[JOINT COMMITTEE PRINT]

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

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

ON OCTOBER 7, 1997

PREPARED BY THE STAFF

OF THE

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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 and Ireland. The proposed treaty and proposed protocol were signed on July 28, 1997.[2] The Senate Committee on Foreign Relations has scheduled a public hearing on the proposed treaty and proposed protocol on October 7, 1997.

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 protocol. Part IV is a discussion of issues with respect to the proposed treaty and proposed protocol.

[1] This phamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of Proposed Income Tax Treaty and Proposed Protocol Between the United States and Ireland.* (JCS–17–97), October 6, 1997.

[2] For a copy of the proposed tax treaty, see Senate Treaty Doc. 105–31, September 24, 1997.

I. SUMMARY

The principal purposes of the proposed income tax treaty between the United States and Ireland 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 income taxes of the two countries. The proposed treaty 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. It is intended to enable the two countries to cooperate in preventing avoidance and evasion of taxes.

As in other U.S. tax treaties, these objectives principally are achieved by each country agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other country. For example, the proposed treaty contains provisions under which neither country generally will 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 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, and 17). The proposed treaty provides that dividends and certain capital gains derived by a resident of either country from sources within the other country may be taxed by both countries (Articles 10 and 13); however, the rate of tax that the source country may impose on a resident of the other country on dividends generally will be limited by the proposed treaty (Article 10). The proposed treaty also provides that interest and royalties derived by a resident of either country generally will be exempt from tax in the other country (Articles 11 and 12).

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

The proposed treaty contains the standard provision (the "saving clause") contained in U.S. tax treaties that each country retains the right to tax its citizens and residents as if the treaty had not come into effect (Article 1). In addition, the proposed treaty contains the standard provision that it 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 23).

The United States and Ireland have an income tax treaty currently in force (signed in 1949). The proposed treaty (as supplemented by the proposed protocol) is similar to other recent U.S. income tax treaties, the 1996 U.S. model income tax treaty ("U.S. model"),[3] and the model income tax treaty of the Organization for Economic Cooperation and Development ("OECD model"). However, the proposed treaty and proposed protocol contain certain substantive deviations from those documents.

[3] The Treasury Department released the U.S. model on September 20, 1996. A 1981 U.S. model treaty was withdrawn by the Treasury Departent on July 17, 1992.

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 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 treaty between the United States and Ireland, as supplemented by the proposed protocol, is presented below. The United States and Ireland also exchanged diplomatic notes on July 28, 1997 reflecting certain common understandings and interpretations of the proposed treaty. In the explanation below, the understandings and interpretations reflected in the diplomatic notes are covered together with the relevant articles of the proposed treaty.

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 residents of Ireland. However, other articles of the proposed treaty provide for specific expansions of this scope to persons that are residents of neither the United States nor Ireland for purposes of such articles (e.g., Article 25 (Non-Discrimination) and Article 27 (Exchange of Information and Administrative Assistance)). The determination of whether a person is a resident of the United States or Ireland is made under the provisions of Article 4 (Residence).

The proposed treaty provides that it does not restrict in any manner any benefit accorded by internal law or by any other agreement between the United States and Ireland. Thus, the proposed treaty will not apply to increase the tax burden of a resident of either the United States or Ireland. According to 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 Treasury Department's Technical Explanation (hereinafter referred to as the "Technical Explanation") sets forth the following example. Assume a resident of Ireland 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.[4]

The proposed treaty provides that the dispute resolution procedures under its mutual agreement article take precedence over the corresponding provisions of any other agreement to which the United States and Ireland are parties 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 Ireland, 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, the proposed treaty is subject to a "saving clause." Under this clause, with specific exceptions described below, the proposed treaty is not to affect a country's taxation 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 Ireland as if the treaty were not in force. Similarly, the United States will continue to tax persons that are treated as U.S. residents under U.S. tax law as if the treaty were not in force, unless such persons are treated as residents of Ireland under the treaty tie-breaker rules governing dual residents provided in Article 4 (Residence). The term "residents" includes corporations and other entities as well as individuals.

The proposed treaty contains a provision under which the saving clause (and therefore the jurisdiction to tax) applies to former citizens whose loss of citizenship had as one of its principal purposes the avoidance of tax. This rule applies only for a period of 10 years following such loss of citizenship. Under the U.S. model, the saving clause applies to both former citizens and former long-term residents. The Code provides special rules for the imposition of U.S. income tax on former U.S. citizens for a period of ten years following their loss of U.S. citizenship. The Health Insurance Portability and Accountability Act of 1996 extended the special income tax rules for former U.S. citizens to apply also to certain former long-term residents of the United States. The proposed treaty provision reflects the reach of the U.S. tax jurisdiction pursuant to these special rules prior to its extension to former U.S. long-term residents. Accordingly, the saving clause in the proposed treaty does not permit the United States to impose tax on former U.S. long-term residents who otherwise would be subject to the special income tax rules contained in the Code.

Exceptions to the saving clause are provided for the following benefits conferred by a country pursuant to the proposed treaty:

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[4] See Rev. Rul. 84-17, 1984-1 C.B. 308.

the provision for correlative adjustments to the profits of an enterprise following an adjustment by Ireland of the profits of a related enterprise (Article 9, paragraph 2); the rule regarding source of directors' fees (Article 16, paragraph 2); the treatment of social security benefits and child support payments (Article 18, paragraphs 1(b) and 4); the provisions for relief from double taxation (Article 24); the non-discrimination rules (Article 25); and the mutual agreement procedures (Article 26). These exceptions to the saving clause allow the provision of the enumerated benefits to citizens and residents of a country, without regard to its internal law.

In addition, exceptions from the saving clause are provided for certain benefits conferred by a treaty country pursuant to the proposed treaty, but only in the case of an individual who neither is a citizen of, nor has immigrant status in, such country. Under this rule, the specified benefits under the proposed treaty are available to an individual who spends enough time in the United States to be taxed as a U.S. resident under Code section 7701(b), provided that the individual has not acquired U.S. immigrant status (i.e., is not a green-card holder). The following benefits are subject to this rule: the treatment of pension fund contributions (Article 18, paragraph 5); the exemption from tax on compensation from government service (Article 19) the exemption from U.S. tax on certain income received by temporary visitors who are students or trainees (Article 20); and the special rules applicable to diplomatic agents and consular officers (Article 28).

Article 2. Taxes Covered

The proposed treaty specifies the particular covered taxes of each country for all purposes of the proposed treaty. Unlike the U.S. model and most other U.S. income tax treaties, the non-discrimination rules of Article 25 apply just to these covered taxes, and not to taxes of all kinds imposed by either country or its political subdivisions or local authorities.

In the case of the United States, the proposed treaty, like the present treaty, applies to the Federal income taxes imposed by the Code. However a specific exclusion is provided for the accumulated earnings tax, the personal holding company tax and social security taxes. The proposed treaty also applies to the U.S. excise taxes imposed on insurance premiums paid to foreign insurers and the U.S. excise tax imposed with respect to private foundations. The present treaty does not apply to any excise taxes.

The proposed treaty applies to the excise taxes on insurance premiums paid to foreign insurers only to the extent that the risks covered by such premiums are not reinsured with a person that is not entitled to an exemption from such taxes either under the proposed treaty or under any other treaty. The proposed protocol further provides that it is understood that the proposed treaty will not apply to the excise taxes on insurance premiums where such premiums are not subject to the generally applicable tax imposed on insurance corporations in the country in which the insurer is resident. Because the insurance excise taxes are covered taxes under the proposed treaty, Irish insurance companies generally are not subject to the U.S. excise taxes on insurance premiums for insuring U.S. risks. The excise taxes continue to apply, however, when an

Irish insurer reinsures a policy it has written on a U.S. risk with a foreign reinsurer that is not entitled to a similar exemption under this or a different tax treaty. Moreover, such taxes continue to apply if the Irish insurance company is entitled to benefits under a special tax regime. Because the present treaty does not cover excise taxes, the U.S. insurance excise taxes may be imposed on Irish insurance company under the present treaty.

In the case of Ireland, the proposed treaty applies to the income tax, the corporation tax, and the capital gains tax.

The proposed treaty also contains a provision generally found in U.S. income tax treaties that applies the treaty to any identical or substantially similar taxes that either country may subsequently impose. 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 (including explanations, regulations, rulings, or judicial decisions). Unlike the U.S. model, the proposed treaty does not specifically obligate the competent authorities to notify each other of significant changes in other laws affecting their obligations under the proposed treaty.

Article 3. General Definitions

This article provides definitions of terms used in the proposed treaty that apply for all purposes of the proposed treaty, unless the context requires otherwise. These definitions generally are consistent with the definitions contained in the U.S. model. In addition, certain terms are defined in the articles 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. A "company" is any body corporate or any entity which is treated as a body corporate for tax purposes.

An "enterprise of a Contracting State" is defined as an enterprise carried on by a resident of that country. Similarly, an "enterprise of the other Contracting State" is defined as an enterprise carried on by a resident of the other country. The proposed treaty does not define the term "enterprise." The Technical Explanation states that it is understood to mean any activity or set of activities that constitutes a trade or business.

The term "international traffic" means any transport by a ship or aircraft, other than transport solely between two points within a country. The Technical Explanation 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 Irish competent authority is the Revenue Commissioners or their authorized representative. The U.S. competent authority is the Secretary of the Treasury or his delegate. In fact, 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) of the IRS. On interpretative

issues, the latter acts with the concurrence of the Associate Chief Counsel (International) of the IRS.

The term "United States" means the United States of America and includes the States and the District of Columbia, but does not include Puerto Rico, the Virgin Islands, Guam or any other U.S. possession or territory. The term also includes any area outside the U.S. territorial waters which in accord with international law has been, or may hereafter be, designated under U.S. law as an area over which U.S. rights with respect to the seabed and subsoil and their natural resources may be exercised.

The term "Ireland" similarly includes areas outside the territorial waters of Ireland.

The terms "the Contracting State," "one of the Contracting States" and "the other Contracting State" mean Ireland or the United States, as the context requires. The term "Contracting States" means Ireland and the United States.

The term "national" with respect to a country means any citizen of that country and any legal person, association or other entity deriving its status as such from the laws in force in that country.

The term "qualified governmental entity" means (1) the government or a department of government of one of the countries or a political subdivision or local authority of a country; (2) a person wholly owned, directly or indirectly, by a country or a political subdivision or local authority, provided it is organized under the laws of the country, its earnings are credited to its own account, and its assets vest in the country, political subdivision or local authority upon its dissolution; and (3) a pension trust or fund of a person described herein that is constituted and operated exclusively to administer or provide government service pension benefits. Under the proposed treaty, a qualified governmental entity may not engage in commercial activity, and its income may not inure to the benefit of a private person.

The proposed treaty also provides that, unless the context otherwise requires or the competent authorities of the two countries agree to a common meaning, all terms not defined in the treaty are to have the meanings which they have under the laws of the country whose tax is being applied. The Technical Explanation states that a meaning of a term provided under the tax laws of a country will take precedence over a meaning of such term under other laws of the country.

Article 4. Residence

The assignment of a country of residence in a treaty is important because the benefits of the treaty generally are available only to a resident of one of the treaty countries as that term is defined in the treaty. Furthermore, double taxation often is avoided by the assignment of a single treaty country as the country of residence when, under the internal laws of the treaty countries, a person is a resident of both. The present treaty does not include a definition of the term "resident."

Under U.S. law, residence of an individual is important because a resident alien is taxed on 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 indi-

vidual who spends substantial time in the United States in any year or over a three-year period generally is treated as a U.S. resident (Code sec. 7701(b)). A permanent resident for immigration purposes (i.e., a green-card holder) also is treated as a U.S. resident. Under the Code, a company is domestic, and therefore taxable on its worldwide income, if it is organized in the United States or under the laws of the United States, a State, or the District of Columbia.

The proposed treaty generally defines the term "resident of a Contracting State" to mean any person who, under the laws of that country, is liable to tax therein by reason of his or her domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature. The proposed treaty further provides that a U.S. citizen or alien admitted for permanent residence (i.e., a green-card holder) is a resident of the United States, but only if the individual has a substantial presence, permanent home, or habitual abode in the United States. Unlike under the U.S. model, citizenship alone does not establish residence. As a result, U.S. citizens residing overseas are not necessarily entitled to the benefits of the proposed treaty as U.S. residents.

The proposed treaty also provides that a qualified governmental entity of a country is a resident of that country.

Special rules apply to treat as residents of a treaty country certain organizations that generally are exempt from tax in that country. Under these rules, pension trusts and any other organizations established in a treaty country and maintained exclusively to administer or provide retirement or employee benefits are treated as residents of such country if they are established or sponsored by a person resident in such country. Similarly, charitable and other exempt organizations are residents, provided that the use of their assets, both currently and upon their dissolution or liquidation, is limited to the accomplishment of the purposes that serve as the basis for its tax exemption.

The proposed treaty also provides special rules to treat certain investment entities as residents of the country in which they are organized or created, even though they may not be subject to significant tax at the entity level. Under this rule, Regulated Investment Companies ("RICs") and Real Estate Investment Trusts ("REITs") are treated as U.S. residents and Collective Investment Undertakings are treated as Irish residents. In addition, this rule may apply to any similar investment entities agreed upon by the competent authorities of both countries.

The proposed protocol contains a special rule for fiscally transparent entities. Under this rule, if a resident of one country is entitled to income, profit or gain in respect of an interest in a person that derives income, profit or gain from the other country, any such item so derived will be considered to be an item of that resident to the extent it is so treated under the taxation laws of the first country. Thus, an item of income will be considered to be derived by a resident of a country if he or she is treated under the tax laws of such country as deriving such income.

The term "resident of a Contracting State" does not include any person who is liable to tax in that country in respect only of income

from sources in that country or of profits attributable to a permanent establishment in that country.

The proposed treaty provides a set of "tie-breaker" rules 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. Such a dual resident 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 economic relations are closer (i.e., the "centre of vital interests"). If the country in which the individual has his or her centre of vital interests cannot be determined, or if the individual does not have a permanent home available in either country, such individual 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, the individual 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 are to settle the question of residence by mutual agreement.

In the case of a person other than an individual that would be considered to be a resident of both countries under the basic treaty definition, the proposed treaty provides that the competent authorities shall endeavor by mutual agreement to deem the person to be a resident of one country only for purposes of 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, and the OECD 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 amounts are taxed as business profits.

In general, under the proposed treaty, a permanent establishment is a fixed place of business through which an enterprise carries on business in whole or in part. A permanent establishment includes especially a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources. It also includes any building site or construction or installation project, if the site or project lasts for more than 12 months. The Technical Explanation states that the 12-month test applies separately to each site or project, but that projects that are commercially and geographically interdependent are to be treated as a single project. The Technical Explanation further states that if the 12-month threshold is exceeded, the site or project is treated as a permanent establishment from the first day of activity.

Notwithstanding this general definition of a permanent establishment, the proposed treaty provides that the following specified activities do not 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 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. The proposed treaty provides that the maintenance of a fixed place of business solely for any combination of these activities does not constitute a permanent establishment, provided that the overall activity resulting from such combination is of a preparatory or auxiliary character. In contrast, the U.S. model provides that such a combination of activities does not give rise to a permanent establishment without regard to whether the combination is 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 an 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 is limited to those activities described above, such as storage, display, or delivery of merchandise, which do not constitute a permanent establishment.

The proposed treaty further provides no permanent establishment is deemed to arise based on an agent's activities if the agent is a broker, general commission agent, or any other agent of independent status acting in the ordinary course of its business as an independent agent. The Technical Explanation states that an independent agent is one that is both legally and economically independent of the enterprise. Whether an agent and an enterprise are independent depends on the facts and circumstances of the particular case.

The fact that a company that is resident in one country controls or is controlled by a company that is a resident of the other country, or that carries on business in that other country, 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, but not gains, from real property. The rules covering gains from the sale of real property are contained in Article 13 (Capital Gains).

Under the proposed treaty, income derived by a resident of one country from immovable property (real property) situated in the other country may be taxed in the country where the real property is situated. Income from real property includes income from agriculture or forestry. The country in which the real property is situated is not, however, granted an exclusive right to tax the income

derived from the real property; such income also may be taxed in the recipient's country of residence.

The term "immovable property (real property)" has the meaning that it has under the law of the country in which the property in question is situated. In the case of the United States, the term "real property" is defined in Treas. Reg. sec. 1.897-1(b).

The country in which real property is situated may tax income derived from the direct use, letting, or use in any other form of such property. The rules of this article allowing source country taxation also apply to income from real property of an enterprise and to income from real property used for the performance of independent personal services. Accordingly, income from real property may be taxed by the country in which it is situated even though such income is not attributable to a permanent establishment or fixed base in such country.

The proposed protocol provides residents of a country that are taxable in the other country on income from real property situated in the other country with an election to be taxed by the other country on such income on a net basis in accordance with the law of that other country. Such election is binding for the taxable year of the election and all subsequent years unless the competent authority of that other country 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 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. 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, and rents) 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.

Foreign source income generally is treated as 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 in the case of insurance companies.

Any income or gain of a foreign person for any taxable year that is attributable to a transaction in another taxable 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 taxable year (Code sec. 864(c)(6)).

Proposed treaty limitations on internal law

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

The taxation of business profits under the proposed treaty differs from U.S. 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 Code, all that is necessary for effectively connected business profits to be taxed is that a trade or business be carried on in the United States.

Under the proposed treaty, the profits of a permanent establishment are determined on an arm's-length basis. The proposed treaty provides that the profits attributed to a permanent establishment are determined based on the profits it would make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. Amounts may be attributed to the permanent establishment whether they are from sources within or without the country in which the permanent establishment is located.

In computing profits of a permanent establishment, the proposed treaty provides that deductions are allowed for expenses incurred for the purposes of the permanent establishment. These deductions include a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part of the enterprise that includes the permanent establishment). This rule applies without regard to where such expenses are incurred. According to the Technical Explanation, this rule permits the United States to use its current expense allocation rules in determining deductible amounts. Thus, for example, an Irish company which has a permanent establishment in the United States but which has its head office in Ireland will, in computing the U.S. tax liability of the permanent establishment, be entitled to deduct a portion of the executive and general administrative expenses incurred in Ireland by the head office for purposes of operating the U.S. permanent establishment, allocated and apportioned in accordance with Treas. Reg. section 1.861–8.

Like the OECD model, the proposed treaty provides that a country may determine the profits attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise. If it is customary in a country to use a total profits apportionment method, such method may be used pursuant to the proposed treaty, provided that the method of apportionment gives results that are consistent with the arm's-length principle of this article. This rule is not specified in the U.S. model; however, the provisions of the U.S. model permit the use of a total profits apportionment method as a means of determining arm's-length profits. The Technical Explanation states that methods other than separate accounting may be used to estimate the arm's-length profits of a permanent establishment, provided that the method approximates the results that would be achieved under a separate accounting approach.

Profits are not attributed to a permanent establishment merely by reason of the purchase of goods or merchandise by a 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 the profit element with respect to its purchasing activities.

The proposed treaty provides that the amount of profits attributable to a permanent establishment shall include only the profits derived from the assets or activities of the permanent establishment and must be determined by the same method each year unless there is good and sufficient reason to change the method. In this regard, the diplomatic notes provide that the assets of a permanent establishment will be understood to include any property or rights used by or held by or for the permanent establishment.

Unlike the U.S. model, the proposed treaty does not contain a general definition of "profits." The Technical Explanation states that such term is understood to mean income derived from any trade or business. Under the proposed treaty, the term "profits" as used in this article includes income from the performance of personal services by an enterprise and income from the rental of tangible movable property. Accordingly, such income may be taxed in the source country only if the income is attributable to a permanent establishment. The Technical Explanation states that the term "profits" is understood to include income attributable to notional principal contracts and other financial instruments to the extent such income is related to a trade or business carried on through the permanent establishment.

Where business profits include items of income which are dealt with separately in other articles of the treaty, those other articles, and not the business profits article, govern the treatment of such items of income. Thus, for example, profits attributable to a U.S. ticket office of an Irish airline generally are exempt from U.S. Federal income tax under the provisions of Article 8 (Shipping and Air Transport). This rule does not apply, however, where the other article specifically provides that this article takes precedence (e.g., Article 10 specifically provides that dividends attributable to a permanent establishment are taxable as business profits).

The proposed protocol provides that income or gain attributable to a permanent establishment during its existence is taxable in the country where the permanent establishment is situated even if the payments are deferred until the permanent establishment has ceased to exist. This incorporates the U.S. internal law rule of Code section 864(c)(6).

Article 8. Shipping and Air Transport

Article 8 of the proposed treaty covers income from the operation of ships and aircraft in international traffic. The rules governing income from the sale of ships and aircraft operated in international traffic are contained in Article 13 (Capital Gains).

Under the proposed treaty, 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 when such transport is operated solely between places in a treaty country (Article 3(1)(d) (General Definitions)). Unlike the exemption provided in the present treaty, the exemption in the proposed treaty applies whether or not the ships or aircraft are registered in the first country.

The proposed treaty provides that profits from the rental of ships or aircraft on a full basis for use in international traffic constitute profits from the operation of ships and aircraft in international traffic. Such profits therefore are exempt from tax in the other country. In addition the proposed treaty provides that profits from the operation of ships or aircraft in international traffic 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 in the course of international traffic by the enterprise.

Under the proposed treaty, income derived by an enterprise of one country from the use, maintenance, or rental of containers (including trailers, barges, and related equipment for the transport of containers) used in international traffic is taxable only in that country.

As under 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.

Article 9. Associated Enterprises

The proposed treaty, like most other U.S. tax treaties, contains an arm's length pricing provision. The provision in the proposed treaty is more detailed than the corresponding provision in the present treaty. The proposed treaty recognizes the right of each

country to determine the profits taxable by that country in the case of transactions between related enterprises, if the profits of an enterprise do not reflect the conditions which would have been made between independent enterprises.

The redetermination rules of the proposed treaty apply where an enterprise of one country participates directly or indirectly in the management, control, or capital of an enterprise of the other country or the same persons participate directly or indirectly in the management, control, or capital of such enterprises. In such cases, if conditions between the two enterprises in their commercial or financial relations differ from those which would be made between independent enterprises, then any profits which would have accrued to one of the enterprises but for these conditions may be included in the profits of such enterprise and taxed accordingly. This provision allows a country to adjust the income or loss of one or both of the enterprises if they have entered into non-arm's-length transactions.

The Technical Explanation states that it is understood that this provision does not limit the rights of the respective countries to apply their internal intercompany pricing rules (e.g., Code sec. 482, in the case of the United States), provided that such rules are in accord with the arm's-length principle. The Technical Explanation also states that it is understood that the U.S. "commensurate with income" standard for determining appropriate transfer prices for intangibles was designed to operate consistently with the arm's-length standard. Finally, the Technical Explanation states that this rule permits adjustments to address thin capitalization issues.

Under the proposed treaty, where a country includes in the profits of an enterprise of that country, and taxes, profits on which an enterprise of the other country has been charged to tax in that other country, and the other country agrees that the profits so included are profits that would have accrued to the enterprise of the first country if conditions between the two enterprises had been those that would have been made between independent enterprises, then the other country shall make an appropriate adjustment to the taxes charged on such profits. In making this adjustment, due regard is to be had to the other provisions of the proposed treaty. Moreover, the competent authorities will consult each other if necessary. To avoid double taxation, the proposed treaty's saving clause retaining each country's full taxing jurisdiction over its citizens and residents does not apply to prevent such correlative adjustments.

Article 10. Dividends

Internal dividend 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 sub-

ject to U.S. tax on such dividends on a net basis at graduated rates in the same manner as 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.

Dividends paid by a U.S. corporation generally are U.S.-source income. Also treated as U.S.-source income 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 further 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 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 particular, in order to qualify as a REIT, the REIT must distribute the bulk of its income on a current basis. Thus, a REIT is treated, in essence, as a conduit for federal income tax purposes: generally no tax is imposed at the entity level and the shareholders are taxed on a current basis on the REIT's earnings. Because a REIT in form is taxable as a U.S. corporation, a distribution of its earnings is treated as a dividend rather than as 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 RIC as both a corporation and a conduit for income tax purposes: generally no tax is imposed at the entity level and the shareholders are taxed on a current basis on the RIC's earnings. The purpose of a RIC is to allow investors to hold a diversified portfolio of securities. Thus, the hold-

er 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.

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 23 (Limitation on Benefits)).

Ireland

Ireland generally does not impose a withholding tax on dividends paid by an Irish company to foreign shareholders. Ireland generally provides resident shareholders with an imputed tax credit on dividends for the taxes paid by the company. This credit may be provided to foreign shareholders by treaty.

Proposed treaty limitations on internal law

The present treaty provides that dividends derived from sources within the United States by a resident of Ireland may be taxed by the United States. The rate of U.S. tax generally is limited to 15 percent. However, the rate of tax is limited to 5 percent if the dividend recipient is a corporation controlling (directly or indirectly) at least 95 percent of the voting power of the payor and not more than 25 percent of the gross income of the payor is derived from interest and dividends (other than interest and dividends received from the payor's subsidiaries). This 5-percent rate does not apply if the relationship between the dividend-paying corporation and the dividend-receiving corporation was arranged or maintained primarily with the intention of qualifying for such rate. The present treaty provides that dividends from sources within Ireland shall be exempt from Irish surtax if derived by an individual who is a U.S. resident, is subject to U.S. tax with respect to such dividends, and is not engaged in a trade or business in Ireland.

Under the proposed treaty, dividends paid to a resident of one country may be taxed in the residence country without limitation. In addition, such dividends also may be taxed in the country in which the dividend paying company is resident in accordance with that country's laws. However, source country taxation is subject to limitations if the beneficial owner of the dividends is a resident of the other country. Under these limitations, source country tax is limited to 5 percent of the gross amount of the dividends if the beneficial owner is a company that owns at least 10 percent of the voting stock of the payor company. Under the proposed treaty, source country tax generally is limited to 15 percent of the gross amount

of the dividends in all other cases. The proposed treaty provides that the competent authorities will by mutual agreement settle the mode of application of these limitations. The proposed treaty provides that these limitations do not affect the taxation of the company on the profits out of which the dividends are paid.

The proposed treaty provides special rules that apply as long as an individual resident in Ireland is entitled under Irish law to a tax credit in respect of dividends paid by an Irish-resident company. Such is the case at the present time. Under these special rules, dividends paid by a company resident in Ireland to a U.S. resident may be taxed in the United States. Where a U.S. resident is entitled to a tax credit in Ireland in respect of the dividend, such dividend may also be taxed in Ireland at a rate not exceeding 15 percent on the aggregate of the amount or value of the dividend and the amount of the tax credit. Where the U.S. resident is not entitled to a tax credit in Ireland in respect of the dividend, such dividend will be exempt from any Irish tax chargeable on dividends. A resident of the United States who receives dividends from an Irish-resident company and who is the beneficial owner of the dividends is entitled to the tax credit in respect of such dividend to which an Irish individual resident would be entitled and to the payment of any excess of such tax credit over his or her liability for Irish tax. This tax credit is treated for U.S. foreign tax credit purposes as a dividend. These tax credit rules do not apply if the beneficial owner of the dividend is (or is associated with) a company which either alone or together with associated companies controls directly or indirectly at least 10 percent of the voting power of the dividend-paying company. For this purpose, two companies are deemed to be associated if one is controlled directly or indirectly by the other or both are controlled directly or indirectly by a third company.

The proposed treaty provides that the 15-percent limitation (and not the 5-percent limitation) applies to dividends paid by a RIC. The proposed treaty provides that the 15-percent limitation applies to dividends paid by a REIT to an individual owning a less than 10-percent interest in the REIT. There is no limitation in the proposed treaty on the tax that may be imposed by the United States on a REIT dividend, if the beneficial owner of the dividend is either an individual holding a 10 percent or greater interest in the REIT or is not an individual. Thus, such a dividend is taxable at the 30-percent United States statutory rate. The present treaty does not include these limitations on the application of the reduced rates of source country taxation to dividends from RICs and REITs.

Like the U.S. model, the proposed treaty defines "dividends" as income from shares or other rights, not being debt-claims. Dividends include any income or distribution treated as income from shares under the tax laws of the country of which the company is resident. The proposed protocol provides that the term "dividends" does not include interest which, because it was paid to a non-resident company, is treated under the domestic law of a country as dividends, to the extent that the interest does not exceed the amount that would be expected to be paid on an arm's length basis.

The proposed treaty's reduced rates of tax on dividends do not apply if the beneficial owner of the dividend carries on business

through a permanent establishment (or a fixed base, in the case of an individual who performs independent personal services) in the source country and the dividends are attributable to the permanent establishment (or fixed base). Such dividends are taxed as business profits (Article 7) or as income from the performance of independent personal services (Article 14). In addition, the proposed protocol provides that dividends attributable to a permanent establishment or fixed base, but received after the permanent establishment or fixed base is no longer in existence are taxable in the country where the permanent establishment or fixed base existed.

The proposed treaty allows a treaty country to impose a branch profits tax on a company resident in the other country if such company either has a permanent establishment in the first country or is subject to tax on a net basis in the first country on income from real property or gains from the disposition of real property interests. In cases where an Irish corporation conducts a trade or business in the United States, but not through a permanent establishment, the proposed treaty generally eliminates the branch profits tax that the Code imposes on such corporation.

In general, the proposed treaty provides that the branch profits tax may be imposed by the United States only on the business profits of the Irish corporation that are attributable to its U.S. permanent establishment and the income that is subject to tax on a net basis as income or gains from real property. The tax is further limited to such amounts that are included in the "dividend equivalent amount," as that term is defined under the Code and as it may be amended from time to time without changing the general principle thereof. In the case of Ireland, such tax may be imposed only on the business profits of the U.S. corporation that are attributable to its Irish permanent establishment and the income that is subject to tax on a net basis as income or gains from real property. The tax is further limited to such amounts that would be distributed as a dividend if the business profits, income or gains were earned by a subsidiary incorporated in Ireland.

The proposed treaty limits the rate of the branch profits tax to the direct investment dividend tax rate of 5 percent.

Article 11. Interest

U.S. internal law

Subject to numerous exceptions (such as those for portfolio interest, bank deposit interest, and short-term original issue discount), the United States imposes a 30-percent 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 to a foreign person by the U.S. trade or business of a foreign corporation. 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

J.S. corporation to a foreign parent and therefore is subject to a vithholding tax.

Portfolio interest generally is defined as any U.S.-source interest hat is not effectively connected with the conduct of a trade or busi-ıess and that (1) is paid on an obligation that satisfies certain reg-stration requirements or specified exceptions thereto, and (2) is ıot received by a 10-percent owner of the issuer of the obligation, aking into account shares owned by attribution. However, the ›ortfolio interest exemption is inapplicable to certain contingent in-erest income.

If an investor holds an interest in a fixed pool of real estate nortgages that is a real estate mortgage interest conduit "REMIC"), the REMIC is treated generally for U.S. tax purposes s a pass-through entity and the investor is subject to U.S. tax on . portion of the REMIC's income (which in turn generally is inter-st income). If the investor holds a so-called "residual interest" in he REMIC, the Code provides that a portion of the net income of he REMIC that is taxed in the hands of the investor—referred to s the investor's "excess inclusion"—may not be offset by any net perating losses of the investor, must be treated as unrelated busi-ıess income if the investor is an organization subject to the unre-ated business income tax and is not eligible for any reduction in he 30-percent rate of withholding tax (by treaty or otherwise) that vould apply if the investor were otherwise eligible for such a rate eduction.

Irish internal law

Ireland generally imposes a withholding tax on interest paid to oreign persons at a rate of 26 percent. This tax does not apply to hort-term trade interest. It also does not apply to interest pay-ıents to or by an Irish bank and certain interest payments within corporate group.

Proposed treaty limitations on internal law

The proposed treaty generally exempts interest derived and ben-ficially owned by a resident of one country from tax in the other ountry. The present treaty also provided an exemption from ource country tax for interest, but included an exception for inter-st paid by a corporation resident in one country to a corporation esident in the other country that controlled (directly or indirectly) ıore than 50 percent of the voting power of the payor.

The treaty defines the term "interest" generally as income from ebt claims of every kind, whether or not secured by mortgage and hether or not carrying a right to participate in the debtor's prof-s. In particular, it includes income from government securities nd from bonds or debentures, including premiums and prizes at-ıching to such securities, bonds, or debentures. The term "inter-st" includes all other income that is treated as income from money nt under the tax law of the country in which the income arises. ıterest does not include income covered in Article 10 (Dividends). enalty charges for late payment also are not treated as interest.

This exemption from source country tax does not apply if the eneficial owner of the interest carries on business through a per-anent establishment (or a fixed base, in the case of an individual

who performs independent personal services) in the source country and the interest paid is attributable to the permanent establishment (or fixed base). In that event, the interest is taxed as business profits (Article 7) or income from the performance of independent personal services (Article 14). In addition, the proposed protocol provides that interest attributable to a permanent establishment or fixed base, but received after the permanent establishment or fixed base is no longer in existence, is taxable in the country where the permanent establishment or fixed base existed.

The proposed treaty, unlike the U.S. model but like the OECD model, contains a rule for determining the source of interest. Under the proposed treaty, interest is deemed to arise in a country if the payor is a resident of that country or if the payor has in that country a permanent establishment or fixed base in connection with which the underlying indebtedness was incurred and by which the interest is borne.

The proposed treaty addresses the issue of non-arm's-length interest charges between related parties (or parties having an otherwise special relationship) by stating that this article applies only to the amount of arm's-length interest. Any amount of interest paid in excess of the arm's-length interest is taxable according to the laws of each country, taking into account the other provisions of the proposed treaty. For example, excess interest paid to a parent corporation may be treated as a dividend under local law and thus entitled to the benefits of Article 10 (Dividends).

The proposed treaty provides that the excess of the amount deductible by a U.S. permanent establishment of an Irish company over the interest actually paid by such permanent establishment as determined under U.S. law, is treated as interest beneficially owned by an Irish resident. Accordingly, the exemption for interest beneficially owned by a resident of a treaty country generally will prevent the United States from imposing its excess interest tax.

Like the U.S. model, the proposed protocol includes two limitations on the application of the exemption in the case of the United States. First, the exemption does not apply to interest arising in the United States if the amount of such interest is determined by reference to the profits of the issuer or an associated enterprise. However, if the beneficial owner is an Irish resident, such interest may be taxed by the United States at a maximum rate of 15 percent. Second, the exemption does not apply to an excess exclusion with respect to a residual interest in a REMIC. Amounts covered by this exception may be taxed by the United States under the proposed treaty at the full statutory rate of 30 percent.

Article 12. Royalties

Internal law

Under the same system that applies to dividends and interest the United States imposes a 30-percent tax on U.S.-source royalties paid to foreign persons and on gains from the disposition of certain intangible property to the extent that such gains are from payments contingent on the productivity, use, or disposition of the intangible property. Royalties are from U.S. sources if they are for the use of property located in the United States. U.S.-source roya

ties include royalties for the use of, or the right to use, intangible property in the United States. Ireland generally imposes a 26-percent withholding tax on patent royalties paid to foreign persons; no withholding tax is imposed on other types of royalties.

Proposed treaty limitations on internal law

The proposed treaty provides that royalties derived and beneficially owned by a resident of a treaty country may be taxed only by the residence country. Thus, the proposed treaty generally continues the rule of the present treaty that exempts U.S.-source royalties paid to Irish residents from the 30-percent U.S. tax. This exemption is similar to that provided in the U.S. model.

Royalties are defined as payments of any kind received as consideration for the use of or the right to use any copyright of literary, artistic, or scientific work (including cinematographic films and audio and video tapes and disks); for the use of or 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 term "royalties" also includes gains derived from the alienation of any property described above which are contingent on the productivity, use, or disposition of the property.

Unlike the U.S. model, the proposed treaty does not include an explicit reference to computer software in the definition of royalties. The Technical Explanation states that it is mutually understood that consideration for the use of software is treated as royalties or business profits, depending on the facts and circumstances of the transaction. In this regard, the Technical Explanation further states that it also is understood that payments for transfers of "shrink-wrap" computer software constitute business profits rather than royalties.

The exemption under the proposed treaty does not apply where the beneficial owner carries on business through a permanent establishment (or a fixed base, in the case of an individual who performs independent personal services) in the source country and the royalties are attributable to the permanent establishment (or fixed base). In that event, such royalties are taxed as business profits (Article 7) or income from the performance of personal services (Article 14). In addition, the proposed protocol provides that royalties attributable to a permanent establishment or fixed base, but received after the permanent establishment or fixed base is no longer in existence, are taxable in the country where the permanent establishment or fixed base existed.

The proposed treaty addresses the issue of non-arm's-length royalties between related parties (or parties having an otherwise special relationship) by stating that this article applies only to the amount of arm's-length royalties. Any amount of royalties paid in excess of the arm's-length royalty is taxable according to the laws of each country, taking into account the other provisions of the proposed treaty. For example, excess royalties paid to a parent corporation by its subsidiary may be treated as a dividend under local law and thus entitled to the benefits of Article 10 (Dividends) of the proposed treaty.

The proposed treaty includes a provision not included in the U.S. or OECD models. Under the proposed treaty, a country may tax royalties paid by a resident of the other country only if one of four conditions is satisfied. First, the royalties are paid to a resident of the first country. Second, the royalties are attributable to a permanent establishment or fixed base in the first country. Third, the contract for the royalties was concluded in connection with a permanent establishment or fixed base in the first country, the royalties are borne by such permanent establishment or fixed base, and the royalties are not paid to a resident of the other country. Fourth, the royalties are paid in respect of intangible property used in the first country and are not paid to a resident of the other country, provided that the payor has received a royalty paid by a resident of the first country (or borne by a permanent establishment or fixed base in the first country) for the use of such property in the first country and provided that the use of the property is not a component part of nor directly related to the active conduct of a trade or business in which the payor is engaged.

Article 13. Capital Gains

U.S. internal law

Generally, gain realized by a nonresident alien individual 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. However, a nonresident alien individual 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 other than solely as a creditor (e.g., stock) in certain corporations if at least 50 percent of the assets of the corporation consist of real property.

Irish internal law

Foreign corporations generally are subject to tax in Ireland on capital gains from assets used in a trade or business through a permanent establishment. In addition, foreign corporations and foreign individuals generally are subject to tax in Ireland on capital gains from real property located in Ireland and certain stock and securities that derive their value from such real property.

Proposed treaty limitations on internal law

Under the proposed treaty, gains derived by a treaty country resident attributable to 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 real property referred to in Article 6 (Income from Immovable Property (Real Property)), a United States real property interest, and shares (other than shares quoted on a stock exchange) deriving the greater part of their value directly or indirectly from immovable property in Ireland. The Technical Explanation states that distributions by a REIT that are attributable to gains derived from a disposition 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 from the alienation of movable property that is attributable to a permanent establishment or fixed base located in that country. This rule also applies to gains from the alienation of such a permanent establishment or such fixed base. The proposed treaty generally does not permit the United States to tax gains from the disposition of any movable property after such property ceases to be used in a U.S. trade or business. However, the proposed protocol provides that gains attributable to a permanent establishment or a fixed base, but received after the permanent establishment or fixed base is no longer in existence, are taxable in the country where the permanent establishment or fixed base existed.

The proposed treaty provides that gains derived by an enterprise of one of the treaty countries 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 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 law

The United States taxes the income of a nonresident alien 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 the conduct of a trade or business within the United States.

Under the Code, the income of a nonresident alien 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: (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.

Proposed treaty limitations on internal law

The proposed treaty limits the right of a country to tax income from the performance of personal services by a resident of the other country. Under the proposed treaty, income from the performance of independent personal services (i.e., services performed as an independent contractor, not as an employee) is treated separately from income from the performance of dependent personal services.

Under the proposed treaty, income in respect of professional services or other activities of an independent character derived by a resident of one country is exempt from tax in the other country unless the individual performing the services has a fixed base regularly available to him or her in the second country for the purpose of performing the activities. In that case, the nonresidence country may tax only that portion of the individual's income which is attributable to the fixed base in such country.

The proposed protocol provides that amounts attributable to a fixed base, but received or incurred after the fixed base is no longer in existence, are taxable in the country in which the fixed base was located.

Under the proposed protocol, in determining taxable independent personal services income, the principles of paragraph 3 of Article 7 (Business Profits) are applicable. According to the Technical Explanation, the taxpayer may deduct all relevant expenses, wherever incurred, in computing the net income from independent personal services subject to tax in the country in which the fixed base is located.

Under the proposed protocol, 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 term "professional services" is not limited to this list, however.

Article 15. Dependent Personal Services

Under the proposed treaty, wages, salaries, 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 in the country of residence if three requirements are met: (1) the recipient is present in the source country for not more than 183 days in any twelve-month period beginning or ending during the taxable year concerned; (2) the individual's employer is not a resident of the source country; and (3) the compensation is not 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 treaty, like the U.S. model, provides that compensation derived from employment as a member of the regular complement of a ship or aircraft operated in international traffic is taxable only in the employee's country of residence.

Article 16. Directors' Fees

Under the proposed treaty, directors' fees and other similar payments derived by a resident of one country in his or her capacity as a member of the board of directors of a company which is a resident of the other country may be taxed in the country where such fees or payments arise. Such amounts are deemed to arise in the country of residence of the company, except to the extent such amounts are paid in respect of attendance at meetings held in the director's country of residence. Accordingly, the company's country of residence may tax all directors' fees and similar payments other than any amounts paid for attendance at meetings in the director's

country of residence (which are taxable in the director's country of residence). By contrast, under the U.S. model, the country in which the company is resident may tax only the portion of the non-resident board member's remuneration that is for services performed in such country.

Article 17. Artistes and Sportsmen

Like the U.S. and OECD models, the proposed treaty contains 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 and 15) and business profits (Article 7), and are intended, in part, to prevent entertainers and sportsmen from using the treaty to avoid paying any tax on their income earned in one of the countries.

Under this article of the proposed treaty, one country may tax an entertainer or sportsman who is a resident of the other country on the income from his or her personal activities as such exercised in the first country during any year in which the gross receipts derived by him or her from such activities, including reimbursed expenses, exceed $20,000 or its Irish pound equivalent.

Under the proposed treaty, if an Irish entertainer maintained no fixed base in the United States and performed (as an independent contractor) for one day of a taxable year in the United States for gross receipts of $2,000, the United States could not tax that income. If, however, that entertainer's gross receipts were $30,000, the full $30,000 (less appropriate deductions) would be subject to U.S. tax. This provision does not bar the country of residence from also taxing that income (subject to a foreign tax credit). (See Article 24 (Relief from Double Taxation.)

The Technical Explanation states that because it is not possible to know whether the $20,000 threshold (or the Irish pound equivalent) is exceeded until the end of the year, the source country may subject all payments to an entertainer or sportsman to withholding and refund any excess amount withheld.

According to the Technical Explanation, this article applies to all income directly connected with a performance by an entertainer or sportsman, such as appearance fees, award or prize money, and a share of the gate receipts. Income derived by an entertainer or sportsman from other than actual performance, such as royalties from record sales and payments for product endorsements, is not covered by this article; instead, these amounts are covered by other articles of the proposed treaty, such as Article 12 (Royalties) or Article 14 (Independent Personal Services). For example, if an Irish entertainer receives royalty income from the sale of recordings of a concert given in the United States, the royalty income will be exempt from U.S. withholding tax under Article 12, even if the remuneration from the concert itself may have been covered by this article.

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 may be taxed 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 participate 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 service articles (Articles 7 and 14).) This provision prevents certain 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.

Article 18. Pensions, Social Security, Annuities, Alimony 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 generally are subject to tax only in the recipient's country of residence. This rule is subject to the provisions of Article 19 (Government Service). Thus, for example, it generally does not apply to pensions paid to a resident of one treaty country attributable to services performed for government entities of the other country. The Technical Explanation states that it is understood that this provision will apply to both periodic and lump sum payments. The present treaty similarly provides for exclusive residence country tax with respect to pensions. The Technical Explanation states that this provision covers amounts paid by all private retirement plans and arrangements in consideration of past employment, regardless of whether they are considered qualified plans under the Code. The Technical Explanation further states that this provision covers individual retirement accounts.

The proposed treaty provides that payments made by a country under provisions of its social security or similar legislation to a resident of the other country are taxable only in the other country. The diplomatic notes state that it is understood that the term "or similar legislation" is intended to refer to United States tier 1 Railroad Retirement benefits. In contrast, the U.S. model provides that social security payments are taxable only in the source country and not in the recipient's country of residence.

The proposed treaty provides that annuities may be taxed only in the country of residence of the person who derives and beneficially owns them. An annuity is defined as a stated sum paid periodically at stated times during a specified number of years or for life, under an obligation to make the payments in return for adequate and full consideration (other than services rendered). The present treaty similarly provides exclusive residence country taxation for annuities. The U.S. model defines "annuity" to include only amounts paid during a specified number of years and not amounts paid for life.

The proposed treaty provides that alimony paid by a resident of one country, and deductible in that country, to a resident of the other country is taxable only in the recipient's country of residence. The term "alimony" means periodic payments made pursuant to a

written separation agreement or decree of divorce, judicial separation, separate maintenance, or compulsory support.

The proposed treaty further provides that periodic payments, not constituting alimony, for the support of a minor child made pursuant to a written separation agreement or decree of divorce, judicial separation, separate maintenance, or compulsory support, paid by a resident of one country to a resident of the other country are exempt from tax in both countries.

The proposed treaty includes special rules addressing the treatment of cross-border pension contributions. Under the proposed treaty, if an individual who is a member of a pension plan established and recognized under the law of one country performs personal services in the other country, contributions made by the individual to the plan during the period he or she performs such personal services are deductible in computing his or her taxable income in the other country within the limits that would apply if the contributions were made to a pension plan established and recognized under the laws of the other country. Similarly, payments made to the plan by or on behalf of his or her employer during such period are not treated as part of his or her taxable income and are allowed as a deduction in computing the employer's profits in the other country. However, these rules apply only if (1) contributions were made by or on behalf of the individual to the plan (or to a similar plan for which this plan is substituted) immediately before he or she visited the other country, (2) the individual has performed personal services in the other country for a cumulative period not exceeding five calendar years, and (3) the competent authority of the other country has agreed that the plan generally corresponds to a pension plan recognized for tax purposes by that country. Moreover, the benefits provided under these rules will not exceed the benefits that would be allowed by the other country to its residents for contributions to a pension plan recognized for tax purposes by that country.

The proposed treaty further provides that where contributions to a foreign pension plan are deductible in computing an individual's taxable income in a country and the individual is subject to tax in that country only in respect of income or gains remitted or received in such country, then the deduction otherwise allowed for such contributions is reduced to an amount that bears the same proportion to such deduction as the amount remitted bears to the full amount of the individual's income or gains that would be taxable in the country if the individual had not been subject to tax on remitted amounts only. This rule is necessary because of Ireland's remittance system of taxation for individuals who are Irish residents not domiciled in Ireland.

Article 19. Government Service

Under the proposed treaty, salaries, wages and other remuneration, other than a pension, paid by a country or one of its political subdivisions or local authorities to an individual for services rendered to the payor generally are taxable in that country only. However, such salaries, wages and other remuneration are taxable only in the other country (the country that is not the payor) if the services are rendered in that other country and the individual is a resi-

dent of that other country who either is a national of that other country or did not become a resident of that country solely for the purpose of rendering the services. Thus, for example, Ireland will not tax the compensation of a U.S. citizen and resident who is in Ireland to perform services for the U.S. Government, and the United States will not tax the compensation of an Irish citizen and resident who performs services for the U.S. Government in Ireland.

Any pension paid by, or out of funds created by, a country, or one of its political subdivisions or local authorities, to an individual for services rendered to the payor generally is taxable only in that country. However, such pensions are taxable only in the other country if the individual is both a resident and a national of that other country.

These rules regarding government remuneration and pensions are exceptions to the saving clause, pursuant to Article 1, paragraph 5(b) of the proposed treaty. Consequently, the saving clause does not apply to benefits conferred by this article to an individual who is neither a U.S. citizen nor a U.S. green-card holder. Thus, for example, the United States would not tax the compensation of an Irish citizen who is not a U.S. green-card holder but who resides in the United States to perform services for the Irish Government.

If a country or one of its political subdivisions or local authorities is carrying on a business (as opposed to functions of a governmental nature), the provisions of Articles 15 (Dependent Personal Services), 16 (Directors' Fees), 17 (Artistes and Sportsmen), and 18 (Pensions, Social Security, Annuities, Alimony and Child Support) will apply to remuneration and pensions for services rendered in connection with such business.

Article 20. Students and Trainees

Under the proposed treaty, a student, apprentice, or business trainee who visits the other country (the host country) for the purpose of full-time education at a recognized educational institution or full-time training, and who immediately before that visit is or was a resident of the other treaty country, is exempt from tax in the host country on payments that he or she receives for the purpose of maintenance, education, or training provided that such payments arise from sources outside the host country. However, in the case of an apprentice or trainee, this exemption is available only for a period of one year from the date the individual first arrives in the host country for the purpose of training. The present treaty contains an exemption for students and trainees but does not contain any time limitation on the availability of such exemption from host country tax.

This article is an exception to the saving clause, pursuant to Article 1, paragraph 5(b) of the proposed treaty. Consequently, the saving clause does not apply to benefits conferred by this article to an individual who is neither a U.S. citizen nor a U.S. green-card holder. Thus, for example, the United States would not tax such amounts paid to an Irish citizen who is not a U.S. green-card holder but who resides in the United States as a full-time student.

Article 21. Offshore Exploration and Exploitation Activities

This article covers the taxation of offshore, exploration and exploitation activities with respect to the sea bed and subsoil and their natural resources in one of the countries. The rules of this article apply to such activities notwithstanding any other provision of the proposed treaty.

Under the proposed treaty, an enterprise of one country which carries on exploration or exploitation activities in the other country generally is deemed to be carrying on business in the other country through a permanent establishment located in such other country. However, exploration activities carried on by an enterprise of one country in the other country for 120 days or less within any 12-month period does not constitute the carrying on of business through a permanent establishment. For purposes of this rule, where associated enterprises are carrying on substantially similar exploration activities, one enterprise is deemed to carry on all such activities of the other enterprise, expect to the extent that the activities of the other enterprise are carried on at the same time as the enterprise's own activities. Enterprises are considered to be associated if one participates, directly or indirectly, in the management, control or capital of the other or if the same persons participate, directly or indirectly, in the management, control or capital of both enterprises.

The proposed protocol provides that a "balancing charge" under Irish tax law will not be imposed solely because a business deemed to have been carried on through a permanent establishment is treated as having permanently ceased because of the termination of activities in Ireland, except to the extent the person carrying on the activities made a claim under Irish law for accelerated capital allowances with respect to machinery or plant used for the purposes of the permanent establishment. Normal wear and tear allowances are allowed and are not subject to recapture through a balancing charge. The Technical Explanation states that Ireland does not currently impose a balancing charge.

Under the proposed treaty, a resident of one country who carries on exploration or exploitation activities in the other country consisting of professional services or other independent activities is deemed to be performing those activities from a fixed base in the other country. However, income derived from exploration activities are not taxable in the source country if the activities are performed in that country for 120 days or less within any 12-month period.

Under the proposed treaty, salaries, wages and other similar remuneration derived by a resident of one country in respect of employment with a deemed permanent establishment with respect to exploration or exploitation activities carried on in the other country may be taxed in the other country to the extent that the employee's duties are performed offshore in that other country.

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 Ireland. This article is substantially similar to the corresponding article in the U.S. model.

As a general rule, items of income beneficially owned by a resident of either country that are not otherwise dealt with in the proposed treaty are taxable only in the country of residence. This rule, for example, gives the United States the sole right under the treaty to tax income derived from sources in a third country and paid to a resident of the United States. This article is subject to the saving clause, so U.S. citizens who are Irish residents would continue to be taxable by the United States on their third-country income, with a foreign tax credit provided for income taxes paid to Ireland.

The general rule just stated does not apply to income if the beneficial owner of the income is a resident of one country and carries on business in the other country through a permanent establishment or a fixed base and the income 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. In addition, the proposed protocol provides that other income attributable to a permanent establishment or fixed base, but received after the permanent establishment or fixed base is no longer in existence, is taxable in the country where the permanent establishment or fixed base existed. An exception to this rule is provided for income from real property. Thus, for example, if a U.S. resident has an Irish permanent establishment and the resident derives income from real property located in a third country that is effectively connected with the Irish permanent establishment, under the proposed treaty, only the United States may tax such income.

Article 23. Limitation on Benefits

In general

The proposed treaty contains a provision generally intended to limit indirect use of the treaty by persons who are not entitled to its benefits by reason of residence in the United States or Ireland, or in some cases, in another member country of the European Union ("EU") or the North America Free Trade Agreement ("NAFTA").

The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Ireland 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 country seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, and without appropriate safeguards, the nonresident may be able to secure these benefits indirectly by establishing a corporation (or other entity) in one of the countries, which entity, as a resident of that country, is entitled to the benefits of the treaty. Additionally, it may be possible for a third-country resident to reduce the income base of a treaty country resident by having the latter pay out interest, royalties, or other deductible amounts under favorable conditions either through relaxed tax provisions in the distributing country or by passing the funds through other treaty countries (essentially, continuing to treaty shop), until the funds can be repatriated under favorable terms.

Summary of treaty provisions

The proposed new anti-treaty shopping article provides that a treaty country resident is entitled to treaty benefits in the other country only if it is in one of several specified categories. This provision of the proposed treaty is in some ways comparable to the U.S. Treasury regulation under the branch tax definition of a qualified resident. However, the proposed treaty provides opportunities for treaty benefit eligibility which are not provided under the regulation.

Generally, a resident of either country qualifies for the benefits accorded by the proposed treaty if such resident is within one of the following categories of qualified persons:

(1) An individual;

(2) A qualified governmental entity;

(3) An entity that satisfies an ownership test and a base erosion test;

(4) An entity other than a company that satisfies a public ownership test;

(5) A company that satisfies a public company test; or

(6) A qualified tax-exempt organization.

A resident that is not a qualified person under any of the above categories may claim treaty benefits for particular items of income if it satisfies an active business test. A resident that is not a qualified person also may claim treaty benefits for shipping income if certain conditions are satisfied. In addition, a resident that is not a qualified person may claim treaty benefits with respect to certain items of income under a derivative benefits test. Special rules apply to income derived by a resident of Ireland in certain "triangular" cases described below. Finally, a treaty country resident is entitled to treaty benefits if the resident is otherwise approved by the source country's competent authority, in the exercise of the latter's discretion.

The proposed treaty provides that the competent authorities are to consult together with a view to developing a commonly agreed application of these provisions, including the publication of regulations or other public guidance. Subject to the limitations in the information exchange article, the competent authorities may exchange such information as is necessary for carrying out these provisions.

Individuals

Under the proposed treaty, individual residents of one of the countries are entitled to all treaty benefits.

Governments

Under the proposed treaty, a qualified governmental entity is entitled to all treaty benefits. Qualified governmental entities include the governments of the two countries and political subdivisions and local authorities thereof. Qualified governmental entities also include certain wholly-owned entities, the earnings of which are credited to the entity's own account, and certain pension trusts or funds providing government service pension benefits.

Entities satisfying ownership and base erosion tests

Under the proposed treaty, an entity that is resident in one of the countries is entitled to treaty benefits if it satisfies an ownership test *and* a base erosion test. Under the ownership test, at least 50 percent of the beneficial interest in such entity (at least 50 percent of the aggregate vote and value of the company's shares, in the case of a company) must be owned, directly or indirectly, by qualified persons or U.S. residents or citizens. For this purpose, qualified persons are those who are entitled to treaty benefits under one of the six categories. The ownership test is not satisfied in a case of indirect ownership through a chain of ownership unless it is satisfied by the last owners in the chain.

The Technical Explanation states that in applying this test to a trust, the beneficial interests in the trust will be considered to be owned by the trust's beneficiaries in proportion to their actuarial interests in the trust. A remainder beneficiary's interest will be computed by backing out the aggregate percentage interests of the income beneficiaries. An interest of a beneficiary will not be considered to be owned by a qualified person if the beneficiary's interest cannot be actuarially determined.

Under the base erosion test, amounts that are paid or accrued by the entity during its fiscal year to persons other than qualified persons or U.S. residents and citizens and that are deductible for income tax purposes in that year in the entity's country of residence must not exceed 50 percent of the entity's gross income. For this purpose, there are not taken into account arm's length payments in the ordinary course of business for services or tangible property or for financial obligations to banks provided that, if the bank is not a resident of either country, the payment must be attributable to a permanent establishment of the bank located in either country. The term "gross income" is not defined in the proposed treaty. As such, it will have the meaning provided under domestic law. The Technical Explanation states that, in the case of the United States, it will mean gross receipts less cost of goods sold.

The proposed treaty provides that the base erosion test is applied using gross income for the fiscal year preceding the current year, provided that the amount of gross income for such year is deemed to be not less than the average of the annual gross income for the four fiscal years preceding the current fiscal year.

Public entities

Under the proposed treaty, an entity other than a company that is a resident of the United States or Ireland is entitled to treaty benefits if the principal class of units in the entity is listed on a recognized stock exchange located in either country and is substantially and regularly traded on one or more recognized stock exchanges. Alternatively, the entity is entitled to treaty benefits if the direct or indirect owners of at least 50 percent of the beneficial interests in the entity are public entities under the preceding sentence or public companies as described below.

The term "units" includes shares and any other instrument, other than a debt instrument, entitling the holder to share in the assets or income of, or to receive a distribution from, the entity.

The term "principal class of units" is not defined. The Technical Explanation states that it is understood that it will be interpreted in accordance with the definition of "principal class of shares", discussed below.

The term "recognized stock exchange" means 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; the NASDAQ System owned by the National Association of Securities Dealers; the Irish stock exchange; the stock exchanges of Amsterdam, Brussels, Frankfurt, Hamburg, London, Madrid, Milan, Paris, Stockholm, Sydney, Tokyo, Toronto, Vienna and Zurich; and any other stock exchange agreed upon by the competent authorities of the two countries.

The proposed protocol provides that a class of units is considered to be substantially and regularly traded on one or more recognized stock exchanges during a fiscal year if trades in the class of such units are effected in more than de minimis quantities every quarter and the aggregate number of units of that class traded on such exchange or exchanges during the previous fiscal year is at least 6 percent of the average number of shares outstanding in that class during the year. However, if such class of units was not listed on a recognized stock exchange in the previous fiscal year, the units will be deemed to satisfy this 6-percent test.

Public companies

A company that is a resident of Ireland or the United States is entitled to treaty benefits if the principal class of its shares is substantially and regularly traded on one or more recognized stock exchanges. Thus, such a company is entitled to the benefits of the treaty regardless of where its actual owners reside.

The term "principal class of shares" is defined generally as the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of shares accounts for more than half of the company's voting power and value, then the principal class of shares is those classes of the company's shares that in the aggregate account for more than half of the company's voting power and value. In this regard, it is necessary only that one such group be primarily and regularly traded on a recognized stock exchange. The principal class of shares always includes any "disproportionate" class of shares. A disproportionate class of shares is any class of shares of a company resident in one country that entitles the shareholder to a disproportionately higher participation (through dividends, redemption payments or otherwise) in the earnings generated in the other country by particular assets or activities. The term "shares" includes depository receipts and trust certificates thereof.

The proposed protocol provides that the term "substantially and regularly traded" is defined as above. The proposed protocol further provides that an Irish Building Society is deemed to be a company the principal class of shares of which is listed on the Irish Stock Exchange and which is substantially and regularly traded thereon. The Technical Explanation further states that the substantially

and regularly traded requirement can be met by trading on any one or more of the recognized stock exchanges.

In addition, a company that is a resident of Ireland or the United States is entitled to treaty benefits if at least 50 percent of the aggregate vote and value of its shares is owned directly or indirectly by publicly traded companies that are residents of Ireland or the United States; qualified governmental entities, or companies that are more than 50 percent owned by qualified governmental entities.

Tax-exempt organizations

Under the proposed treaty, an entity is entitled to treaty benefits if it is a tax-exempt organization (as defined in Article 4(1)(c)) resident in one of the countries, provided that more than half the beneficiaries, members, or participants, if any, in the organization are qualified persons. This rule applies to organizations organized and operated exclusively to administer or provide retirement and employee benefits or to fulfill religious, educational, scientific, and other charitable purposes.

Entities satisfying active trade or business test

In general

Under the active business test, treaty benefits in the source country are available under the proposed treaty to an entity that is a resident of one treaty country if (1) it is engaged in the active conduct of a trade or business in the residence country and (2) the income derived from the source country is derived in connection with, or is incidental to, that trade or business. In addition, if the resident has an ownership interest in the income-producing activity, the trade or business must be substantial in relation to such income-producing activity.

This active 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 specified categories of qualified persons allows treaty benefits for all income derived from the source country.

Trade or business

Under the proposed treaty, the active business test is applied by disregarding the business of making or managing investments, unless such business is carried on by a bank or insurance company acting in the ordinary course of its business.

The proposed protocol provides that whether a resident is engaged in the active conduct of a trade or business is determined based on all the facts and circumstances. The Technical Explanation states that a trade or business generally comprises activities that constitute an independent economic enterprise carried on for profit.

The proposed protocol provides that a bank will be considered to be engaged in the active conduct of a trade or business if it regularly accepts deposits from the public or makes loans to the public. A resident that, as of the date of signature of the proposed treaty,

is licensed to engage in the conduct of a banking business is considered to be engaged in the active conduct of a trade or business. The proposed protocol further provides that an insurance company will be considered to be engaged in the active conduct of a trade or business if its gross income consists primarily of insurance and reinsurance premiums and investment income attributable thereto.

In applying this test to a resident, the resident is deemed to conduct activities conducted by a partnership in which it is a partner or by a person to which it is connected. Persons are connected if one owns at least a 50 percent beneficial interest in the other or if another person possesses, directly or indirectly, at least a 50 percent interest in both. Persons also are considered connected if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

Income derived in connection with a trade or business

Under the proposed treaty, the income eligible for treaty benefits under this active business test is the income derived from the source country in connection with, or incidental to, the active conduct of a trade or business in the residence country. Income is considered derived in connection with an active trade or business in a country if the income-producing activity in the other country is a line of business which is part of or is complementary to the trade or business conducted in the first country. The Technical Explanation states that it is intended that a business activity in the source country will be considered to form a part of a business activity 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 two activities will be considered complementary if they are part of the same overall industry and the success or failure of the two are interrelated. According to the Technical Explanation, where more than one business is conducted in the source country and only one of such businesses forms a part of or is complementary to a business conducted in the residence country, the income attributable to that particular business must be determined for purposes of applying this test.

The Technical Explanation states that income is considered to be incidental to the trade or business carried on in the other country if the production of such income facilitates the conduct of such trade or business. For example, interest income earned from the short-term investment of working capital would be considered to be incidental income.

Substantiality requirement

Under the proposed treaty, if the resident has an ownership interest in the income-producing activity, the trade or business in the residence country must be substantial in relation to such income-producing activity in the other country. In this regard, the proposed treaty provides that "substantiality" will be determined based on all the facts and circumstances. However, a safe harbor is provided if the following test is satisfied: for the preceding fiscal year, or the average of the three preceding fiscal years, the asset

value, gross income, and payroll expense that are related to the trade or business are at least equal to 7.5 percent of the corresponding amounts that are related to the income-producing activity, and the average of these three ratios is at least 10 percent. For purposes of these computations, only the resident's proportionate interest in the trade, business, or activity is taken into account.

Shipping income

A resident of one country that derives shipping income from the other country is entitled to treaty benefits with respect to such income if at least 50 percent of the beneficial interests in the resident is owned, directly or indirectly, by qualified persons, U.S. citizens or residents, or individuals who are residents of a third country, or a company or companies the principal shares of which are substantially and regularly traded on an established securities market in the third country. However, this rule applies only if the third country grants an exemption to shipping income under similar terms to citizens and corporations of the source country.

Derivative benefits rule

The proposed treaty contains a reciprocal derivative benefits rule. This rule effectively allows an Irish company, for example, to receive "derivative benefits" in the sense that it derives its entitlement to U.S. tax reductions in part from the U.S. treaty benefits to which its owners would be entitled if they earned the income directly. If the requirements of this rule are satisfied, a company that is resident in one of the countries will be entitled to treaty benefits.

A company resident in one of the countries satisfies this rule if two requirements are met. First, the ultimate beneficial owners of at least 95 percent of the voting power and value of all its shares must be seven or fewer persons that are qualified persons or residents of a member state of the EU or a party to NAFTA. For this purpose, a person will be considered a resident of an EU member or NAFTA party only if the person would be entitled to the benefits of an income tax treaty between its residence country and the country from which benefits are being claimed. However, if such treaty does not include a comprehensive limitation on benefits provision, the person must be a person that would be a qualified person under the tests described above, applied by treating the person as if the person were a resident of the United States or Ireland. Second, the company must meet the base erosion test described above, applied by treating residents of a member state of the EU or a party to NAFTA as qualified persons.

However, a company otherwise entitled to benefits pursuant to this rule will be denied benefits with respect to an item of income that constitutes dividends, interest, and royalties unless at least 95 percent of its shares is held directly or indirectly by one or more persons that are residents of an EU member or NAFTA party who are entitled to benefits under an income tax treaty between its residence country and the country from which benefits are being claimed that are at least as favorable as the benefits provided in the proposed treaty with respect to such item of income.

Grant of treaty benefits by the competent authority

Finally, the proposed treaty provides a "safety-valve" for a treaty country resident that has not established that it meets one of the other more objective tests. Under this provision, such a person may be granted treaty benefits if the competent authority of the source country determines that the establishment, acquisition, or maintenance of the person seeking benefits under the proposed treaty, or the conduct of such person's operations, has or had as one of its principal purposes the obtaining of benefits under the proposed treaty. Thus, persons that establish operations in either the United States or Ireland with the principal purposes of obtaining benefits under the proposed treaty ordinarily will not be granted such benefits. The competent authority of the source country must consult with the competent authority of the other country before denying benefits under this safety-valve provision. The Technical Explanation states that the competent authorities may determine to grant all, or partial, benefits of the proposed treaty.

This provision of the proposed treaty is similar to a portion of the qualified resident definition under the Code branch tax rules, under which the Secretary of the Treasury may, in his sole discretion, treat a foreign corporation as a qualified resident of a foreign country if the corporation establishes to the satisfaction of the Secretary that it meets such requirements as the Secretary may establish to ensure that individuals who are not residents of the foreign country do not use the treaty between the foreign country and the United States in a manner inconsistent with the purposes of the Code rule (sec. 884(d)(4)(D)).

Triangular cases

Under present laws and treaties that apply to Irish residents, it is possible for profits of a permanent establishment maintained by an Irish resident in a third country to be subject to a very low aggregate rate of Irish and third-country income tax. The proposed treaty, in turn, eliminates the U.S. tax on several specified types of income of an Irish resident. In a case where the U.S. income is earned by a third-country permanent establishment of a Irish resident (the so-called "triangular case") the proposed treaty would have the potential of helping Irish residents to avoid all (or substantially all) taxation, rather than merely avoiding double taxation.

In order to address this issue, the proposed treaty includes a special rule designed to prevent the proposed treaty from reducing or eliminating U.S. tax on income of an Irish resident in a case where no other substantial tax is imposed on that income. Under the special rule, the United States is permitted to tax dividends, interest, and royalties paid to the third-country permanent establishment at the rate of 15 percent. In addition, under the special rule, the United States is permitted to tax other types of income without regard to the proposed treaty.

In order for the special rule to apply, four conditions must be satisfied. First, an Irish enterprise must derive income from the United States. Second, such income must be attributable to a permanent establishment that the Irish enterprise has in a third country. Third, the enterprise is exempt from tax in Ireland on profits at-

tributable to the permanent establishment. Fourth, the combined Irish and third-country taxation of the item of U.S.-source income earned by the Irish enterprise with the third-country permanent establishment must be less than 50 percent of the Irish tax that would be imposed if the income were earned by the same enterprise in Ireland and were not attributable to the permanent establishment.

The special rule does not apply if the U.S.-source income is derived in connection with, or is incidental to, the active conduct of a trade or business carried on by the permanent establishment in the third country (other than the business of making or managing investments unless these activities are banking or insurance carried on by a bank or insurance company).

Article 24. Relief from Double Taxation

U.S. internal law

One of the two principal purposes for entering into an income tax treaty is to limit double taxation of income earned by a resident of one of the countries that may be taxed by the other country. The United States seeks unilaterally to mitigate double taxation by generally allowing U.S. 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 receives a dividend from 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 for the year the dividend is received.

A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax on U.S.-source income. Therefore, the foreign tax credit provisions contain a limitation that ensures that the foreign tax credit only offsets U.S. tax on foreign source income. The foreign tax credit limitation generally is computed on a worldwide consolidated basis. Hence, all income taxes paid to all foreign countries are combined to offset U.S. taxes on all foreign income. The limitation is computed separately for certain classifications of income (e.g., passive income and financial services income) in order to prevent the crediting of foreign taxes on certain high-taxed foreign source income against the U.S. tax on certain types of traditionally low-taxed foreign source income. Other limitations may apply in determining the amount of foreign taxes that may be credited against the U.S. tax liability of a U.S. taxpayer.

Irish law

Ireland generally allows a deduction, rather than a credit, for taxes paid to foreign countries.

Treaty rules

Overview

Unilateral efforts to limit double taxation are imperfect. Because of differences in rules as to when a person may be taxed on busi-

ness income, a business may be taxed by two countries as if it is engaged in business in both countries. Also, a corporation or individual may be treated as a resident of more than one country and may 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 Ireland and the United States would otherwise still tax the same item of income. This article is not subject to the saving clause, so that the United States waives its overriding taxing jurisdiction to the extent that this article applies.

The present treaty generally provides for relief from double taxation of U.S. residents and citizens by requiring the United States to permit a credit against its tax for taxes paid to Ireland. The determination of this credit is made in accordance with U.S. law in effect on the date the present treaty went into effect. The present treaty generally provides for relief from double taxation of Irish residents by requiring Ireland to permit a credit against its tax for taxes paid to the United States.

Treaty restrictions on U.S. internal law

The proposed treaty generally provides that the United States will allow a U.S. citizen or resident a foreign tax credit for Irish tax. The proposed treaty provides that the United States also will allow a deemed-paid credit, with respect to Irish tax, to any U.S. corporate shareholder of an Irish company that receives dividends from such company if the U.S. company owns 10 percent or more of the voting stock of the Irish company.

The credit generally is to be computed in accordance with the provisions and subject to the limitations of U.S. law (as those provisions and limitations may change from time to time without changing the general principles of the treaty provisions). This provision is similar to those found in the U.S. model and many other U.S. income tax treaties.

The proposed treaty provides that any credit allowed by Ireland with respect to dividends received from an Irish resident company, less any excess of such credit that is refunded, is treated as an income tax paid to Ireland.

The proposed treaty, like the U.S. model and other U.S. treaties, contains a special rule designed to provide relief from double taxation for U.S. citizens who are Irish residents. Under this rule, a U.S. citizen who is resident in Ireland will:

(1) Compute the tentative U.S. income tax and the tentative Irish income tax with respect to items of income that, under the proposed treaty, are subject to Irish tax and are either exempt from U.S. tax or are subject to a reduced rate of tax when derived by an Irish resident who is not a U.S. citizen.

(2) Reduce the tentative Irish tax by a hypothetical foreign tax credit for taxes imposed on his or her U.S.-source income. The amount of this credit is limited to the U.S. tax that the citizen would have paid under the proposed treaty on such income if that person were an Irish resident but not a U.S. citizen (e.g., 15 percent in the case of portfolio dividends).

(3) Reduce the tentative U.S. income tax by a foreign tax credit for income tax actually paid to Ireland as computed in step (2) (i.e., after Ireland allowed the credit for U.S. taxes). The proposed treaty recharacterizes the income that is subject to Irish taxation as foreign source income for purposes of this computation.

The end result of this three-step formula is that the ultimate U.S. tax liability of a U.S. citizen who is an Irish resident, with respect to an item of income, should not be less than the tax that would be paid if the individual were an Irish resident and not a U.S. citizen.

Treaty restrictions on Irish internal law

Under the proposed treaty, Ireland will allow as a credit against its tax the U.S. tax payable in accordance with the proposed treaty on profits, income or chargeable gains from sources within the United States. Ireland also will allow a credit, for the U.S. tax paid by a U.S. company, to any Irish company that receives dividends from such company and that controls directly or indirectly 10 percent or more of the voting power of the company. This credit is subject to the foreign tax credit provisions of Irish law.

Other rules

The proposed treaty provides that for purposes of this article, income derived by a resident of a country that may be taxed in the other country under the proposed treaty will be considered to have its source in the other country. However, the source rules of the countries as applicable for purposes of limiting the foreign tax credit will take precedence over this rule.

The proposed treaty further provides that where income or gains are wholly or partly relieved from tax in a country and an individual is taxable in the other country only in respect of the amount of such income or gains that is remitted or received in the other country, then the relief otherwise allowed in the first country will apply only to the portion of such income and gains that is remitted or received in the other country. This rule is necessary because of Ireland's remittance system of taxation for individuals who are Irish residents not domiciled in Ireland.

Article 25. Non-Discrimination

The nondiscrimination article of the proposed treaty applies only with respect to taxes covered by the proposed treaty. In contrast, the U.S. model includes a comprehensive nondiscrimination article relating to all taxes of every kind imposed at the national, state, or local level.

In general, under the proposed treaty, one country cannot 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. This provision applies whether or not the nationals in question are residents of the United States or Ireland. A citizen of one country who is not a resident of that country and a citizen of the other country who is not a resident of the first country are not considered to be in the same circumstances. For example, a U.S. citizen who is not

a resident of the United States and an Irish citizen who is not a resident of the United States are not considered to be in the same circumstances for U.S. tax purposes.

Under the proposed treaty, neither country may tax a permanent establishment of a resident or enterprise of the other country less favorably than it taxes its own enterprise carrying on the same activities. Consistent with the U.S. and OECD model treaties, 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.

Each country is required (subject to the arm's-length pricing rules of Articles 9 (Associated Enterprises), 11 (Interest), and 12 (Royalties)) to allow enterprises of such country to deduct interest, royalties, and other disbursements paid by them 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. The Technical Explanation indicates 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 enterprises.

The nondiscrimination rule also applies under the proposed treaty to enterprises of one country that are owned in whole or in part by residents of the other country. Enterprises resident in 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 similar enterprises.

The proposed treaty provides that nothing in this article will be construed as preventing either country from imposing a branch profits tax.

U.S. internal law generally requires a corporation that distributes property to its shareholders as realizing gain or loss as if the property had been sold. A nonrecognition rule applies, however, to certain distributions of stock and securities of a controlled corporation. U.S. internal law also generally treats a corporation that distributes property in complete liquidation as realizing gain or loss as if the property had been sold to the distributee. If, however, 80 percent or more of the stock of the corporation is owned by another corporation, a nonrecognition rule applies and no gain or loss is recognized to the liquidating corporation. Special provisions make these nonrecognition provisions inapplicable if the distributee is a foreign corporation (Code sec. 367(e)(1) and (2)). The Technical Explanation states that this nondiscrimination article will not prevent the United States from applying Code section 367(e)(1) or (2).

U.S. internal law generally requires a partnership that engages in a U.S. trade or business to pay a withholding tax attributable to a foreign partner's share of the effectively-connected income of the partnership. The withholding tax is not the final liability of the partner, but is a prepayment of tax which will be refunded to the extend it exceeds a partner's final U.S. tax liability. No withholding

is required with respect to a U.S. partner's share of the effectively-connected income of the partnership. The Technical Explanation states that this nondiscrimination article will not prevent the United States from applying Code section 1446.

The saving clause (which allows either country to tax its citizens or residents notwithstanding certain treaty provisions) does not apply to the nondiscrimination article. Therefore, for example, a U.S. citizen resident in Ireland may claim benefits with respect to the United States under this article.

Article 26. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision, with some variation, which authorizes the competent authorities of the United States and Ireland 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 may result in a waiver (otherwise mandated by the proposed treaty) of U.S. taxing jurisdiction over its citizens or residents.

Under this article, a resident of one country, who considers that the actions of one or both of the countries result, or will result, for him or her in taxation not in accordance with the proposed treaty, may present the case to the competent authority of either country. The competent authority will then make a determination as to whether the objection appears justified. If the objection appears to be justified and if the competent authority is not itself able to arrive at a satisfactory solution, then the competent authority will 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. Any agreement reached will be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the countries.

The competent authorities of the countries are to endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the proposed treaty. Like the U.S. model treaty, the proposed treaty makes express provision for competent authorities to mutually agree on various issues, including the attribution of income, deductions, credits, or allowances to a permanent establishment of an enterprise of a treaty country; the allocation of income, deductions, credits, or allowances; the characterization of particular items of income; the characterization of persons; the application of source rules with respect to particular items of income; the common meaning of a term; increases in the dollar thresholds in provisions such as the artistes and sportsmen article (Article 17) and the students and trainees article (Article 20) to reflect economic or monetary developments; advance pricing arrangements; the application of domestic law with respect to penalties, fines, and interest; and the elimination of double taxation in cases not provided for in the treaty. Any principles of general application that are established by an agreement or agreements are required to be published by the competent authorities of both countries in accordance with their laws and administrative practices.

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. 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 treaty.

The proposed treaty also allows for arbitration. If an agreement cannot be reached by the competent authorities pursuant to the mutual agreement procedures, the case may be submitted to arbitration. This procedure applies only if both competent authorities and the taxpayer agree to it and the taxpayer agrees in writing to be bound by the decision of the arbitration board. The decision of the arbitration board in a particular case will be binding on the taxpayer and both countries with respect to such case. The proposed treaty provides that the procedures with respect to arbitration will be established in an exchange of notes between the two countries. The proposed treaty further provides that the provisions with respect to arbitration will take effect only after the two countries have so agreed through an exchange of notes.

Article 27. Exchange of Information and Administrative Assistance

The proposed treaty provides for the exchange of information as is relevant to carry out the provisions of the proposed treaty or the provisions of domestic laws of the countries concerning taxes covered by the proposed treaty provided that taxation thereunder is not contrary to the proposed treaty. The exchange of information is not restricted by Article 1 (General Scope). Therefore, third-country residents are covered by these exchange of information provisions. Unlike the U.S. model, the proposed treaty obligates the parties to exchange information only relating to taxes that are listed under Article 2 (Taxes Covered).

Any information exchanged is to 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 assessment, collection, administration, enforcement, prosecution or determination of appeals with respect to the taxes covered by the proposed treaty. The information exchanged may be used only for the purposes stated above.[6] The Technical Explanation states that the appropriate committees of the U.S. Congress and the U.S. General Accounting Office shall be afforded access to information for use in the performance of their role in overseeing the administration of U.S. tax laws. Information received may be discussed in public court proceedings or in judicial decisions.

As is true under the U.S. and OECD 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 which is not obtainable under the laws of either country, or to supply information which would dis-

[6] 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 this treaty could not be used for these non-tax purposes.

close any trade, business, industrial, or professional secret or trade process or information the disclosure of which would be contrary to public policy.

If information is requested by a country, the proposed treaty provides that the other country will obtain the information in the same manner and to the same extent as if its own tax were involved, notwithstanding the fact that such other country may not need such information at that time. However, paragraph 10 of the proposed protocol states that, as of the date the proposed treaty was signed, the laws and practices of Ireland do not permit its tax authorities to carry out inquiries on behalf of another country unless Irish taxes covered by the proposed treaty are at issue. The proposed protocol also states that if Irish laws and practices change to permit such inquiries, Ireland will then implement this provision of the proposed treaty. The diplomatic notes state that, in addition to these provisions, pursuant to a provision of Irish law, the United States may obtain information of financial institutions in Ireland or depositions of witnesses located in Ireland, for the purpose of investigating or prosecuting criminal fiscal offenses (including criminal revenue offenses) under the laws of the United States. The consequence of both the diplomatic notes and the proposed protocol is that the United States may obtain limited information with respect to criminal offenses, and may obtain no information with respect to civil offenses; Ireland may obtain information generally with respect to both criminal and civil offenses. Where specifically requested by the competent authority of one country, the competent authority of the other country shall provide information in the form of depositions of witnesses and authenticated copies of unedited original documents to the extent such depositions and documents can be obtained under the laws and practice of the other country.

The competent authority of the requested country also shall allow representatives of the other country to enter the requested country to interview individuals and examine a person's books and records with their consent.

Article 28. Diplomatic Agents and Consular Officers

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to 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 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 Irish residents generally may be protected from Irish tax.

Article 29. Entry Into Force

The proposed treaty will enter into force upon the exchange of instruments of ratification. The provisions of the proposed treaty generally take effect, in the case of the United States, for taxable periods beginning on or after the first day of January following the date of entry into force and, in the case of Ireland, for financial

years with respect to the corporation tax and years of assessment with respect to the income tax and capital gains tax beginning on or after the first day of January in the year following the date of entry into force. In the case of taxes payable at source, the proposed treaty generally takes effect for amounts paid or credited on or after the first day of January in the year following the date of entry into force.

Taxpayers may elect temporarily to continue to claim benefits under the present treaty with respect to a period after the proposed treaty takes effect. For such a taxpayer, the present treaty would continue to have effect in its entirety for a twelve-month period from the date on which the provisions of the proposed treaty would otherwise take effect. The present treaty ceases to have effect once the provisions of the proposed treaty take effect under the proposed treaty.

The proposed treaty includes a special transition rule with respect to the limitation on benefits provisions. Under this rule, an Irish company that is claiming the benefits of the proposed treaty on the basis that it is owned by residents of EU or NAFTA countries may do so without regard to the requirement that such owners be entitled to benefits equivalent to those under the proposed treaty. This rule generally applies for the two-year period from the date the proposed treaty otherwise takes effect; however, it applies for the three-year period from the date the proposed treaty takes effect if the election to continue the application of the present treaty is made.

Article 30. Termination

The proposed treaty will continue in force until terminated by a treaty country. Either country may terminate the treaty at any time after it has been in force for five years by giving at least six months' prior notice through diplomatic channels. A termination generally will be effective, in the case of the United States, for taxable periods beginning on or after the first day of January following the expiration of the six month period and, in the case of Ireland, for financial years with respect to the corporation tax and years of assessment with respect to the income tax and capital gains tax beginning on or after the first day of January following the expiration of the six month period. With respect to taxes payable at source, a termination will be effective for payments made after the first day of January following the expiration of the six month period.

IV. ISSUES

The proposed treaty with Ireland, as supplemented by the proposed protocol and the diplomatic notes, presents the following specific issues.

A. Treatment of REIT Dividends

REITs in general

REITs essentially are treated as conduits for U.S. tax purposes. The income of a REIT generally is not taxed at the entity level but is distributed and taxed only at the investor level. This single level of tax on REIT income is in contrast to other corporations, the income of which is subject to tax at the corporate level and is taxed again at the shareholder level upon distribution as a dividend. Hence, a REIT is like a mutual fund that invests in qualified real estate assets.

An entity that qualifies as a REIT is taxable as a corporation. However, unlike other corporations, a REIT is allowed a deduction for dividends paid to its shareholders. Accordingly, income that is distributed by a REIT to its shareholders is not subject to corporate tax at the REIT level. A REIT is subject to corporate tax only on any income that it does not distribute currently to its shareholders. As discussed below, a REIT is required to distribute on a current basis the bulk of its income each year.

In order to qualify as a REIT, an entity must satisfy, on a year-by-year basis, specific requirements with respect to its organizational structure, the nature of its assets, the source of its income, and the distribution of its income. These requirements are intended to ensure that the benefits of REIT status are accorded only to pooling of investment arrangements, the income of which is derived from passive investments in real estate and is distributed to the investors on a current basis.

In order to satisfy the organizational structure requirements for REIT status, a REIT must have at least 100 shareholders and not more than 50 percent (by value) of its shares may be owned by five or fewer individuals. In addition, shares of a REIT must be transferrable.

In order to satisfy the asset requirements for REIT status, a REIT must have at least 75 percent of the value of its assets invested in real estate, cash and cash items, and government securities. In addition, diversification rules apply to the REIT's investment in assets other than the foregoing qualifying assets. Under these rules, not more than 5 percent of the value of its assets may be invested in securities of a single issuer and any such securities held may not represent more than 10 percent of the voting securities of the issuer.

In order to satisfy the source of income requirements, at least 95 percent of the gross income of the REIT generally must be from certain passive sources (e.g., dividends, interest, and rents). In addition, at least 75 percent of its gross income generally must be from certain real estate sources (e.g., real property rents, mortgage interest, and real property gains).

Finally, in order to satisfy the distribution of income requirement, the REIT generally is required to distribute to its shareholders each year at least 95 percent of its taxable income for the year (excluding net capital gains). A REIT may retain 5 percent or less of its taxable income and all or part of its net capital gain.

A REIT is subject to corporate-level tax only on any taxable income and net capital gains that the REIT retains. Under an available election, shareholders may be taxed currently on the undistributed capital gains of a REIT, with the shareholder entitled to a credit for the tax paid by the REIT with respect to the undistributed capital gains such that the gains are subject only to a single level of tax. Distributions from a REIT of ordinary income are taxable to the shareholders as a dividend, in the same manner as dividends from an ordinary corporation. Accordingly, such dividends are subject to tax at a maximum rate of 39.6 percent in the case of individuals and 35 percent in the case of corporations. In addition, capital gains of a REIT distributed as a capital gain dividend are taxable to the shareholders as capital gain. Capital gain dividends received by an individual will be eligible for preferential capital gain tax rates if the relevant holding period requirements are satisfied.

Foreign investors in REITs

Nonresident alien individuals and foreign corporations (collectively, foreign persons) are subject to U.S. tax on income that is effectively connected with the foreign person's conduct of a trade or business in the United States, in the same manner and at the same graduated tax rates as U.S. persons. In addition, foreign persons generally are subject to U.S. tax at a flat 30-percent rate on certain gross income that is derived from U.S. sources and that is not effectively connected with a U.S. trade or business. The 30-percent tax applies on a gross basis to U.S.-source interest, dividends, rents, royalties, and other similar types of income. This tax generally is collected by means of withholding by the person making the payment of such amounts to a foreign person.

Capital gains of a nonresident alien individual that are not connected with a U.S. business generally are subject to the 30-percent withholding tax only if the individual is present in the United States for 183 days or more during the year. The United States generally does not tax foreign corporations on capital gains that are not connected with a U.S. trade or business. However, foreign persons generally are subject to U.S. tax on any gain from a disposition of an interest in U.S. real property at the same rates that apply to similar income received by U.S. persons. Therefore, a foreign person that has capital gains with respect to U.S. real estate is subject to U.S. tax on such gains in the same manner as a U.S. person. For this purpose, a distribution by a REIT to a foreign shareholder that is attributable to gain from a disposition of U.S.

real property by the REIT is treated as gain recognized by such shareholder from the disposition of U.S. real property.

U.S. income tax treaties contain provisions limiting the amount of income tax that may be imposed by one country on residents of the other country. Many treaties, like the proposed treaty, generally allow the source country to impose not more than a 15-percent withholding tax on dividends paid to a resident of the other treaty country. In the case of real estate income, most treaties, like the proposed treaty, specify that income derived from, and gain from dispositions of, real property in one country may be taxed by the country in which the real property is situated without limitation.[7] Accordingly, U.S. real property rental income derived by a resident of a treaty partner generally is subject to the U.S. withholding tax at the full 30-percent rate (unless the net-basis taxation election is made), and U.S. real property gains of a treaty partner resident are subject to U.S. tax in the manner and at the rates applicable to U.S. persons.

Although REITs are not subject to corporate-level taxation like other corporations, distributions of a REIT's income to its shareholders generally are treated as dividends in the same manner as distributions from other corporations. Accordingly, in cases where no treaty is applicable, a foreign shareholder of a REIT is subject to the U.S. 30-percent withholding tax on ordinary income distributions from the REIT. In addition, such shareholders are subject to U.S. tax on U.S. real estate capital gain distributions from a REIT in the same manner as a U.S. person.

In cases where a treaty is applicable, this U.S. tax on capital gain distributions from a REIT still applies. However, absent special rules applicable to REIT dividends, treaty provisions specifying reduced rates of tax on dividends apply to ordinary income dividends from REITs as well as to dividends from taxable corporations. As discussed above, the proposed treaty, like many U.S. treaties, reduces the U.S. 30-percent withholding tax to 15 percent in the case of dividends generally. Prior to 1989, U.S. tax treaties contained no special rules excluding dividends from REITs from these reduced rates. Therefore, under pre-1989 treaties such as the present treaty with Ireland, REIT dividends are eligible for the same reductions in the U.S. withholding tax that apply to other corporate dividends.

Beginning in 1989, U.S. treaty negotiators began including in treaties provisions excluding REIT dividends from the reduced rates of withholding tax generally applicable to dividends. Under treaties with these provisions such as the proposed treaty, REIT dividends generally are subject to the full U.S. 30-percent withholding tax.[8]

Analysis of treaty treatment of REIT dividends

The specific treaty provisions governing REIT dividends were introduced beginning in 1989 because of concerns that the reductions

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[7] The proposed treaty, like many treaties, allows the foreign person to elect to be taxed in the source country on income derived from real property on a net basis under the source country's domestic laws.

[8] Many treaties, like the proposed treaty, provides a maximum tax rate of 15 percent in the case of REIT dividends beneficially owned by an individual who holds a less than 10 percent interest in the REIT.

in withholding tax generally applicable to dividends were inappropriate in the case of dividends from REITs. The reductions in the rates of source country tax on dividends reflect the view that the full 30-percent withholding tax rate may represent an excessive rate of source country taxation where the source country already has imposed a corporate-level tax on the income prior to its distribution to the shareholders in the form of a dividend. In the case of dividends from a REIT, however, the income generally is not subject to corporate-level taxation.

REITs are required to distribute their income to their shareholders on a current basis. The assets of a REIT consist primarily of passive real estate investments and the REIT's income may consist principally of rentals from such real estate holdings. U.S. source rental income generally is subject to the U.S. 30-percent withholding tax. Moreover, the United States's treaty policy is to preserve its right to tax real property income derived from the United States. Accordingly, the U.S. 30-percent tax on rental income from U.S. real property is not reduced in U.S. tax treaties.

If a foreign investor in a REIT were instead to invest in U.S. real estate directly, the foreign investor would be subject to the full 30-percent withholding tax on rental income earned on such property (unless the net-basis taxation election is made). However, when the investor makes such investment through a REIT instead of directly, the income earned by the investor is treated as dividend income. If the reduced rates of withholding tax for dividends apply to REIT dividends, the foreign investor in the REIT is accorded a reduction in U.S. withholding tax that is not available for direct investments in real estate.

On the other hand, some argue that it is important to encourage foreign investment in U.S. real estate through REITs. In this regard, a higher withholding tax on REIT dividends (i.e., 30 percent instead of 15 percent) may not be fully creditable in the foreign investor's home country and the cost of the higher withholding tax therefore may discourage foreign investment in REITs. For this reason, some oppose the inclusion in U.S. treaties of the special provisions governing REIT dividends, arguing that dividends from REITs should be given the same treatment as dividends from other corporate entities. Accordingly, under this view, the 15-percent withholding tax rate generally applicable under treaties to dividends should apply to REIT dividends as well.

This argument is premised on the view that investment in a REIT is not equivalent to direct investment in real property. From this perspective, an investment in a REIT should be viewed as comparable to other investments in corporate stock. In this regard, like other corporate shareholders, REIT investors are investing in the management of the REIT and not just its underlying assets. Moreover, because the interests in a REIT are widely held and the REIT itself typically holds a large and diversified asset portfolio, an investment in a REIT represents a very small investment in each of a large number of properties. Thus, the REIT investment provides diversification and risk reduction that are not easily replicated through direct investment in real estate.

Issue

Under the present treaty with Ireland, as under many older U.S. tax treaties, the U.S. withholding tax on REIT dividends paid to residents of Ireland is limited to a maximum rate of 15 percent. Under the proposed treaty, as under recent U.S. tax treaties, the reduced rates of U.S. withholding applicable to dividends generally do not apply to REIT dividends and, thus, REIT dividends paid to residents of Ireland may be subject to U.S. withholding tax at the full statutory rate of 30 percent. The Committee may wish to consider whether, in light of the competing considerations discussed above, the treatment of REIT dividends in the proposed treaty is appropriate.

B. Exchange of Information

One of the principal purposes of the proposed income tax treaty between the United States and Ireland is to prevent avoidance or evasion of income taxes of the two countries. The exchange of information article of the proposed treaty is one of the primary vehicles used to achieve that purpose.

The exchange of information article contained in the proposed treaty conforms in most respects to the corresponding articles of the U.S. and OECD models. As is true under the U.S. model, under the proposed treaty the countries are to exchange such information as is relevant for carrying out the provisions of the proposed treaty or the domestic tax laws of the countries. As is also true under these model treaties, under the proposed treaty a country is not required to carry out administrative measures at variance with the laws and administrative practices of either country, to supply information which is not obtainable under the laws or in the normal course of the administration of either country, or to supply information which discloses any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which is contrary to public policy.

There is one significant respect in which the exchange of information article will not be fully implemented by Ireland. The proposed treaty conforms to the corresponding article of the U.S. model by including the standard provision that upon request a country shall obtain information to which the request relates in the same manner and to the same extent as if the tax of the requesting country were imposed by the requested country. However, paragraph 10 of the proposed protocol states that, for purposes of this provision regarding obtaining information, as of the date of signature of the proposed treaty,[9] the laws and practices of Ireland do not permit its tax authorities to carry out inquiries on behalf of another country where no Irish liability for a tax covered by the proposed treaty is at issue. The proposed protocol also states that if Irish laws and practices later change to permit such inquiries, Ireland will then implement this provision of the proposed treaty. The diplomatic notes state that, in addition to these provisions, pursuant to a provision of Irish law, the United States may obtain information of financial institutions in Ireland or depositions of wit-

[9] July 28, 1997.

nesses located in Ireland, for the purpose of investigating or prosecuting criminal fiscal offenses (including criminal revenue offenses) under the laws of the United States. The consequence of both the diplomatic notes and the proposed protocol is that the United States may obtain limited information with respect to criminal offenses, and may obtain no information with respect to civil offenses; Ireland may obtain information generally with respect to both criminal and civil offenses. The language of this provision in the proposed treaty does not permit the United States to decline to obtain information that is requested by Ireland solely because the United States is not able to obtain information on a reciprocal basis from Ireland.

One issue is whether the Committee views the exchange of information provisions of the proposed treaty as sufficient to carry out the tax-avoidance purposes for which income tax treaties are entered into by the United States. Some might consider the non-reciprocal nature of the provision[10] on obtaining information to be unusual. The Committee may wish to consider whether such a nonreciprocal provision is appropriate in the context of the proposed treaty. Some might also observe that other countries that have similar local law impediments to obtaining information (such as Thailand) have received less advantageous treatment with respect to U.S. treaties than Ireland has as a consequence of these impediments. The Committee may wish to consider whether this disparate treatment is appropriate in the context of the proposed treaty. Also, unlike the proposed treaty with Thailand, the proposed treaty with Ireland has not been structured to encourage Ireland to change its own laws and practices so that it can fully obtain information pursuant to the proposed treaty. The Committee may wish to consider whether this is an appropriate balancing of incentives and consequences that will achieve the goal of fully implementing the provisions relating to obtaining information. Although broader exchange of information provisions theoretically would be desirable, in practice it may be difficult to achieve broader provisions given the current constraints of Irish laws and practices.

C. Insurance Excise Tax

The proposed treaty, unlike the present treaty, covers the U.S. excise tax on insurance premiums paid to foreign insurers. With the waiver of the excise tax on insurance premiums, for example, an Irish insurer without a permanent establishment in the United States can collect premiums on policies covering a U.S. risk or a U.S. person free of the excise tax on insurance premiums. However, the tax is imposed to the extent that the risk is reinsured by the Irish insurer with a person not entitled to the benefits of an income tax treaty providing exemption from the tax. This latter rule is known as the "anti-conduit" clause. Moreover, the tax is imposed if the premiums paid to the Irish insurer are not subject to generally applicable tax imposed on insurance corporations in Ireland.

Such waivers of the excise tax have raised serious congressional concerns. For example, concern has been expressed over the possi-

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[10] This is a consequence of the provision in the proposed protocol, not of the proposed treaty itself.

bility that such waivers may place U.S. insurers at a competitive disadvantage with respect to foreign competitors in U.S. markets if a substantial tax is not otherwise imposed (e.g., by the treaty partner country) on the insurance income of the foreign insurer (or, if the risk is reinsured, the reinsurer). Moreover, in such case, a waiver of the tax does not serve the primary purpose of treaties to prevent double taxation, but instead has the undesirable effect of eliminating all tax on such income.

The U.S.-Barbados and U.S.-Bermuda tax treaties each contained such a waiver as originally signed. In its report on the Bermuda treaty, the Committee expressed the view that those waivers should not have been included. The Committee stated that waivers should not be given by Treasury in its future treaty negotiations without prior consultations with the appropriate committees of Congress.[11] Congress subsequently enacted legislation to ensure the sunset of the waivers in the two treaties. The insurance excise tax also is waived in the treaty with the United Kingdom (without the so-called "anti-conduit rule"). The inclusion of such a waiver in that treaty has been followed by a number of legislative efforts to redress the perceived competitive imbalance created by the waiver.

The issue is whether the waiver of the insurance excise tax in the proposed treaty is consistent with the Committee's view of sound tax treaty policy. Furthermore, the Committee may wish to satisfy itself that the Irish income tax imposed on Irish insurance companies on insurance premiums results in a burden that is substantial in relation to the U.S. tax on U.S. insurance companies.

D. Treaty Shopping

The proposed treaty, like many 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 residents of Ireland and the United States only, 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. In particular, the proposed treaty provision resembles the anti-treaty-shopping provisions contained in the 1993 U.S. treaty

[11] Limited consultations took place in connection with the proposed treaty.

with the Netherlands and the 1995 U.S. treaty with France. 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.

The anti-treaty-shopping provisions in the proposed treaty differ from those in the Code and other treaties in a number of respects. The proposed treaty contains a particularly broad range of categories under which persons may qualify for some or all benefits of the treaty.

For example, the proposed treaty includes a special rule under which income derived from the operation of ships and aircraft in international traffic will be eligible for the exemption from source country tax provided under the treaty. Under this rule, an Irish resident that derives shipping income from the United States is entitled to exemption from U.S. tax on such income if at least 50 percent of the interests in the resident is owned, directly or indirectly, by qualified persons, U.S. citizens or residents, or individuals who are residents of a third country or a company or companies the principal shares of which are substantially and regularly traded on an established securities market in the third country. This rule applies as long as the third country grants an exemption to shipping income under similar terms to citizens and corporations of the source country. This rule also is included in the treaty with the Netherlands.

The proposed treaty is similar to other U.S. treaties and the branch tax rules in affording treaty benefits to certain publicly traded companies. In comparison with the U.S. branch tax rules, the proposed treaty is more lenient. The proposed treaty allows benefits to be afforded to a company that is at least 50 percent owned, directly or indirectly, by one or more qualifying publicly traded corporations, while the branch tax rules allow benefits to be afforded only to a wholly-owned subsidiary of a publicly traded company. The proposed treaty also allows benefits to non-corporate entities, such as trusts, that satisfy a similar standard for public ownership.

The proposed treaty also provides mechanical rules under which so-called "derivative benefits" are afforded.[12] Under these rules, an entity is afforded certain benefits based in part on its ultimate ownership of at least 95 percent by seven or fewer residents of EU or NAFTA countries who would be entitled to treaty benefits under an existing treaty with the third country. The U.S. model does not contain a derivative benefits provision.

[12] The U.S. income tax treaties with the Netherlands, Jamaica and Mexico also provide similar benefits.

Taken as a whole, some may argue that the derivative benefits provisions of the proposed treaty are more generous to taxpayers claiming U.S. treaty benefits than the derivative benefits provisions of any U.S. tax treaties currently in effect. For example, while most other treaties to which the United States is a party generally allow derivative benefits only with respect to certain income (e.g., interest, dividends or royalties), the proposed treaty allows a taxpayer to claim derivative benefits with respect to the entire treaty.[13] In addition, unlike most existing treaties, the proposed treaty, does not require *any* same-country ownership of an Irish company claiming treaty benefits.[14] In other words, an Irish entity that is 100-percent owned by certain third-country residents and that does not otherwise have a nexus with Ireland (e.g., by engaging in an active trade or business there), may be entitled to claim benefits under the proposed treaty. Moreover, in order for residents of third countries to be taken into account under this rule, the proposed treaty generally requires only that the third country have an income tax treaty with the United States, and does not require that such treaty provide benefits as favorable as those under the proposed treaty. The latter requirement is imposed under the proposed treaty only in order to qualify for benefits with respect to dividends, interest, and royalties. In addition, that requirement with respect to eligibility for derivative benefits with respect to dividends, interest, and royalties does not apply for the first two or three years that the treaty is in force.

The proposed treaty includes a special rule designed to prevent the proposed treaty from reducing or eliminating U.S. tax on income of an Irish resident in a case where no other substantial tax is imposed on that income (the so-called "triangular cases"). This is necessary because an Irish resident may in some cases be wholly or partially exempt from Irish tax on foreign (i.e., non-Irish) income. The special rule applies generally if the combined Irish and third-country taxation of U.S.-source income derived by an Irish enterprise and attributable to a permanent establishment in the third country is less than 50 percent of the tax that would be imposed if the Irish enterprise earned the income in Ireland.

Under the special rule, the United States is permitted to tax dividends, interest, and royalties paid to the third-country permanent establishment at the rate of 15 percent. In addition, under the special rule, the United States is permitted to tax other types of income without regard to the proposed treaty. The special rule generally does not apply if the U.S. income is derived in connection with, or is incidental to, an active trade or business in the third country. The special rule is similar to a provision of the 1993 protocol to the U.S.-Netherlands tax treaty and a provision of the U.S.-France treaty. These special rules for triangular cases are not provided for in the U.S. model.

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[13] The U.S.-Jamaica tax treaty is the only other existing treaty that allows a taxpayer to claim derivative benefits with respect to the entire treaty.

[14] Article 26(4) of the U.S.-Netherlands treaty, for example, requires more than 30-percent Dutch ownership of the entity claiming derivative benefits, and more than 70-percent EU ownership of such entity. On the other hand, the 1995 U.S.-Canada protocol permits a company to claim certain treaty benefits under the derivative benefits provision without any same country ownership; however, the benefits that may be so obtained are limited to reduced withholding rates for dividends, interest and royalties.

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. 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.

E. Arbitration of Competent Authority Issues

The proposed treaty would allow for a binding arbitration procedure, if agreed by both competent authorities and the taxpayer or taxpayers involved, for the resolution of those disputes in the interpretation or application of the proposed treaty that are within the jurisdiction of the competent authorities to resolve. The competent authorities could release to the arbitration board such information as is necessary to carry out the arbitration procedure. The members of the arbitration board are subject to the limitations on disclosure contained in the exchange of information article of the proposed treaty. This provision would take effect only after an exchange of diplomatic notes between the United States and Ireland.

Generally, the jurisdiction of the competent authorities under the proposed treaty is as broad as it is under any U.S. income tax treaties. For example, the competent authorities are empowered (in this as in other treaties) to agree on the attribution of income, deductions, credits, or allowances of an enterprise to a permanent establishment. They may agree on the allocation of income, deductions, credits, or allowances between associated enterprises and others under the provisions of Article 9 (Associated Enterprises), which is the treaty analogue of Code section 482. They also may agree on characterization of particular items of income, on the common meaning of a term, and on the application of procedural aspects of internal law. Finally, the competent authorities may agree on the elimination of double taxation in cases not provided for in the treaty. According to the Technical Explanation with respect to this procedure, agreements reached by the competent authorities need not conform to the internal law provisions of either treaty country.

In approving ratification of the U.S.-Germany treaty, the Committee indicated a belief that the tax system potentially may have much to gain from use of a procedure, such as arbitration, in which independent experts can resolve disputes that otherwise may impede efficient administration of the tax laws. However, the Committee also believed that the appropriateness of such a clause in a future treaty depended strongly on the other party to the treaty, and the experience that the competent authorities would have under the provision in the German treaty. To date there have been

no arbitrations of competent authority cases under the German treaty, and few tax arbitrations outside the context of that treaty.

The Committee may wish to consider whether this provision allowing for the future implementation of an arbitration procedure is appropriate.

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