[JOINT COMMITTEE PRINT]

TAX TREATIES:

STEPS IN THE NEGOTIATION AND RATIFICATION OF TAX TREATIES

AND

STATUS OF PROPOSED TAX TREATIES

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JOINT COMMITTEE ON TAXATION

AND

SENATE COMMITTEE ON FOREIGN RELATIONS

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I. STEPS IN THE NEGOTIATION AND RATIFICATION OF TAX TREATIES

This part outlines the steps and procedures generally involved in the negotiation and ratification of tax treaties.

Negotiators

Tax treaties (and protocols to existing tax treaties) are negotiated by the Office of International Tax Affairs of the Treasury Department with the assistance of Internal Revenue Service personnel. Ordinarily, the involvement of the State Department at the negotiators' level is only peripheral, although the law requires that the State Department be consulted prior to the signing of any treaty. Foreign negotiators ordinarily are representatives of the foreign tax authorities.

Model treaties

U.S. negotiators start from the U.S. model income tax treaty (or, in the case of an estate and gift tax treaty, the U.S. model estate and gift tax treaty), which is a public document prepared by the Treasury Department setting out the preferred U.S. position on each article. The model income and estate tax treaties of the Organization for Economic Cooperation and Development (the OECD) also are used as guides.

Public comments to Treasury

Treasury announces that it intends to negotiate a treaty with a particular foreign country or renegotiate an existing treaty, and this gives interested parties an opportunity to comment. Also, Treasury has recently introduced a policy of having public sessions after negotiations have made substantial progress at which it outlines the issues involved in the treaty and the possible solutions (but not the specific terms or draft language) and solicits the views of interested parties.

Initialling of treaty text

After the text of the treaty is agreed to, it is initialled by the negotiators. The initialling is not of a binding nature but merely serves to identify the text agreed upon at the negotiators' level. Textual changes may be made after the draft is initialled.

Signing of treaty

After an official translation of the text is completed and the text is approved for form by the State Department, it then is signed by the appropriate officials of each government. (In the case of the United States, this is ordinarily the Secretary of State or the U.S. Ambassador to the foreign country.) After signature, Treasury publicly releases the treaty text.

Letter of transmittal

The treaty is then sent to the White House for signature by the President of the letter of transmittal to the Senate requesting approval of the Senate to ratification by the President.

Senate Committee on Foreign Relations

The tax treaty is referred by the Senate to the Committee on Foreign Relations, which conducts hearings on it. After the committee's deliberations, it may report the treaty to the Senate floor with the recommendation that the treaty be approved as negotiated, or that the Senate approve the treaty with certain amendments, reservations, or understandings. The committee may also decline to report the treaty favorably.

Senate deliberation

Following committee action, the treaty is reported to the full Senate which must advise and consent to its ratification by a vote of two-thirds of the Members present. Individual Senators may offer amendments, reservations, or understandings after the Senate has acted upon any amendments, reservations, or understandings proposed by the Committee on Foreign Relations. Any votes to be taken by the Senate on any amendments, reservations, or understandings require a majority with the exception of a motion to table the proposed tax treaty, which requires a two-thirds vote.

Ratification

If the treaty is approved without reservation or amendment, the President may then exchange instruments of ratification with the foreign government (assuming the foreign government has also completed its internal procedures which must be carried out before it can ratify the treaty).

Renegotiation of treaties because of Senate reservation

If the Senate has approved the treaty with a reservation or amendment, it may be necessary to renegotiate portions of the treaty before the foreign country will ratify. If the renegotiation is limited in scope, it will ordinarily be done in the form of a protocol. It would be necessary for the Senate to approve ratification of the protocol by a two-thirds vote as if it were a separate treaty. An example of this situation is the pending U.K. income tax treaty which was approved by the Senate in 1978 with a reservation. Because of the U.S. reservation, the United Kingdom refused to act on the ratification of the treaty until other modifications were made. A protocol incorporating these modifications has been negotiated and transmitted to the Senate. Neither the protocol nor the pending treaty will be ratified by the U.S. and U.K. governments until the protocol is approved by both the Senate and the Parliament.

Revision of existing treaties

Where it is determined that changes to an existing tax treaty would be appropriate because the treaty is outdated in certain respects (for example, where there have been changes in the tax laws of either country since the existing treaty was negotiated), the changes may be made by revising the treaty with a protocol. (An example of this would be the protocol, pending in the Senate, to the existing income tax treaty with France.) Where, however, the changes are substantial enough, a new treaty may be negotiated to replace the existing treaty. (Examples of this are the pending estate and gift tax treaties with the United Kingdom and France, which would replace existing estate tax treaties with those two countries.)

II. STATUS OF U.S. TAX TREATIES AWAITING RATIFICATION*

A. Summary

Treaties scheduled for a hearing on June 6, 1979

Treaty	Status
1. U.S.-South Korea income tax treaty.	Signed; submitted to Senate and referred to Foreign Relations Committee.
2. Protocol to existing U.S.-France income tax treaty.	Signed; submitted to Senate and referred to Foreign Relations Committee.
3. U.S.-France estate and gift tax treaty.	Signed; submitted to Senate and referred to Foreign Relations Committee.
4. Protocol to pending U.S.-U.K. income tax treaty.	Signed; submitted to Senate and referred to Foreign Relations Committee.
5. U.S.-U.K. estate and gift tax treaty.	Signed; submitted to Senate and referred to Foreign Relations Committee.
6. U.S.-Hungary income tax treaty.	Signed; submitted to Senate and referred to Foreign Relations Committee.

Treaties to be considered at a later date

Treaty	Status
1. U.S.-Philippines income tax treaty.	Signed; submitted to Senate and referred to Foreign Relations Committee.
2. U.S.-Morocco income tax treaty.	Signed; submitted to Senate and referred to Foreign Relations Committee.
3. U.S.-Israel income tax treaty and protocol.	Protocol to pending treaty initialled, but not yet signed; submission to Senate probable by early summer.
4. U.S.-Egypt income tax treaty and protocol.	Protocol to pending treaty not yet initialled; submission to Senate probable this year.

* As of May 21, 1979.

B. Treaties Scheduled for a Hearing on June 6, 1979

The following six tax treaties (or protocols to tax treaties) have been scheduled for a hearing on June 6, 1979, by the Senate Committee on Foreign Relations.

1. U.S.-South Korea income tax treaty

The Foreign Relations Committee held hearings on the treaty and ordered it favorably reported during the last Congress but, because of the crowded Senate floor calendar, it was not considered by the Senate. The treaty generally follows the U.S. model income tax treaty. Because it will be considered by a new Congress, the committee must report out the treaty again before it can be acted on by the Senate.

2. Protocol to existing U.S.-France income tax treaty

The principal provisions of the protocol are designed to resolve potential double taxation problems for Americans residing in France which may occur because, effective January 1, 1979, France commenced taxing these individuals on their worldwide income. The manner in which the protocol deals with the problem is complex, but essentially it splits the tax revenue from U.S. source income of Americans resident in France between the U.S. and French Treasuries. France agrees not to tax these individuals on some of their U.S. business income and the United States agrees to give a credit for some of the French taxes imposed on their U.S. source investment income. In this connection, the treatment of partnership income and pension and social security benefits are also modified by the protocol.

In addition, the protocol also provides for the reciprocal exemption from withholding tax by the source country on interest paid by banks in one country to residents in the other. It also follows the pending U.K. income tax treaty and exempts French insurance companies from the U.S. excise tax on premiums paid to foreign insurance companies. (Unlike the pending U.K. treaty, the exemption does not apply to the extent that the French insurer reinsures the risk with a third-country insurance company not entitled to the exemption.) The protocol also revises the article dealing with international shipping so that it conforms more closely with the U.S. model income tax treaty.

3. U.S.-France estate and gift tax treaty

The pending treaty will replace the existing estate tax treaty which has been in effect since 1949. The general principle underlying the proposed treaty is that the country of domicile has the right to tax estates and transfers on a worldwide basis. However, in general, the country of citizenship also retains the residual right to tax such estates and transfers, subject to a credit for the taxes paid to the country of domicile. The proposed treaty is comparable to the 1971 estate tax treaty with the Netherlands.

4. Protocol to pending U.S.-U.K. income tax treaty

The protocol to the pending U.K. income tax treaty was signed on March 15, 1979, and was recently transmitted to the Senate. The pending treaty was approved by the Senate last year subject to the

Senate's reservation on the State taxation provision (Article 9(4)). That provision would have limited the right of States to tax British multinationals using the worldwide combination/unitary method of apportionment of income. Because of the Senate's reservation, the British Government has refused to ratify the pending treaty until this protocol is approved.

In accordance with the Senate's reservation, the protocol deletes the State taxation provision.

As a concession to the British for the United States' not agreeing to the State taxation article, the protocol permits the United Kingdom to tax U.S. companies engaged in oil and gas exploration activities in the North Sea as long as they are present in the British sector for more than 30 days during a year. Under the treaty as approved by the Senate, the taxation of U.S. drilling contractors operating on the North Sea on a temporary basis was not completely clear. Without the change made by the protocol, it might have been possible as a practical matter for most of those U.S. companies to continue to avoid being subject to the British tax on their North Sea operations.

The third major provision of the protocol places a per-country limit on the provision of the pending treaty which requires the United States to grant a foreign tax credit for the U.K. Petroleum Revenue Tax (PRT) paid by the U.S. oil companies. (Subsequent to the Senate action on the treaty in 1978, the Internal Revenue Service ruled that the PRT is not a creditable income tax. Rev. Rul. 78-424, 1978-49 Int. Rev. Bull. 10.) The protocol modifies the proposed treaty so that it requires the United States to allow the credit for the PRT only against the U.S. taxes imposed on U.K. source oil income of the companies. Treasury and the United Kingdom agreed to make this modification after the matter was raised during the Senate's consideration of the treaty last year. (The objection to the treaty as originally drafted was that the oil companies could credit the PRT against their oil income from OPEC countries.)

The protocol also makes several other changes to the proposed treaty which are intended to be of a technical or clarifying nature. These deal with (1) the exemption of British insurance companies from the U.S. excise tax on premiums paid to foreign insurers, (2) the treatment of dividends paid by corporations resident in both countries, (3) the exemption from tax by each country of employees of the other country, and (4) the suspension of the statute of limitations in both countries for three years after the proposed treaty enters into force in any situation where the running of the statute would bar a benefit granted under the treaty.

5. U.S-U.K. estate and gift tax treaty

This treaty would replace the existing estate tax treaty which has been in effect since 1946. It generally provides for primary taxation by the country of domicile. Taxation, after a credit for the taxes imposed by the country of domicile, by the country of citizenship is permitted in the case of a citizen of one country domiciled in the other. It is similar to the proposed estate and gift tax treaty with France and the existing estate tax treaty with the Netherlands.

6. U.S.-Hungary income tax treaty

The treaty was transmitted to the Senate on May 9, 1979. It generally follows the U.S. model income tax treaty.

C. Treaties Which Will Be Considered at a Later Date

1. U.S.-Philippines income tax treaty

During the last Congress, the Foreign Relations Committee held hearings on the treaty. The committee decided to defer the vote on whether to report it out in order to consider the arguments made by the U.S. airlines in opposition to the air transport provision. (Unlike other U.S. tax treaties, it does not provide for the exemption of U.S. airlines flying to the Philippines from Philippine tax.)

2. U.S.-Morocco income tax treaty

The treaty was transmitted to the Senate in May 1978, but has not yet been the subject of hearings or other action by the Foreign Relations Committee. It generally follows the U.S. model income tax treaty but it contains a provision requiring the United States to give a foreign tax credit for compulsory loans to the Moroccan government made by U.S. businesses operating in Morocco.

3. U.S.-Israel income tax treaty and protocol

The income tax treaty was transmitted to the Senate during the last Congress, but consideration was delayed because of difficulties with the provisions dealing with Israeli grants and compulsory loans. A protocol which is designed to resolve these problems has been initialled and should be signed by this summer.

The treaty generally follows the U.S. model income tax treaty. However, the article providing favorable U.S. tax treatment to grants by Israel to U.S. controlled businesses operating in Israel and the article providing for a foreign tax credit for existing compulsory loans by U.S. controlled businesses to the Israeli government are not found in other existing treaties. (However, as noted in No. 2 above, the pending Moroccan treaty also has a provision governing the U.S. tax treatment of compulsory loans.) The protocol also provides, subject to certain limitations, for a U.S. tax deduction for contributions to Israeli charities. (A precedent for this article is provided by a similar provision in the present U.S.-Canadian tax treaty.)

4. U.S.-Egypt income tax treaty and protocol

The income tax treaty was transmitted to the Senate during the last Congress at the same time as the U.S.-Israeli tax treaty. Consideration of the Egyptian treaty was delayed so that certain problems with the Egyptian withholding tax on dividends could be worked out. A protocol to the pending income tax treaty has not yet been initialled but has been substantially worked out and should be signed this year.

III. TAX TREATIES PRESENTLY UNDER NEGOTIATION

A. Bangladesh, Malta, and Denmark

It is expected that income tax treaties will be signed this year with Bangladesh, Malta, and Denmark. It is also expected that an estate and gift tax treaty with Denmark will be signed. They are expected to conform generally with the U.S. model tax treaties.

B. Others

It is possible that income tax treaties with Argentina, Cyprus, Indonesia, Italy, and Jamaica, and a protocol to the existing income tax treaty with Norway, may be signed later this year, although several issues remain in each case. Serious negotiations concerning the revision of the existing income tax treaties with both Canada and Germany have been ongoing for some time, but some major issues remain and there is no target date for the signing of either treaty. An estate and gift tax treaty with Germany is also under negotiation but there is no target date for completion.

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