Department has maintained that a country's political situation should be a factor in determining whether to build stronger economic ties with that country. In a July 5, 1995, letter to the Senate Foreign Relations Committee the Treasury Department wrote:

> A country's political situation is a factor that is considered in determining whether to build stronger economic ties with that country. When consideration of this and other factors leads to a policy of building stronger economic ties with a particular country, a tax treaty becomes a logical part of that policy. One of a treaty's main purposes is to foster the competitiveness of U.S. firms that enter the treaty partner's market place. As long as it is U.S. policy to encourage U.S. firms to compete in these market places, it is in the interest of the United States to enter tax treaties.
>
> Moreover, in countries where an unstable political climate may result in rapid and unforeseen changes in economic and fiscal policy, a tax treaty can be especially valuable to U.S. companies, as the tax treaty may restrain the government from taking actions that would adversely im-

pact U.S. firms, and provide a forum to air grievances that otherwise would be unavailable.[13]

Background of political developments in Venezuela

Venezuela currently is in a period of constitutional and institutional change. In a recent statement, Peter F. Romero, Acting Assistant Secretary of State for Western Hemisphere Affairs, described the political situation in Venezuela as follows.

> Hugo Chavez was elected president of Venezuela by a wide margin in December 1998 on the promise of eliminating corruption and inefficiency in government and ensuring social justice. Seven months after his inauguration, Chavez continues to enjoy an approval rating around 80%.
>
> In April, Venezuelans returned to the polls to vote on a referendum, voting overwhelmingly in favor of the formation of a National Constituent Assembly (ANC) to draft a new Constitution. Elected on July 25, the vast majority of the 131–member ANC supports President Chavez. The ANC was given 6 months to complete a draft of a new Constitution; however, Chavez has asked the ANC to accelerate its work and to finish within 3 months.
>
> The process was off to a difficult start in August, when turf conflicts between the new ANC and established institutions threatened to overtake action on Venezuela's needed reforms. In August the ANC issued two decrees to establish committees to investigate the judicial and legislative branches. The Assembly's claim to "originating" powers (in essence, establishing its superiority to the existing branches of government) was indirectly upheld in a Supreme Court opinion and the President of the Court resigned in protest. The Congress attempted to come back into plenary session, despite a previous agreement to remain in recess, and the ANC issued emergency decrees limiting Congress's powers. Approximately two weeks after the crisis began, an agreement brokered by the Catholic Church, resulted in a new written "cohabitation" accord. Under the terms of the agreement, the Congress will resume plenary sessions on October 2, the traditional end of the summer recess.
>
> In the wake of the public dispute with the Congress, the ANC declared it would intensify its work on the new Constitution. While further political friction is almost certain, it appears that the [government], the ANC and the opposition are buckling down to the work of writing the constitution and revamping the country's institutions.[14]

President Chavez's popularity, his appeal to the disadvantaged of Venezuela, his failed military coup attempt in 1992, and the possi-

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[13] This quote appears in the Report of the Senate Foreign Relations Committee on the Income Tax Convention with Ukraine, Exec. Rept. 104–5, August 10, 1995, regarding an issue that was raised with respect to that treaty in connection with the stability of the Ukrainian tax law.

[14] Statement of Ambassador Peter F. Romero, Acting Assistant Secretary of State for Western Hemisphere Affairs, before the Western Hemisphere Subcommittee of the House International Relations Committee on "Current Issues in the Western Hemisphere Region," September 29, 1999.

bility of change to existing political institutions have raised both expectations and fears regarding institutional change. The Joint Committee staff has been told that President Chavez and his government have assured the United States that all changes will proceed in a democratic fashion. The Joint Committee staff further has been told that President Clinton, at his two meetings with President Chavez in January and September 1999, reinforced with President Chavez the U.S. interest in democratic fair play and cooperation on regional issues.

Issues

Several issues arise in the consideration of a tax treaty with a government that is experiencing political instability. One is that it may be difficult to identify correctly the other country's competent authority in situations where there are competing claims as to who is authorized to exercise legislative, executive, or judicial authority. Another issue is the extent to which any political instability also causes uncertainty as to the precise nature of the substantive law of that country. These uncertainties may make it difficult to administer the treaty.

A more specific issue arises in the context of the exchange of information provisions of the proposed treaty (Article 27 of the proposed treaty, as explicated by paragraph 19 of the proposed protocol). The exchange of information provision requires that information that is exchanged shall be treated as secret by the receiving country in the same manner as information obtained under its local laws and may only be disclosed to persons involved in the assessment, collection, or administration of taxes covered by the provision. Several issues may arise with respect to the utilization of this provision with a government that is experiencing political instability. First, it may be more difficult to assess whether confidentiality will be respected when the information is initially exchanged. Second, it may be more difficult to assess the possibility that inappropriate use will be made in the future of the exchanged information. Third, the country receiving the information could weaken (or potentially eliminate) the confidentiality protections under its local laws, which would concomitantly weaken or eliminate those protections for exchanged information.

The Committee may wish to consider the implications of this political instability on this proposed treaty. Some might argue that, in light of the instability, it might be prudent to consider delaying consideration of ratification. Others might respond that the United States has tax treaties with other countries that have also experienced political instability, so that should not be a disqualifying factor. In addition, the proposed treaty would provide benefits (as well as certainty) to taxpayers who have no choice but to live through the period of political instability; some would argue that these taxpayers should not be denied the benefits of the treaty. The Committee may wish to consider the benefits provided under the proposed treaty as well as the concerns over political instability. Finally, the issues involving the exchange of information provisions,

while serious, may be dealt with by the United States competent authority in administering the provisions of the proposed treaty.