[JOINT COMMITTEE PRINT]

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

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

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INTRODUCTION

This pamphlet,[1] prepared by the staff of the Joint Committee on Taxation, describes the proposed income tax treaty, as supplemented by the proposed protocol, between the United States of America and the Kingdom of Denmark ("Denmark"). The proposed treaty and proposed protocol were both signed on August 19, 1999.[2] The Senate Committee on Foreign Relations has scheduled a public hearing on the proposed treaty and proposed protocol on October 13, 1999.

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

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

[2] For a copy of the proposed treaty and proposed protocol, see Senate Treaty Doc. 106–12, September 21, 1999.

I. SUMMARY

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

As in other U.S. tax treaties, these objectives principally are achieved through each country's agreement to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other country. For example, the proposed treaty contains provisions under which each country generally agrees not to tax business income derived from sources within that country by residents of the other country unless the business activities in the taxing country are substantial enough to constitute a permanent establishment or fixed base (Articles 7 and 14). Similarly, the proposed treaty contains "commercial visitor" exemptions under which residents of one country performing personal services in the other country will not be required to pay tax in the other country unless their contact with the other country exceeds specified minimums (Articles 14, 15, and 17). The proposed treaty provides that dividends, interest, royalties, and certain capital gains derived by a resident of either country from sources within the other country generally may be taxed by both countries (Articles 10, 11, 12, and 13); however, the rate of tax that the source country may impose on a resident of the other country on dividends, interest, and royalties generally will be limited by the proposed treaty (Articles 10, 11, and 12).

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the proposed treaty generally provides for relief from the potential double taxation through the allowance by the country of residence of a tax credit for certain foreign taxes paid to the other country (Article 23).

The proposed treaty contains the standard provision (the "saving clause") included in U.S. tax treaties pursuant to which each country retains the right to tax its residents and citizens as if the treaty had not come into effect (Article 1). In addition, the proposed treaty contains the standard provision providing that the treaty may not be applied to deny any taxpayer any benefits the taxpayer would be entitled to under the domestic law of a country or under any other agreement between the two countries (Article 1). The proposed treaty also contains a detailed limitation on benefits provision to prevent the inappropriate use of the treaty by third-country residents (Article 22).

The United States and Denmark have an income tax treaty currently in force (signed in 1948).[3] The proposed treaty is similar to other recent U.S. income tax treaties, the 1996 U.S. model income tax treaty ("U.S. model"), and the model income tax treaty of the Organization for Economic Cooperation and Development ("OECD model"). However, the proposed treaty contains certain substantive deviations from those treaties and models.

[3] A prior proposed U.S. income tax treaty with Denmark was signed in 1980 with a related proposed protocol that was signed in 1983. The Committee reported favorably on this proposed treaty (and protocol) in 1984. However, the Senate did not consider the treaty further in 1984. The Committee also reported favorably on the treaty (and protocol) in 1985. During Senate consideration of the treaty in 1985, objections were raised regarding the creditability under the treaty of the Danish hydrocarbon tax. The Senate has not given its advice and consent to ratification of this treaty.

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

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

A. U.S. Tax Rules

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

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

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

Specific statutory exemptions from the 30-percent withholding tax are provided. For example, certain original issue discount and certain interest on deposits with banks or savings institutions are exempt from the 30-percent withholding tax. An exemption also is provided for certain interest paid on portfolio debt obligations. In addition, income of a foreign government or international organization from investments in U.S. securities is exempt from U.S. tax.

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

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

Because the United States taxes U.S. citizens, residents, and corporations on their worldwide income, double taxation of income can arise when income earned abroad by a U.S. person is taxed by the country in which the income is earned and also by the United States. The United States seeks to mitigate this double taxation generally by allowing U.S. persons to credit foreign income taxes paid against the U.S. tax imposed on their foreign-source income. A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax liability on U.S.-source income. Therefore, the foreign tax credit provisions contain a limitation that ensures that the foreign tax credit offsets only the U.S. tax on foreign-source income. The foreign tax credit limitation generally is computed on a worldwide basis (as opposed to a "per-country" basis). The limitation is applied separately for certain classifications of income. In addition, a special limitation applies to the credit for foreign taxes imposed on foreign oil and gas extraction income.

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

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 relevant 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, U.S. treaties generally contain an "anti-treaty shopping" provision that is designed to limit treaty benefits to bona fide residents of the two countries.

III. EXPLANATION OF PROPOSED TREATY AND PROPOSED PROTOCOL

A detailed, article-by-article explanation of the proposed income tax treaty between the United States and Denmark is set forth below. The provisions of the proposed protocol are covered together with the relevant articles of the proposed treaty.

Article 1. General Scope

Overview

The general scope article describes the persons who may claim the benefits of the proposed treaty. It also includes a "saving clause" provision similar to provisions found in most U.S. income tax treaties.

The proposed treaty generally applies to residents of the United States and to residents of Denmark, with specific modifications to such scope provided in other articles (*e.g.,* Article 19 (Government Service), Article 24 (Non-Discrimination), and Article 26 (Exchange of Information)). This scope is consistent with the scope of other U.S. income tax treaties, the U.S. model, and the OECD model. For purposes of the proposed treaty, residence is determined under Article 4 (Residence).

The proposed treaty provides that it does not restrict in any manner any benefit (*e.g.,* an exclusion, exemption, deduction, credit, or other allowance) accorded by internal law or by any other agreement between the United States and Denmark. Thus, the proposed treaty will not apply to increase the tax burden of a resident of either the United States or Denmark. According to the Treasury Department's Technical Explanation (hereinafter referred to as the "Technical Explanation"), the fact that the proposed treaty only applies to a taxpayer's benefit does not mean that a taxpayer may select inconsistently among treaty and internal law provisions in order to minimize its overall tax burden. In this regard, the Technical Explanation sets forth the following example. Assume a resident of Denmark 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 Denmark 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 non-discrimination rules, and not the non-discrimination rules of any other agreement in effect between the United States and Denmark, generally apply to that 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 similar provision or action.

Saving clause

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

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

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

Exceptions to the saving clause are provided for the following benefits conferred by a treaty country: the allowance of correlative adjustments when the profits of an associated enterprise are adjusted by the other country (Article 9, paragraph 2); the allowance of a special basis adjustment election with respect to gains recognized in the other country, and the ability to coordinate the timing of gain recognition between countries (Article 13, paragraphs 7 and 8); the source rule for pension distributions, the exemption from residence country tax for social security benefits, and certain child support payments (Article 18, paragraphs 1(c), 2, and 5); relief from double taxation through the provision of a foreign tax credit (Article 23); protection from discriminatory tax treatment with respect to transactions with residents of the other country (Article 24); and benefits under the mutual agreement procedures (Article 25). These exceptions to the saving clause permit residents or citizens of the United States or Denmark to obtain such benefits of the proposed treaty with respect to their country of residence or citizenship.

In addition, the saving clause does not apply to the following benefits conferred by one of the countries upon individuals who neither are citizens of that country nor have been admitted for permanent residence in that country. Under this set of exceptions to the saving clause, the specified treaty benefits are available to, for example, a Danish citizen who spends enough time in the United States to be taxed as a U.S. resident but who has not acquired U.S. permanent residence status (*i.e.,* does not hold a "green card"). The benefits that are covered under this set of exceptions are the exemptions from host country tax for certain compensation from government service (Article 19), certain income received by students or trainees (Article 20), and certain income of diplomats and consular officers (Article 28).

Article 2. Taxes Covered

The proposed treaty generally applies to the income taxes of the United States and Denmark. However, Article 24 (Non-Discrimination) is applicable to all taxes imposed at all levels of government, including State and local taxes. Moreover, Article 26 (Exchange of Information) generally is applicable to all national-level taxes, including, for example, estate and gift taxes.

In the case of the United States, the proposed treaty applies to the Federal income taxes imposed by the Code and the excise taxes imposed with respect to private foundations, but excludes social security taxes.

In the case of Denmark, the proposed treaty applies to (1) Denmark's income tax (indkomstskatten til staten), (2) the municipal income tax (den kommunale indkomstskat), (3) the income tax to the county municipalities (den amtskommunale indkomstskat), and (4) taxes imposed under the Hydrocarbon Tax Act (skatter i henhold til kulbrinteskatteloven).

The proposed treaty also contains a rule generally found in U.S. income tax treaties which provides that the proposed treaty applies to any identical or substantially similar taxes that are imposed subsequently in addition to, or in place of, the taxes covered. The proposed treaty obligates the competent authority of each country to notify the competent authority of the other country of any significant changes in its internal tax laws (or other laws) that affect its obligations under the treaty or of any official published materials concerning the application of the treaty (including explanations, regulations, rulings, or judicial decisions). The Technical Explanation states that this requirement relates to changes that are significant to the operation of the proposed treaty.

Article 3. General Definitions

The proposed treaty provides definitions of a number of terms for purposes of the proposed treaty. Certain of the standard definitions found in most U.S. income tax treaties are included in the proposed treaty.

The term "person" includes an individual, an estate, a trust, a partnership, a company, and any other body of persons.

A "company" under the proposed treaty is any body corporate or any entity which is treated as a body corporate for tax purposes according to the laws of the state in which it is organized.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean, respectively, an enterprise carried on by a resident of a treaty country and an enterprise carried on by a resident of the other treaty country. The terms also include an enterprise carried on by a resident of a treaty country through an entity that is treated as fiscally transparent in such country. The proposed treaty does not define the term "enterprise." However, despite the absence of a clear, generally accepted meaning, the Technical Explanation states that the term is understood to refer to any activity or set of activities that constitute a trade or business.

The proposed treaty defines "international traffic" as any transport by a ship or aircraft, except when the transport is solely between places in a treaty country. Accordingly, with respect to a Danish enterprise, purely domestic transport within the United States does not constitute "international traffic."

The U.S. "competent authority" is the Secretary of the Treasury or his delegate. The U.S. competent authority function has been delegated to the Commissioner of Internal Revenue, who has redelegated the authority to the Assistant Commissioner (International). On interpretative issues, the latter acts with the concurrence of the Associate Chief Counsel (International) of the IRS. The Danish "competent authority" is the Minister for Taxation or his authorized representative.

The term "United States" means the United States of America (encompassing 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 "United States" also includes the territorial sea of the United States, and the sea bed and subsoil of the submarine areas adjacent to the territorial sea of the United States over which the United States exercises sovereignty in accordance with international law. The Technical Explanation states that this extension of the definition applies, however, only for the purpose of natural resource exploration and exploitation of such areas and only if the person, property, or activity to which the proposed treaty is being applied is connected with such natural resource exploration or exploitation. Thus, the term "United States" would not include any activity involving the sea floor of an area over which the United States exercised sovereignty for natural resource purposes if that activity was unrelated to the exploration and exploitation of natural resources.

The term "Denmark" means the Kingdom of Denmark, including any area outside the territorial sea of Denmark which in accordance with international law has been or may be designated under Danish laws as an area within which Denmark may exercise sovereign rights with respect to the exploration and exploitation of the natural resources of the sea-bed or its subsoil and the superjacent waters and with respect to other activities for the exploration and economic exploitation of the area. The proposed treaty provides that the term "Denmark" does not comprise the Faroe Islands or Greenland. However, the proposed protocol provides that the treaty may, through a supplementary treaty, be extended in its entirety or with any necessary modifications to the Faroe Islands or Greenland if they impose taxes substantially similar in character to those covered by the proposed treaty. The Technical Explanation states that such an extension would be subject to ratification in the case of the United States, and approval in accordance with Denmark's constitutional procedures.

The term "national of a Contracting State" means (1) any individual possessing the nationality or citizenship of a treaty country; and (2) any legal person, partnership, or association deriving its status as such from the laws in force in a treaty country.

The term "qualified governmental entity" means: (1) the governing body, political subdivision, or local authority of a treaty country; (2) a person wholly owned (directly or indirectly) by the treaty country or its political subdivisions or local authorities, provided that it is organized under the laws of such country, its earnings are credited to its own account with no portion of its income inuring to the benefit of a private person, and its assets vest in the country, political subdivision or local authority upon dissolution; and (3) a pension trust or fund of a person described in (1) or (2) above that is constituted and operated exclusively to administer or provide pension benefits described in Article 19 (Government Service). A qualified governmental entity described in (2) and (3) above cannot engage in any commercial activity. This definition is the same as that contained in the U.S. model.

The proposed treaty also contains the standard provision that, unless the context otherwise requires or the competent authorities agree to a common meaning, all terms not defined in the treaty have the meaning pursuant to the respective laws of the country that is applying the treaty. Where a term is defined both under a country's tax law and under a non-tax law, the definition in the tax law is to be used in applying the proposed treaty.

Article 4. Residence

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

Internal taxation rules

United States

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

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

Denmark

Under Danish law, resident individuals are subject to tax on their worldwide income, while nonresident individuals are subject to tax only on income earned in Denmark. Individuals are considered to be residents of Denmark if they are present in Denmark for more than six months or if their permanent place of residence is in Denmark. Companies that are incorporated in Denmark, or whose seat of management is in Denmark, are considered as residents of Denmark and subject to tax on their worldwide income.

Proposed treaty rules

The proposed treaty specifies rules to determine whether a person is a resident of the United States or Denmark for purposes of the proposed treaty. The rules generally are consistent with the rules of the U.S. model.

The proposed treaty generally defines "resident of a Contracting State" to mean any person who, under the laws of that country, is liable to tax by reason of the person's domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. The term "resident of a Contracting State" does not include any person that is liable to tax in that country only on income from sources in that country or on profits attributable to a permanent establishment in that country. A United States citizen or an alien lawfully admitted for permanent residence in the United States (*i.e.,* a "green card" holder) is a U.S. resident only if he or she has a substantial presence, permanent home, or habitual abode in the United States. The determination of whether a citizen or national is considered a resident of the United States or Denmark is made based on the principles of the treaty tie-breaker rules described below.

The proposed treaty also provides that a resident includes a legal person organized under the laws of a treaty country and that is generally exempt from tax in the treaty country because it is established and maintained in that country either (1) exclusively for a religious, charitable, educational, scientific, or other similar purpose; or (2) to provide pensions or other similar benefits to employees, including self-employed individuals, pursuant to a plan. The Technical Explanation states that the term "similar benefits" is intended to encompass employee benefits such as health and disability benefits.

A qualified governmental entity is also treated as a resident of the country in which it is established.

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

A set of "tie-breaker" rules is provided to determine residence in the case of an individual who, under the basic residence definition, would be considered to be a resident of both countries. Under these rules, an individual is deemed to be a resident of the country in which he or she has a permanent home available. If the individual has a permanent home in both countries, the individual's residence is deemed to be the country with which his or her personal and economic relations are closer (*i.e.,* his or her "center of vital interests"). If the country in which the individual has his or her center of vital interests cannot be determined, or if he or she does not have a permanent home available in either country, he or she is deemed to be a resident of the country in which he or she has an habitual abode. If the individual has an habitual abode in both countries or in neither country, he or she is deemed to be a resident of the country of which he or she is a national. If the individual is a national of both countries or neither country, the competent authorities of the countries will settle the question of residence by mutual agreement.

If a company would be a resident of both countries under the basic definition in the proposed treaty, the competent authorities of the countries will attempt to settle the question of residence by mutual agreement and to determine the mode of application of the treaty to such person.

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 items of income will be taxed as business profits.

In general, under the proposed treaty, a permanent establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on. A permanent establishment includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources. It also includes a building site or a construction or installation project, or an installation or drilling rig or ship used for the exploration of natural resources, but only if the site, project, or activity continues for more than twelve months. For these purposes, activities carried on by an enterprise related to another enterprise, within the meaning of Article 9 (Associated Enterprises), are treated as carried on by the enterprise to which it is related if the activities in question are substantially the same as those carried on by the last-mentioned enterprise and are concerned with the same project or operation (except to the extent that those activities are carried on at the same time). The Technical Explanation states that the twelve-month test applies separately to each individual site or project, with a series of contracts or projects that are interdependent both commercially and geographically treated as a single project. The Technical Explanation further states that if the twelve-month threshold is exceeded, the site or project constitutes a permanent establishment as of the first day that work in the country began.

Under the proposed treaty, the following activities are deemed not to constitute a permanent establishment: (1) the use of facilities solely for storing, displaying, or delivering goods or merchandise belonging to the enterprise; (2) 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; (3) the maintenance of a fixed place of business solely for the purchase of goods or merchandise or for the collection of information for the enterprise; and (4) 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.

Under the U.S. model, the maintenance of a fixed place of business solely for any combination of the above-listed activities does not constitute a permanent establishment. Under the proposed treaty (as under the OECD Model), a fixed place of business used solely for any combination of these activities does not constitute a permanent establishment, provided that the overall activity of the fixed place of business is of a preparatory or auxiliary character. In this regard, the Technical Explanation states that it is assumed that a combination of preparatory or auxiliary activities generally will also be of a character that is preparatory or auxiliary.

Under the proposed treaty, if a person, other than an independent agent, is acting in a treaty country on behalf of an enterprise of the other country and has, and habitually exercises, the authority to conclude contracts in the name of such enterprise, the enterprise is deemed to have a permanent establishment in the first country in respect of any activities undertaken by such person for that enterprise. This rule does not apply where the activities of such person are limited to the activities listed above, such as storage, display, or delivery of merchandise, which are excluded from the definition of a permanent establishment.

Under the proposed treaty, no permanent establishment is deemed to arise if the agent is a broker, general commission agent, or any other agent of independent status, provided that the agent is acting in the ordinary course of its business. The Technical Explanation states that whether an enterprise and an agent are independent is a factual determination, a relevant factor of which includes the extent to which the agent bears business risk.

The proposed treaty provides that the fact that a company that is a resident of one country controls or is controlled by a company that is a resident of the other country or that carries on business in the other country does not of itself cause either company to be a permanent establishment of the other.

Article 6. Income from Real Property

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

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

The term "real property" has the meaning which it has under the law of the country in which the property in question is situated.[5] The proposed treaty specifies that the term in any case includes property accessory to real property; livestock and equipment used in agriculture and forestry; rights to which the provisions of general law respecting landed property apply; usufruct of real property; and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources. Ships, boats, and aircraft are not considered to be real property.

The proposed treaty specifies that the country in which the property is situated also may tax income derived from the direct use, letting, or use in any other form of real property. The rules of Article 6, permitting source country taxation, also apply to the income from real property of an enterprise and to income from real property used for the performance of independent personal services.

The proposed treaty provides that residents of a treaty country that are liable for tax in the other treaty country on income from real property situated in such other treaty country may elect to

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

compute the tax on such income on a net basis. Such an election will be binding for the taxable year of the election and all subsequent taxable years unless the competent authority of the country in which the property is situated agrees to terminate the election. U.S. internal law provides such a net-basis election in the case of income of a foreign person from U.S. real property (Code secs. 871(d) and 882(d)).

Article 7. Business Profits

Internal taxation rules

United States

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

The treatment of income as effectively connected with a U.S. trade or business depends upon whether the source of the income is U.S. or foreign. In general, U.S.-source periodic income (such as interest, dividends, rents, and wages) and U.S.-source capital gains are effectively connected with the conduct of a trade or business within the United States if the asset generating the income is used in (or held for use in) the conduct of the trade or business or if the activities of the trade or business were a material factor in the realization of the income. All other U.S.-source income of a person engaged in a trade or business in the United States is treated as effectively connected with the conduct of a trade or business in the United States (under what is referred to as a "force of attraction" rule).

Foreign-source income generally is effectively connected income only if the foreign person has an office or other fixed place of business in the United States and the income is attributable to that place of business. Only three types of foreign-source income are considered to be effectively connected income: rents and royalties for the use of certain intangible property derived from the active conduct of a U.S. business; certain dividends and interest either derived in the active conduct of a banking, financing or similar business in the United States or received by a corporation the principal business of which is trading in stocks or securities for its own account; and certain sales income attributable to a U.S. sales office. Special rules apply for purposes of determining the foreign-source income that is effectively connected with a U.S. business of an insurance company.

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

Denmark

Foreign corporations and nonresident individuals generally are subject to Danish tax only on income derived in Denmark. Business income derived in Denmark by a foreign corporation or nonresident individual generally is taxed in the same manner as the income of a Danish corporation or resident individual.

Proposed treaty limitations on internal law

Under the proposed treaty (and similar to the present treaty), business profits of an enterprise of one of the countries 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. This is one of the basic limitations on a country's right to tax income of a resident of the other country. The rule is similar to those contained in the U.S. and OECD models.

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

The proposed treaty (similar to the present treaty) provides that there will be attributed to a permanent establishment the business profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions. For this purpose, the business profits to be attributed to the permanent establishment include only the profits derived from the assets or activities of the permanent establishment. The Technical Explanation states that this provision permits the use of methods other than separate accounting to determine the arm's-length profits of a permanent establishment where it is necessary to do so for practical reasons, such as when the affairs of the permanent establishment are so closely bound up with those of the head office that it would be impossible to disentangle them on any strict basis of accounts.

The proposed protocol provides that nothing in Article 7 (Business Profits) or 24 (Non-Discrimination) prevents either treaty country from applying their special rules dealing with the taxation of insurance companies. Thus, for example, the proposed treaty will not prevent the United States from continuing to tax permanent establishments of Danish insurance companies in accordance with section 842(b) of the Code.

In computing taxable business profits, the proposed treaty provides that deductions are allowed for expenses, wherever incurred, which are incurred for the purposes of the permanent establishment. 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 which includes the permanent establishment). The Technical Explanation states that this rule permits (but does not require) each treaty country to apply the type of expense allocation rules provided by U.S. law (such as in Treas. Reg. secs. 1.861–8 and 1.882–5). The Technical Explanation clarifies that deductions will not be allowed for expenses charged to a permanent establishment by another unit of the enterprise. Thus, a permanent establishment may not deduct a royalty deemed paid to the head office.

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

The proposed treaty requires the determination of business profits of a permanent establishment to be made in accordance with the same method year by year unless a good and sufficient reason to the contrary exists. Where business profits include items of income that are dealt with separately in other articles of the proposed treaty, those other articles, and not the business profits article, govern the treatment of those items of income (except where such other articles specifically provide to the contrary). Thus, for example, dividends are taxed under the provisions of Article 10 (Dividends), and not as business profits, except as specifically provided in Article 10.

For purposes of the proposed treaty, the term "business profits" means income derived from any trade or business, including income derived by an enterprise from the performance of personal services and from the rental of tangible personal property.

The proposed treaty incorporates the rule of Code section 864(c)(6) and provides that any income or gain attributable to a permanent establishment or a fixed base during its existence is taxable in the country where the permanent establishment or fixed base is located even though payments are deferred until after the permanent establishment or fixed base has ceased to exist. This rule applies with respect to business profits (Article 7, paragraphs 1 and 2), dividends (Article 10, paragraph 6), interest (Article 11, paragraph 3), royalties (Article 12, paragraph 3), capital gains (Article 13, paragraph 3), independent personal services income (Article 14), and other income (Article 21, paragraph 2).

Article 8. Shipping and Air Transport

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

The United States generally taxes the U.S.-source income of a foreign person from the operation of ships or aircraft to or from the

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

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" is defined in Article 3(1)(d) (General Definitions) as any transport by a ship or aircraft, except when the transport is solely between places in a treaty country.

For purposes of the proposed treaty, profits from the operation of ships or aircraft include profits derived from the rental of ships or aircraft on a full (time or voyage) basis (*i.e.,* with crew). It also includes profits from the rental of ships or aircraft on a bareboat basis (*i.e.,* without crew) if such ships or aircraft are operated in international traffic by the lessee or if such rental income is incidental to profits from the operation of ships or aircraft in international traffic. Profits derived by an enterprise from the inland transport of property or passengers within either treaty country are treated as profits from the operation of ships or aircraft in international traffic if such transport is undertaken as part of international traffic by the enterprise. These rules are the same as the corresponding rules in the U.S. model.

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

The shipping and air transport provisions of the proposed treaty apply to profits from participation in a pool, joint business, or international operating agency. This refers to various arrangements for international cooperation by carriers in shipping and air transport. According to the proposed protocol, the Scandinavian Airlines System (SAS) is a consortium within the meaning of this article; its participating members being SAS Danmark A/S, SAS Norge ASA, and SAS Sverige AB. In order to avoid the problems inherent in operating in the United States through a consortium, the members of the consortium in 1946 established a New York corporation, Scandinavian Airlines System, Inc. (SAS, Inc.) to act on their behalf in the United States pursuant to an agency agreement dated September 18, 1946. A similar agreement was entered into by SAS directly and SAS, Inc., on March 14, 1951. Pursuant to the agency agreement, SAS, Inc., is authorized to perform only such functions as SAS assigns to it, all in connection with international air traffic. Under that agreement, all revenues collected by SAS, Inc., are automatically credited to SAS. Operation expenses incurred by SAS, Inc., are debited to SAS in accordance with the terms of the agency agreement. SAS is obligated under the terms of the agency agreement to reimburse SAS, Inc. for all of its expenses irrespective of the revenues of SAS, Inc. SAS, Inc., does not perform any functions except those connected with or incidental to the business of SAS as an operator of aircraft in international traffic. According to the Technical Explanation, the income share of SAS Danmark A/S from its participation in the SAS consortium is taxable in accordance with this article of the proposed treaty. In addition, the proposed protocol provides that in view of the special nature of the SAS consortium and the agency agreement as described above, for purposes of this article, the United States will treat all of the income earned by SAS, Inc. that is derived from the operation in international traffic of aircraft as income of the SAS consortium.

The profits of an enterprise of a treaty country from the transport by ships or aircraft of supplies or personnel to a location where offshore activities in connection with the exploration or exploitation of natural resources are being carried on in the other country, or from the operation of tugboats and similar vessels in connection with such activities, are taxable only in the first-mentioned country (*i.e.,* the residency country). This rule applies notwithstanding provisions under the permanent establishment article that would otherwise subject such activities to source country taxation. This rule is not contained in the U.S. model.

Article 9. Associated Enterprises

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

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

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

The Technical Explanation states that the treaty countries reserve their rights to apply internal law provisions that permit adjustments between related parties. The Technical Explanation also states that adjustments are permitted under internal law provisions even if such adjustments are different from, or go beyond, the adjustments authorized by this article, provided that such adjustments are consistent with the general principles of this article permitting adjustments to reflect arm's-length terms.

Article 10. Dividends

Internal taxation rules

United States

The United States generally imposes a 30-percent tax on the gross amount of U.S.-source dividends paid to nonresident alien individuals and foreign corporations. The 30-percent tax does not apply if the foreign recipient is engaged in a trade or business in the United States and the dividends are effectively connected with that trade or business. In such a case, the foreign recipient is subject to U.S. tax on such dividends on a net basis at graduated rates in the same manner that a U.S. person would be taxed.

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

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

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

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

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

U.S. internal law also generally treats a regulated investment company ("RIC") as both a corporation and a conduit for income tax purposes. The purpose of a RIC is to allow investors to hold a diversified portfolio of securities. Thus, the holder of stock in a RIC may be characterized as a portfolio investor in the stock held by the RIC, regardless of the proportion of the RIC's stock owned by the dividend recipient.

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." The dividend equivalent amount is the corporation's earnings and profits which are attributable to its income that is effectively connected with its U.S. trade or business, decreased by the amount of such earnings that are reinvested in business assets located in the United States (or used to reduce liabilities of the U.S. business), and increased by any such previously reinvested earnings that are withdrawn from investment in the U.S. business. The dividend equivalent amount is limited by (among other things) aggregate earnings and profits accumulated in taxable years beginning after December 31, 1986.

Denmark

Denmark generally imposes a 25 percent withholding tax on dividend payments to nonresidents that own less than 25 percent of the paying corporation. However, there is no dividend withholding tax in the case of shareholders that own 25 percent or more of the paying corporation. Denmark does not impose a branch tax on the repatriation of the after-tax profit of a permanent establishment.

Proposed treaty limitations on internal law

Under the proposed treaty, dividends paid by a resident of a treaty country to a resident of the other country may be taxed in such other country. Dividends paid by a resident of a treaty country and beneficially owned by a resident of the other country may also be taxed by the country in which the payor is resident, but the rate of such tax is limited. Under the proposed treaty, source country taxation (*i.e.,* taxation by the country in which the payor is resident) generally is limited to 5 percent of the gross amount of the dividend if the beneficial owner of the dividend is a resident of the other country and is a company that owns at least 10 percent of the share capital of the payor company. The source country dividend withholding tax generally is limited to 15 percent of the gross amount of the dividends paid to residents of the other country in all other cases. These provisions do not affect the taxation of the company in respect of the profits out of which the dividends are paid.

The present treaty provides for a similar dividend withholding rate structure. However, in order to obtain the 5-percent withholding rate under the present treaty, the beneficial owner must control (directly or indirectly) at least 95 percent of the voting power of the paying corporation. Furthermore, the paying corporation cannot derive more than 25 percent of its gross income from interest and dividends, other than interest and dividends received from its own subsidiary corporations. The 5-percent withholding rate does not apply under the present treaty if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

Under the proposed treaty, dividends paid by a U.S. RIC are eligible only for the limitation that applies the 15-percent rate, regardless of the beneficial owner's percentage ownership in such entity. Dividends paid by a U.S. REIT are not eligible for the 5-percent rate. Moreover, such REIT dividends are eligible for the 15-percent rate only if (1) the dividends are beneficially owned by an individual who holds 10 percent or less of the REIT; (2) the dividends are paid with respect to a class of stock that is publicly traded and the beneficial owner of the dividends is a person owning not more than 5 percent of any class of the REIT's stock; or (3) the beneficial owner of the dividends is a person owning not more than 10 percent of the REIT and the REIT is diversified. Otherwise, dividends paid by a U.S. REIT are subject to U.S. taxation at the full statutory rate. For purposes of this provision, the Technical Explanation states that a REIT will be considered to be diversified if the value of no single interest in the REIT's real property exceeds 10 percent of the REIT's total interests in real property.

Notwithstanding the discussion above, dividends cannot be taxed by the source country if the beneficial owner of the dividends is a qualified governmental entity that does not control the payor of the dividends. This rule is the same as that contained in the U.S. model.

The proposed treaty defines a "dividend" to include income from shares or other rights, not being debt-claims, participating in profits, as well as income that is subject to the same tax treatment as income from shares by the internal laws of the treaty country of which the company making the distribution is a resident.

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

The proposed treaty provides that a country may not impose any tax on dividends paid by a company that is a resident of the other country, except to the extent that the dividends are paid to a resident of the first country or the dividends are attributable to a permanent establishment or fixed base situated in that first country. Thus, this provision overrides the ability of the United States to impose its second-level withholding tax on the U.S.-source portion of dividends paid by a Danish corporation. The proposed treaty also provides that a country may not impose a tax on a corporation's undistributed profits, except as provided below. These rules apply even if the dividends paid or the undistributed profits consist wholly or partially of profits arising in that country.

The proposed treaty permits the imposition of a branch profits tax, but limits the rate of such tax to 5 percent (*i.e.,* the rate prescribed in paragraph 2(a) of this article). The branch profits tax may be imposed on a company that is a resident of a treaty country and that has a permanent establishment in the other treaty country or is subject to tax in the other treaty country on a net basis on its income from real property (Article 6) or capital gains (Article 13). Such tax may be imposed only on the portion of the business profits attributable to such permanent establishment, or the portion of such real property income or capital gains, that represents the "dividend equivalent amount," and in the case of Denmark, an amount that is analogous to the dividend equivalent amount. The Technical Explanation states that the term "dividend equivalent amount" has the same meaning that it has under Code section 884, as amended from time to time, provided the amendments are consistent with the purpose of the branch profits tax.

Article 11. Interest

Internal taxation rules

United States

Subject to several exceptions (such as those for portfolio interest, bank deposit interest, and short-term original issue discount), the United States imposes a 30-percent withholding tax on U.S.-source interest paid to foreign persons under the same rules that apply to dividends. U.S.-source interest, for purposes of the 30-percent tax, generally is interest on the debt obligations of a U.S. person, other than a U.S. person that meets specified foreign business requirements. Also subject to the 30-percent tax is interest paid by the U.S. trade or business of a foreign corporation. A foreign corporation is subject to a branch-level excess interest tax with respect to certain "excess interest" of a U.S. trade or business of such corporation; under this rule, an amount equal to the excess of the interest deduction allowed with respect to the U.S. business over the interest paid by such business is treated as if paid by a U.S. corporation to a foreign parent and therefore is subject to the 30-percent withholding tax.

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

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

Denmark

Denmark generally does not impose a withholding tax on interest paid to nonresidents.

Proposed treaty limitations on internal law

Like the U.S. model and the present treaty, the proposed treaty exempts interest derived and beneficially owned by a resident of one country from tax in the source country.

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

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

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

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

Article 12. Royalties

Internal taxation rules

United States

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

Denmark

Denmark generally imposes a withholding tax on royalties paid to nonresidents at a rate of 30 percent.

Proposed treaty limitations on internal law

The proposed treaty provides that royalties derived and beneficially owned by a resident of a treaty country are taxable only in that country. Thus, the proposed treaty generally exempts U.S.-source royalties beneficially owned by Danish residents from the 30-percent U.S. tax. This exemption from source country taxation is similar to that provided in the U.S. model and the present treaty.

The term "royalties" means any consideration for the use of, the right to use, or the sale (which is contingent on the productivity, use, or further disposition) of any copyright of literary, artistic, scientific, or other work (including computer software, cinematographic films, audio or video tapes or disks, and other means of image or sound reproduction), patent, trademark, design or model, plan, secret formula or process, or other like right or property. The term also includes consideration for the use of, or the right to use information concerning industrial, commercial, or scientific experience. The Technical Explanation states that it is understood that payments with respect to transfers of "shrink wrap" computer software will not be considered as royalty income.

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

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

Article 13. Capital Gains

U.S. internal law

Generally, gain realized by a nonresident alien or a foreign corporation from the sale of a capital asset is not subject to U.S. tax unless the gain is effectively connected with the conduct of a U.S. trade or business or, in the case of a nonresident alien, he or she is physically present in the United States for at least 183 days in the taxable year. A nonresident alien or foreign corporation is subject to U.S. tax on gain from the sale of a U.S. real property interest as if the gain were effectively connected with a trade or business conducted in the United States. "U.S. real property interests" include interests in certain corporations if at least 50 percent of the assets of the corporation consist of U.S. real property.

Proposed treaty limitations on internal law

The proposed treaty specifies rules governing when a country may tax gains from the alienation of property by a resident of the other country. The rules are generally consistent with those contained in the U.S. model.

Under the proposed treaty, gains derived by a resident of one treaty country from the alienation of real property situated in the other country may be taxed in the country where the property is situated. For the purposes of this article, real property in the other country includes (1) real property as defined in Article 6 (Income From Real Property), (2) a U.S. real property interest, and (3) an equivalent interest in real property situated in Denmark.

Gains from the alienation of personal property that are attributable to a permanent establishment which an enterprise of one country has in the other country, gains from the alienation of personal property attributable to a fixed base which is available to a resident of one country in the other country for the purpose of performing independent personal services, and gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or such a fixed base, may be taxed in that other country. This rule also applies if the permanent establishment or fixed base no longer exists when the gains are recognized but such gains relate to the former permanent establishment or fixed base.

Gains derived by an enterprise of a treaty country from the alienation of ships, boats, aircraft, or containers operated or used in international traffic (or personal property pertaining to the operation or use of such ships, boats, aircraft, or containers), are taxable only in such country.

Gains derived by an enterprise of a treaty country from the deemed alienation of an installation, drilling rig, or ship used in the other country for the exploration or exploitation of oil and gas resources may be taxed by such other country in accordance with its internal law, but only to the extent of any depreciation taken in such other country. Thus, at the time of deemed alienation of the property under the law of the host country, an enterprise of the other treaty country may be required to recapture the depreciation claimed in the host country of an oil or gas exploration or exploitation installation, drilling rig, or ship. Because the amount that may be taxable is limited to the amount of any gain, depreciation will be recaptured only to the extent it has reduced the basis of the property below its fair market value. This provision is not contained in the U.S. model. The Technical Explanation states that the provision was included to permit Denmark to impose its income tax at the same time an oil or gas exploration or exploitation installation, drilling rig or ship is deemed alienated under Denmark's income tax laws. The Technical Explanation also states that other rules (described below) were included in the proposed treaty in order to prevent double taxation that might otherwise result from this provision.

Gains from the alienation of any property other than that discussed above is taxable under the proposed treaty only in the country where the person disposing of the property is resident.

The proposed treaty coordinates U.S. and Danish taxation of gains in circumstances where a treaty country resident is subject to tax in both treaty countries and one country deems a taxable disposition of property to have occurred, but the other country does not currently tax such gains. In such a case, the resident can elect in the annual return of income for the year of disposition to be liable to tax in the residence country as if he had sold and repurchased the property for an amount equal to its fair market value at a time immediately prior to the deemed disposition. This election applies to all property disposed of during the taxable year for which the election is made or at any time thereafter. The Technical Explanation states that this provision might be useful in a case where a U.S. corporation transfers a drilling rig, on which depreciation was taken in Denmark, to its home office in the United States. According to the Technical Explanation, Denmark generally would tax any built-in gain upon the transfer, limited to the amount of depreciation taken in Denmark, but the United States would defer taxation until the rig actually was sold. If the period for foreign tax credit carryovers had expired at the time of actual disposition, the U.S. corporation might not receive a foreign tax credit, resulting in double taxation. The Technical Explanation states that if the U.S. corporation elected the benefits of this provision, it would be subject to U.S. tax currently on the built-in gain, and take a new tax basis in the property.

The proposed treaty also provides coordination rules with respect to gains from the alienation of property in a corporate or other reorganization. Under the proposed treaty, if a transaction is tax-deferred in the country of residence, then the competent authority of the source country may agree, if requested to do so by the person acquiring property in the transaction, to enter into an agreement to defer tax to the extent necessary to avoid double taxation. For this purpose, a tax-deferred transaction includes a corporate or other organization, reorganization, amalgamation, division, or similar transaction in which profit, gain, or income is not recognized for tax purposes. The Technical Explanation states that one situation in which this provision might be useful is the merger of two companies that are resident in one treaty country, both of which have permanent establishments in the other country. According to the Technical Explanation, if two U.S. resident corporations, each with a permanent establishment in Denmark, merged in a transaction that qualified as a tax-free reorganization under Code section 368 but was taxable in Denmark, Denmark could tax built-in gain on assets of the permanent establishments. When those assets eventually were sold, the United States might also tax the gain, but without a foreign tax credit if the period for tax credit carryovers had already expired. The Technical Explanation states that the company surviving the merger could request that the Danish competent authority defer recognition of the gain until actual disposition of the assets, in order to assure a U.S. foreign tax credit for the Danish tax. The Technical Explanation also states that whether deferral should be granted is a matter to be decided by the competent authority.

Article 14. Independent Personal Services

U.S. internal law

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

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

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 personal services of an independent character performed in one country by a resident of the other country is exempt from tax in the country where the services are performed (the source country) unless the individual performing the services has a fixed base regularly available to him or her in that country for the purpose of performing the services.[6] In that case, the source country is permitted to tax only that portion of the individual's income which is attributable to the fixed base.

Under the proposed treaty, income that is taxable in the source country pursuant to this article will be determined under the principles of Article 7 (Business Profits). Thus, all relevant expenses, including expenses not incurred in the source country, must be allowed as deductions in computing the net income from services subject to tax in the source country.

Article 15. Dependent Personal Services

Under the proposed treaty, salaries, wages, and other remuneration derived from services performed as an employee in one country (the source country) by a resident of the other country are taxable only by the country of residence if three requirements are met: (1) the individual must be present in the source country for not more than 183 days in any twelve-month period; (2) the individual is paid by, or on behalf of, an employer who is not a resident of the

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[6] According to the Technical Explanation, it is understood that the concept of a fixed base is similar, but not identical, to the concept of a permanent establishment.

source country; and (3) the compensation must not be borne by a permanent establishment or fixed base of the employer in the source country. These limitations on source country taxation are the same as the rules of the U.S. model and the OECD model. If these three requirements are not met and the employee's services are performed in the other country, such other country may tax the related compensation.

The proposed treaty provides that remuneration derived by a resident of one country in respect of employment as a member of the regular complement (including the crew) of a ship or aircraft operated in international traffic is taxable only in that country.

This article is subject to the provisions of the separate articles covering directors' fees (Article 16), pensions, social security, annuities, alimony, and child support payments (Article 18), and government service income (Article 19).

Article 16. Directors' Fees

Under the proposed treaty, directors' fees and other similar payments derived by a resident of one country as a member of the board of directors of a company which is a resident of that other country is taxable in that other country. Under this rule, which is the same as the OECD model, the country in which the company is resident may tax all of the remuneration paid to nonresident board members, regardless of where the services are performed. The U.S. model contains a different rule, which provides that the country in which the company is resident may tax nonresident directors, but only with respect to compensation for services performed in that country.

Article 17. Artistes and Sportsmen

Like the U.S. and OECD models, the proposed treaty contains a separate set of rules that apply to the taxation of income earned by entertainers (such as theater, motion picture, radio, or television artistes, or musicians) and sportsmen. These rules apply notwithstanding the other provisions dealing with the taxation of income from personal services (Articles 14 and 15) 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 the proposed treaty, income derived by an entertainer or sportsman who is a resident of one country from his or her personal activities as such exercised in the other country may be taxed in the other country if the amount of the gross receipts derived by him or her from such activities exceeds $20,000 or its equivalent in Danish kroner. The $20,000 threshold includes reimbursed expenses. Under this rule, if a Danish entertainer or sportsman maintains no fixed base in the United States and performs (as an independent contractor) for one day of a taxable year in the United States for total compensation of $10,000, the United States could not tax that income. If, however, that entertainer's or sportsman's total compensation were $30,000, the full amount would be subject to U.S. tax.

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

Article 18. Pensions, Social Security, Annuities, Alimony and Child Support Payments

Under the proposed treaty, pension distributions arising in a treaty country and beneficially owned by a resident of the other country, whether paid periodically or in a single sum, are taxable only in the country in which they arose. Under the present treaty, on the other hand, pension distributions are taxable only in the country of residence. The proposed treaty provides that pension distributions will only be considered to arise in a treaty country if paid by a pension scheme established in such country. The proposed protocol provides that a payment is treated as a pension distribution for these purposes if paid under a pension scheme recognized for tax purposes in the country in which the pension scheme is established. For these purposes, pension schemes recognized for tax purposes include, under U.S. law, qualified plans under section 401(a), individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k), individual retirement accounts, individual retirement annuities, section 408(p) accounts, and Roth IRAs under section 408A), section 403(a) qualified annuity plans, and section 403(b) plans. Under Danish law, pension schemes recognized for tax purposes include pension schemes under Section 1 of the Act on Taxation of Pension Schemes (pensionsbeskatningslovens afsnit I). The proposed treaty includes a grandfather rule preserving taxation only by the residence country if, prior to the entry into force of the proposed treaty, a person was a resident of a treaty country and was receiving pension distributions arising in the other country.

Like the U.S. model, the proposed treaty provides that payments made by one of the countries under the provisions of the social security or similar legislation of a country to a resident of the other country or to a U.S. citizen are taxable only by the source country, and not by the country of residence. The Technical Explanation states that the term “similar legislation” is intended to include U.S. tier 1 Railroad Retirement benefits. Consistent with the U.S. model, this rule with respect to social security payments is an exception to the proposed treaty’s saving clause.

The proposed treaty provides that annuities are taxed only in the country of residence of the individual who beneficially owns and derives them. The term "annuities" is defined for purposes of this provision 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).

Under the proposed treaty, alimony paid by a resident of one country, and deductible therein, to a resident of the other country is taxable only in the other country. For this purpose, the term "alimony" means periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, which payments are taxable to the recipient under the laws of the country of residence. However, periodic payments (other than alimony) for the support of a child made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, paid by a resident of one country to a resident of the other country, are taxable only in the payor's country of residence.

Article 19. Government Service

Under the proposed treaty, salaries, wages, and other remuneration (other than a pension) paid from the public funds of a treaty country or a political subdivision or local authority thereof to an individual in respect of services rendered to that country (or subdivision or authority) in the discharge of functions of a governmental nature generally are taxable only by that country. Such remuneration is taxable only in the other country, however, if the services are rendered in that other country by an individual who is a resident of that country and who (1) is also a national of that country or (2) did not become a resident of that country solely for the purpose of rendering the services. This treatment is similar to the rules under the U.S. and OECD models.

The proposed treaty further provides that any pension paid from the public funds of one of the countries (or a political subdivision or local authority thereof) to an individual in respect of services rendered to that country (or subdivision or authority) in the discharge of functions of a governmental nature (other than social security payments described in Article 18) is taxable only by that country. Such a pension is taxable only by the other country, however, if the individual is a resident and national of that other country. Social security benefits in respect of government service are subject to Article 18 (Pensions, Social Security, Annuities, Alimony and Child Support Payments) and not this article.

The Technical Explanation states that the phrase "functions of a governmental nature" is generally understood to encompass functions traditionally carried on by a government. It generally would not include functions that commonly are found in the private sector (*e.g.,* education, health care, utilities). Rather, it is limited to functions that generally are carried on solely by the government (*e.g.,* military, diplomatic service, tax administrators) and activities that directly support the carrying out of those functions.

The provisions of this article do not apply to remuneration and pensions paid in respect of services rendered in connection with a business carried on by a treaty country (or a political subdivision or a local authority thereof). Rather, such payments are subject to

Articles 15 (Dependent Personal Services), 16 (Directors' Fees), 17 (Artistes and Sportsmen), and 18 (Pensions, Social Security, Annuities, Alimony and Child Support Payments) as the case may be.

Article 20. Students and Trainees

Under the proposed treaty, payments received by a student, apprentice, or business trainee who is, or was immediately before visiting a country (the host country), a resident of the other country, and who is present in the host country for the purpose of his or her full-time education at an accredited educational institution, or for his or her full-time training, is not subject to tax in the host country. The exemption from host country tax only applies to payments that arise outside of the other country and are for the purpose of his or her maintenance, education, or training. In the case of an apprentice or business trainee, the exemption from host country tax only applies for a period of no more than three years from the date of first arrival for the purpose of his or her training. The proposed treaty provides that this article does not apply to income from research undertaken not in the public interest, but primarily for the private benefit of a specific person or persons.

This article of the proposed treaty is an exception from the saving clause in the case of persons who are neither citizens nor permanent residents of the host country. Thus, for example, the United States would not tax such amounts paid to a Danish citizen who is not a U.S. green-card holder but who resides in the United States as a full-time student.

Article 21. 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 Denmark. As a general rule, items of income not otherwise dealt with in the proposed treaty, wherever arising, which are beneficially owned by residents of one of the countries are taxable only in the country of residence. This rule is similar to the rules in the U.S. and OECD models.

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

The general rule just stated does not apply to income (other than income from real property as defined in Article 6) 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 performs independent personal services in the other country from 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. Such exception also applies where the income is received after the permanent establishment or fixed base is no longer in existence, but the income is attributable to the former permanent establishment or fixed base.

Article 22. Limitation of Benefits

In general

The proposed treaty contains a provision generally intended to limit the indirect use of the proposed treaty by persons who are not entitled to its benefits by reason of residence in the United States or Denmark.

The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Denmark as they apply to residents of the two countries. At times, however, residents of third countries attempt to use a treaty. This use is known as "treaty shopping," which refers to the situation where a person who is not a resident of either treaty country seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, and without appropriate safeguards, the third-country resident may be able to secure these benefits indirectly by establishing a corporation or other entity in one of the treaty countries, which entity, as a resident of that country, is entitled to the benefits of the treaty. Additionally, it may be possible for the third-country resident to reduce the income base of the treaty country resident by having the latter pay out interest, royalties, or other amounts under favorable conditions either through relaxed tax provisions in the distributing country or by passing the funds through other treaty countries until the funds can be repatriated under favorable terms.

The proposed anti-treaty-shopping article provides that a resident of either Denmark or the United States will be entitled to the benefits of the proposed treaty only if the resident is:

(1) an individual;

(2) a treaty country, a political subdivision or a local authority thereof, or an agency or instrumentality of such country, subdivision, or authority;

(3) a company that satisfies one of three public company tests;

(4) a charitable organization or other legal person established and maintained exclusively for a religious, charitable, educational, scientific, or other similar purpose;

(5) a pension fund that satisfies an ownership test;

(6) an entity that satisfies both an ownership and base erosion test; or

(7) in the case of Denmark, a taxable nonstock corporation that satisfies a modified base erosion test.

A resident that does not fit into any of the above categories may claim treaty benefits with respect to certain items of income under an active business test, or for shipping and air transport income if certain conditions are satisfied. A resident that does not fit into any of the above categories also may claim treaty benefits if it satisfies a derivative benefits test. Finally, in any case a resident of either country may be entitled to the benefits of the proposed treaty if the competent authority of the country in which the income in question arises so determines.

Individuals

An individual resident of a treaty country is entitled to the benefits of the proposed treaty.

Governments

Under the proposed treaty, the two countries, their political subdivisions or local authorities, or agencies or instrumentalities of the countries or their political subdivisions or local authorities, are entitled to all treaty benefits.

Public company tests

A company that is a resident of Denmark or the United States is entitled to treaty benefits if more than 50 percent of the vote and value of all classes of the shares in such company are listed on a recognized stock exchange and are substantially and regularly traded on one or more recognized stock exchanges.

In addition, the company is entitled to treaty benefits if more than 50 percent of the voting power of the company is owned by one or more Danish taxable nonstock corporations entitled to treaty benefits (described below), and all other shares of the company are listed on a recognized stock exchange and are substantially and regularly traded on one or more recognized stock exchanges. The Technical Explanation states that this rule is included to ensure that a corporation whose voting shares are substantially owned by a Danish taxable nonstock corporation is not precluded from qualifying as a publicly traded company, so long as there is sufficient trading in the remainder of its shares.

Alternatively, the company is entitled to treaty benefits if at least 50 percent of each class of shares of the company is owned (directly or indirectly) by five or fewer companies that satisfy one of the two public company tests previously described, provided that each intermediate owner used to satisfy the control requirement is a resident of Denmark or the United States.

For purposes of the above rules, the proposed treaty provides that shares are considered to be substantially and regularly traded on one or more recognized stock exchanges in a taxable year if two conditions are satisfied. First, trades must be effected other than in de minimis quantities during every quarter. Second, the aggregate number of shares or units traded during the previous taxable year must be at least 6 percent of the average number of shares or units outstanding during that taxable year (including shares held by taxable nonstock corporations).

A further test applies for a company in order to meet the public company test described above through ownership by Danish taxable nonstock corporations. Under this test, the substantially and regularly traded requirement (described above) is to be determined as if all the shares issued by the company are one class of shares. Thus, shares held by Danish taxable nonstock corporations in such company would be considered outstanding for purposes of determining whether six percent of the outstanding shares of the company are traded during a taxable year. Without this rule, it might be possible for a small class of shares to qualify a company as being substantially and regularly traded.

Under the proposed treaty, the term “recognized stock exchange” means (1) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934; (2) the Copenhagen Stock Exchange and the stock exchanges of Amsterdam, Brussels, Frankfurt, Hamburg, London, Paris, Stockholm, Sydney, Tokyo, and Toronto; and (3) any other stock exchange agreed upon by the competent authorities of the countries.

Tax exempt organizations

An entity is entitled to the benefits under the proposed treaty if it is a legal person organized under the laws of a treaty country, generally exempt from tax in such country, and established and maintained in such country exclusively for a religious, charitable, educational, scientific, or other similar purpose.

Pension funds

A legal person, whether or not exempt from tax, is entitled to treaty benefits if (1) it is organized under the laws of a treaty country to provide pension or other similar benefits to employees, including self-employed individuals, pursuant to a plan, and (2) more than 50 percent of the person’s beneficiaries, members, or participants are individuals resident in either treaty country. This rule is similar but not identical to the rule in the U.S. model. The Technical Explanation states that since Denmark taxes pension funds, the U.S. model rule was modified to allow such taxable entities to qualify for treaty benefits.

Ownership and base erosion tests

Under the proposed treaty, an entity that is a resident of one of the countries is entitled to treaty benefits if it satisfies an ownership test and a base erosion test. Under the ownership test, on at least half of the days during the taxable year at least 50 percent of the beneficial interests in an entity must be owned (directly or indirectly) by certain qualified residents of the treaty country (*i.e.,* an individual; a treaty country, a political subdivision or a local authority thereof, or its agencies or instrumentalities; a company that satisfies one of the public company tests (described in the discussion of public company tests above); a charitable organization or other legal person established and maintained exclusively for a religious, charitable, educational, scientific, or other similar purpose; or a legal person that satisfies the test for pension funds (described in the discussion of pension funds above)). In the case of a company, ownership is determined by reference to both the vote and value of the company’s shares. The Technical Explanation states that trusts may be entitled to treaty benefits if they are treated as residents of a treaty country and otherwise satisfy the requirements under these provisions.

The base erosion test is satisfied only if less than 50 percent of the person’s gross income for the taxable year is paid or accrued (directly or indirectly), in the form of deductible payments, to persons who are not residents of either treaty country (unless the payment is attributable to a permanent establishment situated in either treaty country). For this purpose, deductible payments include payments for interest or royalties, but do not include arm's length payments for the purchase or use of or the right to use tangible property in the ordinary course of business or arm's length remuneration for services performed in the treaty country in which the person making such payments is a resident. The competent authorities may agree to add to, or eliminate from, the exceptions mentioned in the preceding definition of "deductible payments." For purposes of measuring gross income, the term means gross income for the first taxable period preceding the current taxable period, provided that the amount of gross income for such first taxable period is deemed to be no less than the average of the annual amounts of gross income for the four taxable periods preceding the current taxable period.

Danish taxable nonstock corporations

Under the proposed treaty, a Danish taxable nonstock corporation is entitled to treaty benefits if it satisfies a two-part modified base erosion test. The proposed treaty provides that the term "taxable nonstock corporation" means a foundation that is taxable in accordance with the Danish Act on Taxable Nonstock Corporations (fonde der beskattes efter fondsbeskatningsloven). The Technical Explanation states that a Danish taxable nonstock corporation is a legal person that is controlled by a professional board of directors, who must be unrelated to the persons that formerly owned the operating company controlled by the taxable nonstock corporation. The Technical Explanation also states that a Danish taxable nonstock corporation's capital is irrevocably separated from the control of any founder that contributes assets at the time such entity is established.

The modified base erosion test is satisfied if two requirements are met. First, the amount paid or accrued by the Danish taxable nonstock corporation in the form of deductible payments in the taxable year and in each of the preceding three taxable years (directly or indirectly) to persons who are not generally qualified residents (excluding, for this purpose, from the definition of qualified residents any companies that satisfy the public company test through ownership by Danish taxable nonstock corporations) of the proposed treaty under the tests described above may not exceed 50 percent of its gross income (excluding tax-exempt income).

Second, the amount paid or accrued, in the form of both deductible payments and non-deductible distributions, in the taxable year and in each of the preceding three taxable years (directly or indirectly) to persons who are not generally qualified residents of the proposed treaty under the tests described above may not exceed 50 percent of its total income (including tax-exempt income). For purposes of these rules, deductible payments include deductible distributions made by a Danish taxable nonstock corporation. This two-part test is a modification of the ownership-base erosion test. The Technical Explanation states that the ownership-base erosion test needed to be modified because Danish taxable nonstock corporations do not have owners and, thus, cannot be subject to any ownership test. The Technical Explanation also states that the test described above was included for Danish taxable nonstock corporations in order to treat them as similarly as possible to other Danish corporations.

Active business test

A resident satisfies the active business test if it is engaged in the active conduct of a trade or business in its country of residence; the income is connected with or incidental to that trade or business; and the trade or business is substantial in relation to the activity in the other country generating the income. However, the business of making or managing investments does not constitute an active trade or business (and benefits therefore may be denied) unless such activity is a banking, insurance, or securities activity conducted by a bank, insurance company, or registered securities dealer. Under the proposed treaty, the term "engaged in the active conduct of a trade or business" applies to a person that is directly engaged or to a partner in a partnership that is so engaged, or is so engaged through one or more associated enterprises, wherever resident.

The determination of whether a trade or business is substantial is made based on all facts and circumstances. However, the proposed treaty provides a safe harbor rule under which a trade or business of the resident is considered to be substantial if certain attributes of the residence-country business exceed a threshold fraction of the corresponding attributes of the trade or business located in the source country that produces the source-country income. Under this safe harbor, the attributes are assets, gross income, and payroll expense. To satisfy the safe harbor, the level of each such attribute in the active conduct of the trade or business by the resident (and any related parties) in the residence country, and the level of each such attribute in the trade or business producing the income in the source country, is measured for the prior year or for the prior three years. For each separate attribute, the ratio of the residence country level to the source country level is computed.

In general, the safe harbor is satisfied if, for the prior year or for the average of the three prior years, the average of the three ratios exceeds 10 percent, and each ratio separately is at least 7.5 percent. These rules are similar to those contained in the U.S. model. In determining these ratios, only amounts to the extent of the resident's direct or indirect ownership interest in the activity in the other treaty country are taken into account. Under the proposed treaty, if neither the resident nor any of its associated enterprises has an ownership interest in the activity in the other country, the resident's trade or business in its country of residence is considered substantial in relation to such activity.

The proposed treaty provides that income is derived in connection with a trade or business if the activity in the other country generating the income is a line of business that forms a part of or is complementary to the trade or business. The Technical Explanation states that a business activity generally is considered to "form a part of" a business activity conducted in the other country if the two activities involve the design, manufacture, or sale of the same products or type of products, or the provision of similar services. The Technical Explanation further provides that in order for two activities to be considered to be "complementary," the activities need not relate to the same types of products or services, but they should be part of the same overall industry and be related in the sense that the success or failure of one activity will tend to result in success or failure for the other. Under the proposed treaty, income is incidental to a trade or business if it facilitates the conduct of the trade or business in the other country.

The term "trade or business" is not specifically defined in the proposed treaty. However, as provided in Article 3 (General Definitions), undefined terms are to have the meaning which they have under the laws of the country applying the proposed treaty. In this regard, the Technical Explanation states that the U.S. competent authority will refer to the regulations issued under Code section 367(a) to define an active trade or business.

Derivative benefits test

The proposed treaty contains a reciprocal derivative benefits rule. This rule effectively allows a Danish 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 the benefits of the treaty.

First, the company must satisfy an ownership test. Under this test, at least 95 percent of the aggregate vote and value of all of the company's shares must be owned (directly or indirectly) by seven or fewer residents of the member states of the European Union ("EU"), European Economic Area ("EEA"), or parties to the North American Free Trade Agreement ("NAFTA").

Second, the company must satisfy a base erosion test. Under this test, less than 50 percent of the gross income of the company for the year may be paid or accrued by the company as deductible amounts (directly or indirectly) to persons other than residents of the member states of the EU, EEA, or parties to the NAFTA.

A company will not be considered to have satisfied the ownership or base erosion requirements above if it, or a company that controls it, has an outstanding class of shares (1) with terms (or other arrangements) that entitle its holders to a portion of the company's income derived in the other treaty country that is larger than the portion applicable in the absence of such terms (or arrangements) and (2) which is 50-percent or more owned (based on vote or value) by persons who are not residents of member states of the EU, the EEA, or parties to the NAFTA .

For purposes of the rules described above, the proposed treaty provides that a person is considered a resident of an EU, EEA, or NAFTA country, only if such person would be entitled to the benefits of a comprehensive income tax treaty in force between any member state of the EU, EEA, or party to the NAFTA and the country from which the benefits of such treaty are being claimed; provided that, if the applicable treaty between the owner's country of residence and the source country does not contain a comprehensive limitation on benefits article (including provisions similar to the public company tests, the ownership and base erosion tests, and the active business test, as described above), the owner itself would be a qualified resident under the proposed treaty (under the rules described above) if such person were a resident of the United States or Denmark, as the case may be under Article 4 (Residence).

The proposed treaty imposes an additional condition for a company that is claiming benefits under the treaty with respect to certain types of income. Specifically, dividends, interest, or royalties in respect of which benefits are claimed under the proposed treaty must be subject to a rate of tax under such other treaty that is at least as low as the rates applicable to such company under the corresponding provisions of the proposed treaty.

Shipping and air transport test

A resident of one country that derives shipping or aircraft income from the other country is entitled to treaty benefits with respect to such interest if at least 50 percent of the beneficial interests in the resident (or in the case of a company, at least 50 percent of the vote and value of such company) is owned, directly or indirectly, by qualified persons (as described above), U.S. citizens or residents, or individuals who are residents of a third country, or a company or companies the stock of which is primarily and regularly traded on an established securities market in the third country. However, this rule applies only if the third country grants an exemption for shipping and aircraft income under similar terms to citizens and corporations of the source country either under its laws, in common agreement with the other country, or under a treaty between the third country and the other country.

Grant of treaty benefits by the competent authority

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

Article 23. Relief from Double Taxation

Internal taxation rules

United States

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

Denmark

Danish double tax relief is allowed either through a foreign tax credit or through an exemption with progression (where tax-exempt income is considered for purposes of determining the tax rate on taxable income, but is otherwise not taxable income). Danish tax credits are, like in the United States, limited to the lesser of the foreign tax paid or the Danish tax that would have been imposed on the amount of the income. Unlike the United States, the foreign tax credit limitation is determined on a per-country basis.

Proposed treaty limitations on internal law

One of the principal purposes for entering into an income tax treaty is to limit double taxation of income earned by a resident of one of the countries that may be taxed by the other country. Unilateral efforts to limit double taxation are imperfect. Because of differences in rules as to when a person may be taxed on business income, a business may be taxed by two countries as if it were engaged in business in both countries. Also, a corporation or individual may be treated as a resident of more than one country and be taxed on a worldwide basis by both.

Part of the double tax problem is dealt with 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 Denmark and the United States otherwise still tax the same item of income. This article is not subject to the saving clause, so that the country of citizenship or residence will waive its overriding taxing jurisdiction to the extent that this article applies.

The present treaty provides separate rules for relief from double taxation for the United States and Denmark. The present treaty generally provides for relief from double taxation of U.S. citizens, residents and corporations by requiring the United States to permit a credit against its tax for taxes paid to Denmark. The determination of this credit is made in accordance with U.S. law. In the case of Denmark, the present treaty generally provides for relief from double taxation for taxes paid to the United States on the following types of income: industrial or commercial profits, natural resource royalties, certain government services income, student and trainee income, teacher and professor income, and income earned within the United States. However, the amount of relief granted by Denmark cannot exceed the proportion of Danish taxes which such income bears to the entire income subject to tax by Denmark. Denmark also allows as a deduction from its taxes an amount equal to 15 percent (5 percent in certain cases) of the gross amount of U.S.-source dividends.

The proposed treaty generally provides that the United States will allow a U.S. resident or citizen a foreign tax credit for the income taxes imposed by Denmark. The proposed treaty also requires the United States to allow a deemed-paid credit, with respect to Danish income tax, to any U.S. company that receives dividends from a Danish company if the U.S. company owns 10 percent or more of the voting stock of such Danish company. The credit generally is to be computed in accordance with the provisions and subject to the limitations of U.S. law (as such law may be amended from time to time without changing the general principles of the proposed treaty provisions). This provision is similar to those found in the U.S. model and many U.S. treaties.

The proposed treaty provides that the taxes referred to in paragraphs 1(b) and 2 of Article 2 (Taxes Covered) will be considered creditable income taxes for purposes of the proposed treaty, subject to all the provisions and limitations of Article 23 (Relief from Double Taxation) of the proposed treaty. This includes the Danish national income tax, the Danish municipal income tax, the Danish income tax to the county municipalities, and taxes imposed under the Danish Hydrocarbon Tax Act.

The proposed treaty provides special rules and limits to determine the appropriate amount of creditable taxes paid or accrued to Denmark by or on behalf of a U.S. national or resident on income separately assessed under the Hydrocarbon Tax Act. In connection with the special rules with respect to the creditability of taxes imposed under the Hydrocarbon Tax Act, the Technical Explanation states that the provisions in some respects allow for greater foreign tax credits than under U.S. statutory law. Specifically, the proposed treaty provides that, in the case of a U.S. resident or national subject to taxes imposed under the Hydrocarbon Tax Act, the United States will allow as a credit against United States tax on income the amount of tax paid or accrued to Denmark by the U.S. resident or national pursuant to the Hydrocarbon Tax Act on oil and gas extraction income from oil or gas wells in Denmark. The proposed treaty limits the creditable amount, however, to the product of (1) the maximum statutory U.S. rate applicable to the U.S. resident or national for the taxable year and (2) the amount of income separately assessed under the Hydrocarbon Tax Act. The proposed treaty further provides that its special rules on creditability apply separately, and in the same way, to the amount of tax paid or accrued to Denmark pursuant to the Hydrocarbon Tax Act on Danish-source oil related income and other Danish-source income.

The proposed treaty also provides that for persons claiming benefits under the treaty, the amount of any U.S. tax credit with respect to taxes paid in connection with the Hydrocarbon Tax Act is also subject to any other limitations imposed under U.S. law, as it may be amended from time to time, that apply to creditable taxes under section 901 or 903 of the Code.

Any taxes paid on income assessed separately under the Hydrocarbon Tax Act in excess of the creditable amount after application of the proposed treaty and Code limitations may be used only as a credit in another taxable year (carried over to those years specified under U.S. law—*i.e.,* carried back two years and carried forward five years), and only against United States tax on income assessed separately under the Hydrocarbon Tax Act.

Thus, the proposed treaty operates to create a separate "per-country" limitation with respect to each U.S. category of extraction income or oil-related income on which tax is separately assessed under the Hydrocarbon Tax Act. Accordingly, the taxes paid pursuant to the Hydrocarbon Tax Act with respect to oil and gas extraction income in Denmark cannot be used as a credit to offset U.S. tax on (1) oil and gas extraction income arising in another country, (2) Danish-source oil-related income or other income on which tax is imposed under the Hydrocarbon Tax Act, or (3) other Danish-source non-oil-related income. The Technical Explanation states that if a person earning income that is separately assessed under the Hydrocarbon Tax Act chooses in a year not to rely on the provisions of the proposed treaty to claim a foreign tax credit for any amounts paid to Denmark, then the special "per-country" limitation would not apply for that year. Instead, the current overall foreign tax credit limitations of the Code would apply, and the Danish taxes creditable under the Code could be used, subject to the Code's limitations, to offset U.S. tax on income from Danish and other foreign sources.

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 Danish residents. Under this rule, Denmark will allow a foreign tax credit to a U.S. citizen who is resident in Denmark by taking into account only the amount of U.S. taxes paid pursuant to the proposed treaty (other than taxes that may be imposed solely by reason of citizenship under the saving clause of paragraph 4 of Article 1 (General Scope)) with respect to items of income that are either exempt from U.S. tax or are subject to a reduced rate of tax when derived by a Danish resident who is not a U.S. citizen. The United States will then credit the income tax actually paid to Denmark, determined after application of the preceding sentence. The proposed treaty recharacterizes the income that is subject to Danish taxation as foreign source income for purposes of this computation, but only to the extent necessary to avoid double taxation of such income.

The proposed treaty generally provides that Denmark will allow its residents, who derive income that may be subject to tax in the United States and Denmark, a deduction against Danish income tax for the U.S. income taxes paid. The reduction cannot exceed the pre-credit amount of Danish income tax attributable to the income that may be taxed in the United States. Under the proposed treaty, a Danish resident who derives income which, in accordance with the proposed treaty, is taxable only in the United States may be required to include such income in its tax base for Danish tax purposes, but will also be allowed a deduction from income tax for that part of the income tax which is attributable to the income derived from the United States.

Article 24. Non-Discrimination

The proposed treaty contains a comprehensive non-discrimination article relating to all taxes of every kind imposed at the national, state, or local level. It is similar to the non-discrimination article in the U.S. model and to provisions that have been included in other recent U.S. income tax treaties.

In general, under the proposed treaty, one country cannot discriminate by imposing more burdensome taxes (or requirements connected with taxes) on nationals of the other country than it would impose on its citizens in the same circumstances, particularly with respect to taxation of worldwide income. This provision applies whether or not the persons in question are residents of the United States or Denmark.

Under the proposed treaty, neither country may tax a permanent establishment of an enterprise (or a fixed base of a resident) of the other country less favorably than it taxes its own enterprises carrying on the same activities. Consistent with the U.S. model and the OECD model, however, a country is not obligated to grant residents of the other country any personal allowances, reliefs, or reductions for tax purposes on account of civil status or family responsibilities that are granted to its own residents.

Each country is required (subject to the arm's-length pricing rules of paragraph 1 of Article 9 (Associated Enterprises), paragraph 4 of Article 11 (Interest), and paragraph 4 of Article 12 (Royalties)) to allow its residents 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 states that the term "other disbursements" is understood to include a reasonable allocation of executive and general administrative expenses, research and development expenses, and other expenses incurred for the benefit of a group of related persons. The Technical Explanation further states that the rules of section 163(j) of the Code are not discriminatory within the meaning of this provision. The proposed treaty further provides that any debts of an enterprise of one country to a resident of the other country are deductible for purposes of computing the capital tax of the debtor's country of residence under the same conditions as if the debt had been owed to a resident of the country imposing such tax.

The non-discrimination rules also apply to enterprises of one country that are owned in whole or in part by residents of the other country. Enterprises 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 more burdensome than the taxation (or connected requirements) that the first country imposes or may impose on its similar enterprises. The Technical Explanation includes examples of Code provisions that are understood by the two countries not to violate this provision of the proposed treaty. Those examples include the rules that impose a withholding tax on non-U.S. partners of a partnership and the rules that prevent foreign persons from owning stock in Subchapter S corporations.

The proposed treaty provides that nothing in the non-discrimination article is to be construed as preventing either of the countries from imposing a branch profits tax. Notwithstanding the definition of taxes covered in Article 2, this article applies to taxes of every kind and description imposed by either country, or a political subdivision or local authority thereof.

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

citizen resident in Denmark may claim benefits with respect to the United States under this article.

Article 25. Mutual Agreement Procedure

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

Under this article, a resident of one country who considers that the action of one or both of the countries will cause him or her to be subject to tax which is not in accordance with the proposed treaty may present his or her case to the competent authority of the country of which he or she is a resident or national. A case may be presented to the competent authority irrespective of the remedies provided by domestic law and the time limits prescribed in such laws for presentation of claims for refund.

If the objection appears to the competent authority to be justified and if it is not itself able to arrive at a satisfactory solution, that 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. The provision authorizes a waiver of the statute of limitations of either country. Any assessment and collection procedures are suspended during the pendency of any mutual agreement proceeding.

The competent authorities of the countries will endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the proposed treaty. In particular, the competent authorities may agree to the following: (1) the same attribution of income, deductions, credits, or allowances of an enterprise of one treaty country to the enterprise's permanent establishment situated in the other country; (2) the same allocation of income, deductions, credits, or allowances between persons; (3) the same characterization of particular items of income; (4) the same characterization of persons; (5) the same application of source rules with respect to particular items of income; (6) a common meaning of a term; (7) increases in any specific dollar amounts referred to in the proposed treaty to reflect economic or monetary developments; (8) advance pricing arrangements; and (9) the application of the provisions of each country's internal law regarding penalties, fines, and interest in a manner consistent with the purposes of the proposed treaty. The competent authorities may also consult together for the elimination of double taxation regarding cases not provided for in the proposed treaty. This treatment is similar to the treatment under the U.S. model.

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

Article 26. Exchange of Information

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

The proposed treaty provides that the two competent authorities will exchange such information as is relevant to carry out the provisions of the proposed treaty or the provisions of the domestic laws of the two countries concerning taxes to which the proposed treaty applies (provided that the taxation under those domestic laws is not contrary to the proposed treaty). Such information may relate to the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the proposed treaty. This exchange of information is not restricted by Article 1 (General Scope). Therefore, information with respect to third-country residents is covered by these procedures.

Any information exchanged under the proposed treaty will be treated as secret in the same manner as information obtained under the domestic laws of the country receiving the information. The exchanged information may be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes to which the proposed treaty would apply. Such persons or authorities must use the information for such purposes only.[7] The Technical Explanation states that persons involved in the administration of taxes include legislative bodies with oversight roles with respect to the administration of the tax laws, such as, for example, the tax-writing committees of Congress and the General Accounting Office. Information received by these bodies must be for use in the performance of their role in overseeing the administration of U.S. tax laws. Exchanged information may be disclosed in public court proceedings or in judicial decisions.

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

Notwithstanding the preceding paragraph, a country has the authority to obtain and provide information held by financial institutions, nominees, or persons acting in an agency or fiduciary capacity. It also has the authority to obtain information respecting interests in a person. If information is requested by a treaty country

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

pursuant to this article, the other country is obligated to obtain the requested information in the same manner and to the same extent as if the tax in question were the tax of the requested country, even if the requested country has no direct tax interest in the case to which the request relates. If specifically requested, the competent authority of a country must provide information in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, and writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of the requested country with respect to its own taxes.

Article 27. Administrative Assistance

The proposed treaty provides that the countries are to undertake to lend assistance to each other in collecting all categories of taxes (as described in Article 2) collected by or on behalf of the government of each country, together with interest, costs, additions to such taxes, and civil penalties (referred to as a "revenue claim"). The assistance provision is substantially broader than the most nearly comparable provision in the U.S. model, but similar in scope to the existing U.S.-Denmark treaty. It is also similar to the corresponding provisions in several U.S. treaties, including the treaties with Canada and the Netherlands.

When one country applies to the other for assistance in enforcing a revenue claim, its application must include a certification that the taxes have been finally determined under its own laws. For purposes of this article, a revenue claim is finally determined when the applicant country has the right under its internal law to collect the revenue claim and all administrative and judicial rights of the taxpayer to restrain collection in the applicant country have lapsed or been exhausted.

The proposed treaty specifies that each country may accept for collection a revenue claim of the other country which has been finally determined. Consistent with this language, the Technical Explanation states that each country has the discretion whether to accept any particular application for collection assistance. If the application for assistance is accepted, generally the accepting country is to collect the revenue claim as though it were its own revenue claim, finally determined in accordance with the laws applicable to the collection of its own taxes. However, a revenue claim of an applicant country accepted for collection will not have, in the requested country, any priority accorded to the revenue claims of the requested country.

When a treaty country accepts a request for assistance in collection, the claim will be treated by such country as an assessment under its laws against the taxpayer as of the time the application is received.

Nothing in this administrative assistance article is to be construed as creating or providing any rights of administrative or judicial review of the applicant country's finally determined revenue claim by the requested country, based on any such rights that may be available under the laws of either country. On the other hand, if, at any time pending execution of a request for assistance under this provision, the applicant country loses the right under its internal law to collect the revenue claim, its competent authority must promptly withdraw the request for assistance in collection.

In general, amounts collected under this article by the requested country must be forwarded to the competent authority of the applicant country. Unless the competent authorities otherwise agree, the ordinary costs incurred in providing assistance are to be borne by the requested country, and any extraordinary costs by the applicant country.

No assistance is required to be provided under this article for a revenue claim with respect to an individual taxpayer to the extent that the taxpayer can demonstrate that the claim relates to a taxable period in which the taxpayer was a citizen of the country from which assistance is requested. Similarly, where the taxpayer is a company, estate, or trust, no assistance is required to be provided under this article for a revenue claim to the extent that the claim relates to a taxable period in which the taxpayer derived its status as such an entity from the laws in force in the requested country. The only collection assistance required in such cases would be assistance authorized under the proposed treaty's mutual agreement procedure article.

Each treaty country will endeavor to collect on behalf of the other country such amounts as may be necessary to ensure that relief granted by the proposed treaty from taxation imposed by the other country does not inure to the benefit of persons not entitled thereto.

Nothing in this article is to be construed as requiring either country to carry out administrative measures of a different nature from those used in the collection of its own taxes, or that would be contrary to its public policy. The competent authorities shall agree upon the mode of application of the article, including agreement to ensure comparable levels of assistance to each country.

A requested country is not obligated to accede to the request of the applicant country if the applicant country has not pursued all appropriate collection action in its own jurisdiction or in those cases where the administrative burden for the requested country is disproportionate to the benefit to be derived by the applicant country.

Article 28. Diplomatic Agents and Consular Officers

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

Article 29. Entry into Force

The proposed treaty will enter into force on the date on which the second of the two notifications of the completion of ratification requirements has been received. Each country must notify the other when its requirements for ratification have been satisfied.

With respect to taxes withheld at source, the proposed treaty will be effective for amounts paid or credited on or after the first day of the second month next following the date on which the proposed treaty enters into force. With respect to other taxes, the proposed treaty will be effective for taxable years beginning on or after the first day of January next following the date on which the proposed treaty enters 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 one year after 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, and will terminate on the last date on which it has effect in accordance with the provisions of this article.

Article 30. Termination

The proposed treaty will continue in force until terminated by either country. Either country may terminate the proposed treaty at any time by giving written notice of termination through diplomatic channels. A termination is effective, with respect to taxes withheld at source for amounts paid or credited six months after the date on which notice of termination was given. In the case of other taxes, a termination is effective for taxable periods beginning on or after six months from the date on which notice of termination was given.

IV. ISSUES

The proposed treaty with Denmark, as supplemented by the proposed protocol, presents the following specific issues.

A. Creditability of Danish Hydrocarbon Tax

Treatment under the proposed treaty

The proposed treaty extends coverage to taxes imposed under the Danish Hydrocarbon Tax Act (paragraph 1(b)(iv) of Article 2 (Taxes Covered)). Article 23 of the proposed treaty (Relief from Double Taxation) further provides, among other things, that the taxes imposed under the Hydrocarbon Tax Act are to be considered income taxes that are creditable against U.S. tax on income, subject to the provisions and limitations of that provision of the proposed treaty.

Specifically, the proposed treaty provides that, in the case of a U.S. resident or national subject to taxes imposed under the Hydrocarbon Tax Act, the United States will allow as a credit against United States tax on income the amount of tax paid or accrued to Denmark by the U.S. resident or national pursuant to the Hydrocarbon Tax Act on oil and gas extraction income from oil or gas wells in Denmark. The proposed treaty limits the creditable amount, however, to the product of (1) the maximum statutory U.S. rate applicable to the U.S. resident or national for the taxable year and (2) the amount of income separately assessed under the Hydrocarbon Tax Act. The proposed treaty further provides that its special rules on creditability apply separately, and in the same way, to the amount of tax paid or accrued to Denmark pursuant to the Hydrocarbon Tax Act on Danish-source oil related income and other Danish-source income.

The proposed treaty also provides that for persons claiming benefits under the treaty, the amount of any U.S. tax credit with respect to taxes paid in connection with the Hydrocarbon Tax Act is also subject to any other limitations imposed under U.S. law, as it may be amended from time to time, that apply to creditable taxes under section 901 or 903 of the Code.

Any taxes paid on income assessed separately under the Hydrocarbon Tax Act in excess of the creditable amount after application of the treaty and Code limitations may be used only as a credit in another taxable year (carried over to those years specified under U.S. law—*i.e.,* carried back two years and carried forward five years), and only against United States tax on income assessed separately under the Hydrocarbon Tax Act.

Thus, the proposed treaty operates to create a separate "per-country" limitation with respect to *each* U.S. category of extraction income or oil-related income on which tax is separately assessed under the Hydrocarbon Tax Act. Accordingly, the taxes paid pursuant to the Hydrocarbon Tax Act with respect to oil and gas extraction income in Denmark cannot be used as a credit to offset U.S. tax on (1) oil and gas extraction income arising in another country, (2) Danish-source oil-related income or other income on which tax is imposed under the Hydrocarbon Tax Act, or (3) other Danish-source non-oil-related income.

To the extent that a taxpayer would obtain a more favorable result with respect to the creditability of the Danish taxes under the Code than under the proposed treaty, the taxpayer could choose not to rely on the proposed treaty.[8] The Technical Explanation to Article 23 states that if a person earning income that is separately assessed under the Hydrocarbon Tax Act chooses in a year not to rely on the provisions of the proposed treaty to claim a foreign tax credit for any amounts paid to Denmark, then the special "per-country" limitation of Article 23 would not apply for that year. Instead, the current overall foreign tax credit limitations of the Code would apply, and the Danish taxes creditable under the Code could be used, subject to the Code's limitations, to offset U.S. tax on income from Danish and other foreign sources.

Danish internal law

The Danish Hydrocarbon Tax Act was introduced in 1982 to tax income earned from certain activities in connection with the surveying, exploration and extraction of hydrocarbons. The Act extends the jurisdiction to tax under Danish internal law in certain circumstances to areas beyond the Danish land territory and the territorial sea.

Under the Hydrocarbon Tax Act, taxpayers with oil and gas concessions are required to pay a company tax at the same rate (currently 32 percent) as other companies, which is assessed under ordinary rules, but with additional limitations. In addition, a separate hydrocarbon tax is assessed at a rate of 70 percent of the aggregate taxable income of fields showing profits. The Hydrocarbon Tax Act generally imposes a tax on income in connection with preliminary surveys, exploration, and extraction of hydrocarbons in Denmark, and any related activity, including the installation of pipelines, supply services and transport by ship and pipelines of hydrocarbons extracted. Regular Danish corporate and income taxes are deductible in computing taxable income subject to the separate hydrocarbon tax. Losses arising from other activities may not be set off against hydrocarbon income, but hydrocarbon losses may be deducted from other profits. Other special deduction and allowance rules also apply.

Issues

The proposed treaty treats the Danish hydrocarbon tax, and any substantially similar tax, as a creditable tax for U.S. foreign tax credit purposes. No specific determination has been made administratively or judicially concerning the creditability of the Danish hydrocarbon tax under the Code.[9] It is unclear the extent to which

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[8] See paragraph 2 of Article 1 of the proposed treaty (General Scope), and accompanying description in the Technical Explanation.

[9] Although there have been no specific determinations with respect to the Danish hydrocarbon tax, the United States Tax Court has recently addressed the issue of the creditability under the

Continued

the taxes imposed under the Hydrocarbon Tax Act would be creditable under U.S. law. In fact, the Technical Explanation to Article 23 states that in connection with the Hydrocarbon Tax Act, the proposed treaty in some respects allows for greater foreign tax credits than under U.S. statutory law.

The primary issue is the extent to which treaties should be used to provide a credit for taxes that may not otherwise be fully creditable and, in cases where a treaty does provide creditability, to what extent the treaty should impose limitations not contained in the Code. A related issue is whether a controversial matter in U.S. tax policy such as the tax credits to be allowed U.S. oil companies on their foreign extraction operations should be resolved through the treaty process rather than the regular legislative process. In considering these issues, it is important for the Committee to be aware that the tax credits allowed under the proposed treaty for Danish taxes could be somewhat larger than the credits otherwise allowed under Treasury regulations and, therefore, potentially could reduce somewhat the U.S. taxes collected from U.S. oil companies operating in the Danish sector of the North Sea. Because of the treaty's per-country limitation on the treaty credit and the creditability of the regular Danish income tax in the absence of the treaty, that reduction will be limited. However, taxpayers are likely to rely upon the proposed treaty only to the extent that it provides them with a more favorable foreign tax credit result than would otherwise result from the application of the Code.

Although it is no longer U.S. treaty policy generally to provide a credit for foreign taxes on oil and gas extraction income like the Danish hydrocarbon tax, similar provisions making the United Kingdom's Petroleum Revenue Tax, Norway's Submarine Petroleum Resource Tax, and the Netherlands' Profit Share creditable are contained in the third protocol to the U.S.-United Kingdom income tax treaty, the protocol to the U.S.-Norway income tax treaty, and the U.S.-Netherlands income tax treaty, respectively.[10] Also at issue, therefore, is whether Denmark should be denied a special treaty credit for taxes on oil and gas extraction income when Norway, the Netherlands, and the United Kingdom, its North Sea competitors, now receive a similar treaty credit under the U.S. income tax treaties with those countries currently in force. On the one hand, it would appear fair to treat Denmark like Norway, the Netherlands, and the United Kingdom. On the other hand, the United States should not view any particular treaty concession to one country as requiring identical or similar concessions to other countries.

A prior proposed U.S. income tax treaty with Denmark contained a similar provision providing for the creditability of taxes imposed under the Hydrocarbon Tax Act. The Committee reported favorably on the treaty (and its protocol) in 1984 and 1985. During Senate

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Code and the prior temporary Treasury regulations under Code section 901 of special charges imposed under Norway's Petroleum Tax Act in *Phillips Petroleum Co.* v. *Commissioner*, 104 T.C. 256 (1995). The Norwegian petroleum tax was found to be creditable; however, the court was not applying the current final Treasury regulations under section 901. In addition, such determinations are inherently factual; therefore, the determination of the creditability of taxes imposed under the Danish Hydrocarbon Tax Act under U.S. law is still an open issue.

[10] In the case of the U.S.-United Kingdom treaty, there was a threatened reservation on the provision. In response, the per-country limitation was inserted in that protocol.

consideration of the treaty in 1985, objections were raised regarding the creditability under the treaty of the Danish hydrocarbon tax. The Senate has not given its advice and consent to ratification of that treaty. The Committee may wish to consider whether the proposed treaty is an appropriate vehicle for granting creditability of the Danish hydrocarbon tax.

B. Treaty Shopping

The proposed treaty, like a number of U.S. income tax treaties, generally limits treaty benefits for treaty country residents so that only those residents with a sufficient nexus to a treaty country will receive treaty benefits. Although the proposed treaty generally is intended to benefit residents of Denmark 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. 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 benefits under the treaty.

For example, the proposed treaty includes a special rule under which income derived from the operation of ships or aircraft in international traffic will be eligible for the exemption from source country tax provided under the treaty. Under this rule, a Danish resident that derives shipping or aircraft 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 case of a company, at least 50 percent of the aggregate vote and value of the stock of such company) in the resident is owned, directly or indirectly, by certain qualified persons, U.S. citizens or residents, or individuals who are residents of a third country or a company or companies the stock of which is primarily and regularly traded on an established securities market in a third country. This rule applies as long as the third country grants an exemption to shipping and aircraft income under similar terms to citizens and corporations of the source country. Similar rules are included in the treaties with the Netherlands and Ireland.

The proposed treaty also includes special rules relating to Danish taxable nonstock corporations. The Technical Explanation states that under Danish law, such corporations are foundations that are taxable in a similar manner to other Danish corporations. However, such corporations do not have owners per se. As a foundation, the taxable nonstock corporation is required to have a charter governing the corporation's distributions and identifying the corporation's beneficiaries and their entitlement to distributions. According to the Technical Explanation, like any other foundation, taxable nonstock corporations can deduct distributions to members of the founder's family provided that these family members are resident in Denmark and are fully taxable on such distributions in Denmark. Under the proposed treaty, a Danish taxable nonstock corporation is entitled to treaty benefits under a modified base erosion test which provides that: (1) no more than 50 percent of its gross income (excluding tax-exempt income) may be paid by the taxable nonstock corporation in the form of deductible payments (for the taxable year and the three preceding years) to persons who are not qualified residents of the treaty countries, and (2) no more than 50 percent of its total income (including tax-exempt income) may be paid by the taxable nonstock corporation, in the form of deductible payments and non-deductible distributions (for the taxable year and the three preceding years), to persons who are not qualified residents of the treaty countries. In addition, under the public company tests of the anti-treaty-shopping article, a company is entitled to treaty benefits if more than 50 percent of the voting power of the company is owned by one or more taxable nonstock corporations entitled to treaty benefits (as described above), and all of the other shares of the company are listed on a recognized stock exchange and substantially and regularly traded on one or more recognized stock exchanges. The Technical Explanation states that this test is necessary because it is common for Danish taxable nonstock corporations to own all of a certain class of shares of another company that provide disproportionate voting power but little or no rights to dividends. The shares held by the taxable nonstock corporation are listed but not traded on a stock exchange.

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 five or fewer qualifying publicly traded companies (including companies owned by qualifying taxable nonstock corporations). The branch tax rules allow benefits to be afforded only to a wholly-owned subsidiary of a publicly traded company.

The proposed treaty also provides mechanical rules under which so-called "derivative benefits" are afforded.[11] Under these rules, an entity is afforded treaty benefits based in part on its ultimate ownership of at least 95 percent by seven or fewer residents of EU, EEA or NAFTA countries. The U.S. model does not contain a derivative benefits provision.

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 some other U.S. tax treaties currently in effect. For example, while other treaties to which the United States is a party generally allow derivative benefits only with respect to certain income (*e.g.,* dividends, interest, or royalties), the proposed treaty allows a taxpayer to claim derivative benefits with respect to the entire treaty.[12] In addition, unlike other treaties, the proposed treaty does not require any same-country ownership of a Danish company claiming treaty benefits.[13] In other words, a Danish entity that is 100-percent owned by certain third-country residents and that does not have a nexus with Denmark (*e.g.,* by being engaged 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 that the third country have a comprehensive 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.

One provision of the anti-treaty shopping article differs from the comparable rule of some earlier U.S. treaties, but the effect of the change is not clear. The general test applied by those treaties to allow benefits to an entity that does not meet the bright-line ownership and base erosion tests is a broadly subjective one, looking to whether the acquisition, maintenance, operation of an entity did not have "as a principal purpose obtaining benefits under" the treaty. By contrast, the proposed treaty contains a more precise test that allows denial of benefits only with respect to income not derived in connection with (or incidental to) the active conduct of a substantial trade or business. (However, this active trade or business test does not apply with respect to a business of making or managing investments carried on by a person other than a bank, insurance company, or registered securities dealer, so benefits may be denied with respect to such a business regardless of how actively it is conducted). In addition, the proposed treaty (like all recent treaties) gives the competent authority of the country in which

[11] The U.S. income tax treaties with Ireland, Jamaica, Mexico, the Netherlands, and Switzerland provide similar benefits.

[12] The U.S. income tax treaties with Ireland, Jamaica, and Switzerland allow a taxpayer to claim derivative benefits with respect to the entire treaty.

[13] 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.

the income arises the authority to determine that the benefits of the treaty will be granted to a person even if the specified tests are not satisfied.

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

The Committee has in the past expressed its belief that the United States should maintain its policy of limiting treaty-shopping opportunities whenever possible. The Committee has further expressed its belief that, in exercising any latitude Treasury has with respect to the operation of a treaty, the treaty rules should be applied to deter treaty-shopping abuses. 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.