

**EXPLANATION OF PROPOSED INCOME TAX TREATY BETWEEN  
THE UNITED STATES AND BELGIUM**

Scheduled for a Hearing  
Before the  
COMMITTEE ON FOREIGN RELATIONS  
UNITED STATES SENATE

On July 17, 2007

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Prepared by the Staff  
of the  
JOINT COMMITTEE ON TAXATION



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## INTRODUCTION

This pamphlet,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, describes the proposed income tax treaty between the United States and Belgium as supplemented by a protocol (the “proposed protocol”). Unless otherwise specified, the proposed treaty and the proposed protocol are hereinafter referred to collectively as the “proposed treaty.” The proposed treaty was signed on November 27, 2006. The Senate Committee on Foreign Relations (the “Committee”) has scheduled a public hearing on the proposed treaty for July 17, 2007.<sup>2</sup>

Part I of the pamphlet provides a summary of the proposed treaty. 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 a brief overview of Belgian tax laws. Part IV provides a discussion of investment and trade flows between the United States and Belgium. Part V contains an article-by-article explanation of the proposed treaty. Part VI contains a discussion of issues relating to the proposed treaty.

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<sup>1</sup> This pamphlet may be cited as follows: Joint Committee on Taxation, *Explanation of Proposed Income Tax Treaty Between the United States and Belgium* (JCX-45-07), July 13, 2007. References to “the Code” are to the U.S. Internal Revenue Code of 1986, as amended.

<sup>2</sup> For a copy of the proposed treaty, *see* Senate Treaty Doc. 110-3.

## I. SUMMARY

The principal purposes of the proposed treaty 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 (Article 7). Similarly, the proposed treaty contains certain 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 and 16).

The proposed treaty provides that dividends and certain gains derived by a resident of either country from sources within the other country generally may be taxed by both countries (Articles 10 and 13); however, the rate of tax that the source country may impose on a resident of the other country on dividends may be limited by the proposed treaty and source-country tax may be eliminated on certain dividends in which certain ownership thresholds and other requirements are satisfied (Article 10). The proposed treaty provides that, subject to certain rules and exceptions, interest and royalties derived by a resident of either country from sources within the other country may be taxed only by the residence country (Articles 11 and 12).

In situations in which 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 22).

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 to which the taxpayer would be entitled under the domestic law of a country or under any other agreement between the two countries (Article 1).

The proposed treaty adds to the present treaty certain provisions regarding cross-border contributions to, and benefit accruals of, pension plans (Article 17). These rules are intended to remove barriers to the flow of personal services between the two countries that could otherwise result from discontinuities under the laws of each country and are similar to provisions included in other recent U.S. treaties and protocols, including the United States Model Income Tax Convention of November 15, 2006 ("U.S. Model treaty").

The proposed treaty (Article 19) generally provides that students, teachers, business trainees, and researchers visiting the other treaty country are exempt from host country taxation on certain types of payments received.

The proposed treaty adds a mandatory arbitration procedure (Article 24) that is sometimes referred to as “last best offer” arbitration, in which each of the competent authorities proposes one and only one figure for settlement, and the arbitrator must select one of those figures as the award. Under the proposed treaty, unless a taxpayer or other “concerned person” (in general, a person whose tax liability is affected by the arbitration determination) does not accept the arbitration determination, it is binding on the treaty countries with respect to the case. The mandatory and binding arbitration procedure is new to the U.S. treaty network.

The proposed treaty provides authority for the two countries to exchange information (Article 25) and assist in the collection of tax (Article 26) in order to carry out the provisions of the proposed treaty.

The proposed treaty also contains a detailed limitation-on-benefits provision that reflects the anti-treaty-shopping provisions included in the U.S. Model treaty and more recent U.S. income tax treaties. The new rules are intended to prevent the inappropriate use of the treaty by third-country residents (Article 28).

The proposed treaty replaces the existing treaty (signed in 1970) and protocol (signed in 1987). The rules of the proposed treaty generally are similar to rules of recent U.S. income tax treaties, the U.S Model treaty,<sup>3</sup> and the 2005 Model Convention on Income and on Capital of the Organisation for Economic Cooperation and Development (“OECD Model treaty”). However, the proposed treaty contains certain substantive deviations from these treaties and models. These deviations are noted throughout the explanation of the proposed treaty in Part V of this pamphlet.

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<sup>3</sup> For a comparison of the U.S. Model treaty with its 1996 predecessor, see Joint Committee on Taxation, *Comparison of the United States Model Income Tax Convention of September 20, 1996 with the United States Model Income Tax Convention of November 15, 2006* (JCX-27-07), May 8, 2007.

## **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 one or four percent of the premiums. These taxes generally are collected by means of withholding.

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

U.S.-source capital gains of a nonresident alien individual or a foreign corporation that are not effectively connected with a U.S. trade or business generally are exempt from U.S. tax, with two exceptions: (1) gains realized by a nonresident alien individual who is present in the

United States for at least 183 days during the taxable year, and (2) certain gains from the disposition of interests in U.S. real property.

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

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



## **B. U.S. Tax Treaties**

The traditional objectives of U.S. tax treaties have been the avoidance of international double taxation and the prevention of tax avoidance and evasion. Another related objective of U.S. tax treaties is the removal of the barriers to trade, capital flows, and commercial travel that may be caused by overlapping tax jurisdictions and by the burdens of complying with the tax laws of a jurisdiction when a person's contacts with, and income derived from, that jurisdiction are minimal. To a large extent, the treaty provisions designed to carry out these objectives supplement U.S. tax law provisions having the same objectives; treaty provisions modify the generally applicable statutory rules with provisions that take into account the particular tax system of the treaty partner.

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

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

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

The objective of preventing tax avoidance and evasion generally is accomplished in treaties by the agreement of each country to exchange tax-related information. Treaties generally provide for the exchange of information between the tax authorities of the two countries when such information is necessary for carrying out provisions of the treaty or of their domestic tax laws. The obligation to exchange information under the treaties typically does not require either

country to carry out measures contrary to its laws or administrative practices or to supply information that is not obtainable under its laws or in the normal course of its administration or that would reveal trade secrets or other information the disclosure of which would be contrary to public policy. The Internal Revenue Service (the “IRS”) and the treaty partner’s tax authorities 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 the tax it imposes on its own nationals (or on its own enterprises). Similarly, in general, neither treaty country may discriminate against enterprises owned by residents of the other country.

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

### III. OVERVIEW OF TAXATION IN BELGIUM<sup>4</sup>

#### A. National Income Taxes

##### Overview

Belgium imposes income tax on net income at the national and local levels. The definition of income subject to tax is expansive and includes capital gains. Taxable income is computed on an annual basis and is either taxed by assessment or by a withholding tax. Any withholding tax paid may be credited against the income tax liability, and any excess is refunded. Aside from a few special exceptions, Belgium residents and nonresidents are generally subject to the same tax rules and tax rates on Belgian-source income.

##### Individuals

Individuals resident in Belgium are subject to tax on their worldwide income. An individual's taxable income is the sum of the net income from each of the following categories: income from real property, income from personal property (e.g., dividends, interest, and royalties), income from professional activities, and miscellaneous income. Losses of one category of income may not be set off against income of another category. Losses incurred with respect to professional activities may be carried forward indefinitely and offer again future income from such activities. No losses may be deducted with respect to income from personal or real property. Belgian-source dividends and interest income are subject to a final withholding tax of 25 percent (reduced to 15 percent or 20 percent in certain cases) and 15 percent, respectively. Foreign-source dividends and interest payments, however, must be included in the individual income tax return of the recipient. A withholding tax is also imposed on income from real property located in Belgium. The withholding tax rate varies depending on the region in which the property is located. Capital gains realized on the sale of business assets are taxable, as are capital gains derived from speculative transactions, the sale of developed and undeveloped real estate within five years of acquisition, the sale of a substantial participation (more than 25 percent) in a resident corporation to a nonresident legal entity, and the sale of certain intangible rights. Certain deductions are allowed against the total taxable income, including alimony payments, gifts and charitable contributions, remuneration paid to household staff, child day care, restoration of classified real property and landscape, and interest on mortgage loans. The rate structure is progressive and extends from 25 percent for taxable income up to €7,420 (\$9,796) to 50 percent for taxable income exceeding €32,270 (\$42,605).<sup>5</sup> Certain items of

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<sup>4</sup> The information in this section relates to foreign law and is based on the Joint Committee staff's review of publicly available secondary sources, including in large part Jacques Malherbe and Pascal Faes, *Business Operations in Belgium*, Tax Management Portfolio No. 953-2nd. The description is intended to serve as a general overview; it may not be fully accurate in all respects, as many details have been omitted and simplifying generalizations made for ease of exposition.

<sup>5</sup> The quoted tax rates and local currency amounts apply in 2007. U.S. dollar equivalents were calculated using the exchange rate for January 1, 2007 according to OANDA's FX Converter, available at [www.oanda.com](http://www.oanda.com). See Article 130 of the Belgian Tax Code, Belgium Ministry of Finances, available at

income (e.g., capital gains) are taxable at separate tax rates unless aggregation with other income taxable at the regular progressive rates is more beneficial. A basic allowance of €6,040 (\$7,974) is tax free; the allowance is increased to €7,320 (\$9,664) for single parents or disabled taxpayers. Additional allowances are granted for dependents. The allowance for four children, for example is €1,980 (\$15,817). The national income tax is subject to a municipal surcharge ranging generally from zero to nine percent (no explicit maximum is provided), depending on the municipality.

### **Corporations**

Corporations resident in Belgium are subject to tax on their worldwide income. A corporation is any company, association, establishment, or institution that has legal personality and is engaged in business or in profit-making activities. A corporation is a resident of Belgium if it has its legal seat, main establishment, or place of effective management in Belgium.

In general, all income derived by a corporation is taxable business income; this includes income from real property or personal property. Capital gains are normally taxed at the ordinary rates, but capital gains on shares may be exempt. The standard corporate tax rate is 33 percent; however, most companies with taxable income of €22,500 (\$425,787) or less are subject to progressive rates ranging from 24.25 percent to 34.5 percent. In addition, the corporate tax rates are increased by a three percent austerity surcharge.

Dividends paid by a resident company to a resident shareholder are subject to a 25-percent withholding tax. The rate is reduced to 15 percent on dividends distributed with respect to certain shares issued on or after January 1, 1994, certain qualifying shares issued in 1982 or 1983, and shares of investment companies. If the resident shareholder is a corporation, it may benefit from the dividends received deduction. Under the dividends received deduction, 95 percent of the dividends paid to a resident corporation are exempt from the withholding tax if: (1) the distributing corporation is subject to the corporate income tax or a tax similar to the Belgian corporate income tax; (2) the recipient corporation owns at least 10 percent of the capital or has an investment value of at least €1,200,000 (\$1,584,324) in the distributing corporation; and (3) the shares with respect to which the dividends are distributed have been held in full ownership for an uninterrupted period of one year and qualify as financial fixed assets. Belgian-source interest on bonds, public securities, loans, and deposits is subject to a withholding tax of 15 percent. A 15-percent withholding tax is payable on Belgian-source income arising from the rental or use of, or the grant of rights over, any type of personal property. However, royalties paid to resident companies are not subject to withholding tax but are instead subject to corporate income tax on their net amount.

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[www.fisconet.fgov.be](http://www.fisconet.fgov.be); IBFD European Taxation Analysis, Belgium, available at [www.checkpoint.riag.com](http://www.checkpoint.riag.com).

## **B. International Aspects of Taxation in Belgium**

### **Individuals**

Individuals resident in Belgium are taxed on their worldwide income. An individual is considered a resident of Belgium if his or her main home or center of economic interests is in Belgium. Nonresident individuals are subject to the same tax rules and tax rates on their Belgian-source income as those generally applicable to resident individuals. Belgian-source income includes: income from real property located in Belgium; personal property income (e.g., dividends, interest, and royalties) produced or collected in Belgium; profits generated through a Belgian establishment; gains derived from a professional activity exercised in Belgium; profits and gains derived from a former independent professional activity exercised in Belgium; certain employment; certain pension and annuities; income derived by nonresident public performers and athletes from performances in Belgium; and miscellaneous income obtained in Belgium. For nonresidents, the municipal surcharge is replaced by a flat six-percent surcharge levied at the national level. Nonresident individuals who have maintained a permanent abode in Belgium are entitled to most of the same personal deductions as resident individuals. Belgium imposes a 25-percent (reduced to 15 percent or 20 percent in certain cases) withholding tax on dividends paid by resident companies to nonresident individuals. Interest and royalty income arising from Belgian sources are subject to a 15-percent withholding tax. Belgian-source capital gains on the sale of business assets are taxable, but capital gains on investment assets (other than real property) are not taxable.

### **Corporations**

Companies resident in Belgium are generally taxed on their worldwide income. A foreign company is subject to the same tax rules and tax rates as resident companies if it has an establishment in Belgium or receives Belgian-source income. A Belgian establishment is any fixed installation through which a foreign enterprise conducts, either wholly or partly, its business activities in Belgium. The activities of a nonresident's representative are also deemed to constitute a Belgium establishment. Belgian-source income includes: income from real property located in Belgium; dividends, interest, and royalties produced or collected in Belgium; profits generated through a Belgian establishment; gains derived from a professional activity exercised in Belgium; profits and gains derived from a former independent professional activity exercised in Belgium; certain employment income; certain pension and annuities; income derived by nonresident public performers and athletes from performances in Belgium; and miscellaneous income obtained in Belgium.

Dividends paid by resident companies to nonresident corporate shareholders are subject to withholding tax at a rate of 25 percent (reduced to 15 percent or 20 percent in certain cases). Belgian-source interest payments and royalties paid to nonresident companies are subject to a withholding tax rate of 15 percent. A real estate withholding tax may also be levied against nonresident companies.

### **Relief from double taxation**

In the absence of a treaty, relief from double taxation of foreign source income may be provided in the form of an exemption, credit, or tax reduction, depending on the type of income. For example, Belgian residents are taxed at one-half the normal tax rate on income from property situated abroad, professional income earned and taxed abroad, and miscellaneous income that includes profits and gains derived and taxed abroad, subsidies paid by foreign entities, and alimony payments due from nonresidents.

## C. Other Taxes

### **Inheritance, gift, and wealth taxes**

Belgium imposes an inheritance tax on all assets of a deceased person if the deceased was a resident in Belgium at the time of death. If the deceased was residing abroad at the time of his or her death, the Belgian inheritance tax is limited to Belgian real property that was owned, wholly or partly, by the deceased. The property of the deceased is valued at its market value at the time of death. The inheritance tax rate varies depending on the inherited amount, the degree of kinship between the deceased and the beneficiary, and the region in which the deceased was domiciled. A gift tax is levied on gifts of real property located in Belgium and gifts of personal property, wherever located, that are evidenced by a registered written document. The rate of the gift tax is determined by the region in which the donor permanently resides. Belgium does not levy a wealth tax.

### **Social security**

Social security contributions are levied on gross income at a total contribution rate of 13.07 percent. For self-employed individuals, the contribution rate varies depending on net income. Social security contributions are deductible for income tax purposes.

### **Other indirect taxes**

Belgium imposes a value added tax (“VAT”) on the consumption of goods and services. Although the VAT is levied at each stage of the economic chain, it is ultimately borne by the final customer. The VAT due on any sale is a percentage of the sale price less all the tax paid at the preceding stages. The standard VAT rate is 21 percent. The rate is reduced for certain products and services and in some cases is zero.

Belgium also imposes registration duties on documents recorded in an official registry, stamp fees, road tax, betting tax and tax on gambling machines, tax on the right to use highways, excise duty on petroleum vehicles, and tax on employee profit-sharing. Also, companies are subject to a commissions’ tax of 300 percent for failure to document certain payments that constitute earned income.

Ecotaxes are regional taxes levied on a product that is placed on the market for consumption. Ecotaxes are imposed because of the negative ecological effects the product may generate. The following categories of products are subject to ecotaxes: drink receptacles, disposable items, batteries, and receptacles for certain industrial products.

## **IV. THE UNITED STATES AND BELGIUM: CROSS-BORDER INVESTMENT AND TRADE**

### **A. Introduction**

A principal rationale for negotiating tax treaties is to improve the business climate for business persons in one country who might aspire to sell goods and services to customers in the other country and to improve the investment climate for investors in one country who might aspire to own assets in the other country. Clarifying the application of the two nations' income tax laws makes more certain the tax burden that will arise from different transactions, but may also increase or decrease that burden. Where there is, or where there is the potential to be, substantial cross-border trade or investment, changes in the tax structure applicable to the income from trade and investment has the potential to alter future flows of trade and investment. Therefore, in reviewing the proposed protocol it may be beneficial to examine the cross-border trade and investment between the United States and Belgium. Whether measured by trade in goods or services or when measuring by direct and non-direct cross-border investment, the United States and Belgium engage in significant cross-border activity. The income from cross-border trade and investment generally is subject to net-basis income tax in either the United States or Belgium and in many cases also is subject to gross basis withholding taxes in the source country.



## **B. Overview of International Transactions Between the United States and Belgium**

### **Cross-border trade**

The current account consists of three primary components: trade in goods; trade in services; and payment of income on assets invested abroad. While detail regarding the balance of payments between the United States and Belgium is not publicly available, one can document that the value of trade between the United States and Belgium is large. In 2005, the United States exported \$18.7 billion of goods and services to Belgium and imported \$13.0 billion in goods and services from Belgium. This made Belgium the United States' 12th largest merchandise and service export destination and the 24th largest source of imported merchandise.<sup>6</sup>

Numerous disparate activities constitute trade in services. Among the sources of receipts from exported services are payments for transportation of goods, travel by persons and passenger fares, payments for professional services such as management consulting, architecture, engineering, and legal services, financial services, insurance services, computer and information services, and film and television tape rentals. Also included in receipts for services are the returns from investments in intangible assets in the form of royalties and license fees. In 2005, U.S. parent businesses received approximately \$535 million in royalty and license fees from their affiliates in Belgium. In 2005, U.S. affiliates paid approximately \$60 million in royalties and license fees to their Belgian parents.<sup>7</sup>

### **Cross-border investment**

Income from foreign assets is categorized as income from "direct investments" and income from "non-direct investments." Direct investment constitutes assets over which the owner has direct control. The Department of Commerce defines an investment as direct when a single person owns or controls, directly or indirectly, at least 10 percent of the voting securities of a corporate enterprise or the equivalent interest in an unincorporated business. Often the income that crosses borders from direct investments is in the form of dividends from a subsidiary to a parent corporation, although interest on loans between such related corporations is another source of income from a direct investment. In non-direct investments the investor generally does not have control over the assets that underlie the financial claims. Non-direct investments consist mostly of holdings of corporate equities and corporate and government bonds, generally referred to as "portfolio investments," and bank deposits and loans. Hence, the income from non-direct investments generally is interest, dividends, or gains.

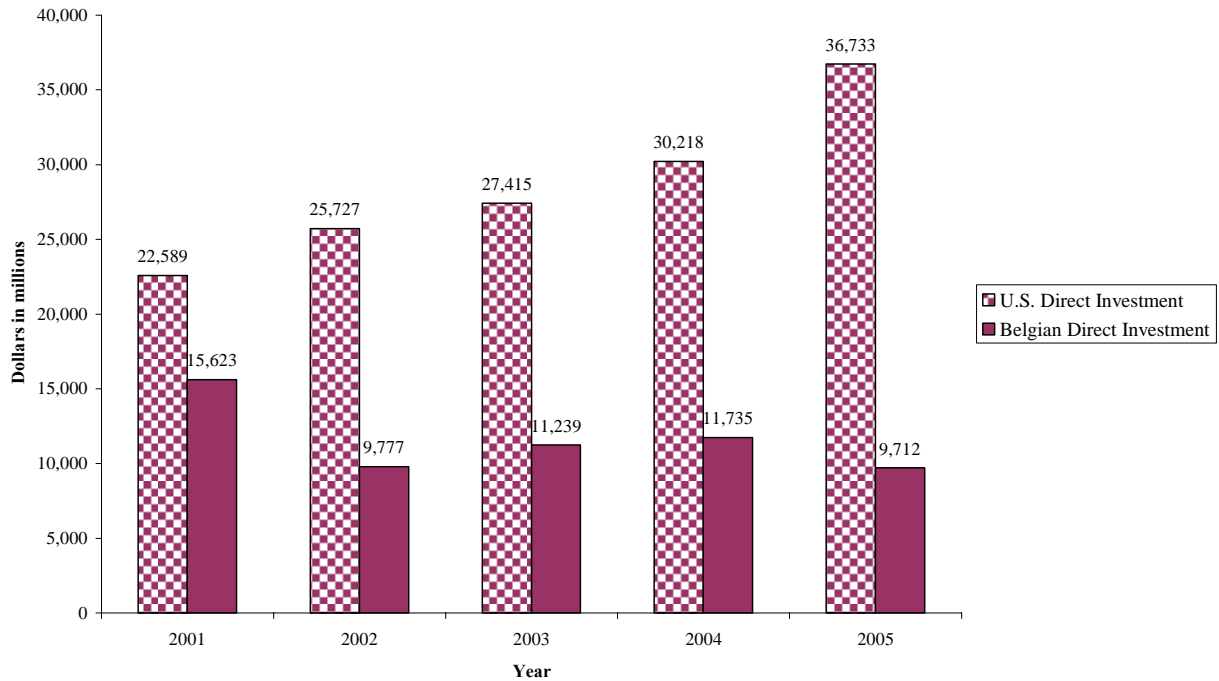
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<sup>6</sup> Bureau of Economic Analysis, U.S. Department of Commerce, "U.S. International Trade in Goods and Services, Annual Revision for 2005," June 9, 2006.

<sup>7</sup> Bureau of Economic Analysis, U.S. Department of Commerce, "International Economic Accounts," [www.bea.gov/international](http://www.bea.gov/international), May 2007.

Commensurate with the size of the Belgian economy in comparison to other European countries, the value of cross-border investment between the United States and Belgium is smaller than that of cross border investment between the United States and other European countries. In 2005, U.S. persons held direct investments in Belgium valued at \$36.7 billion on a historic cost basis and Belgian persons held direct investments in the United States valued at \$9.7 billion. Figure 1, below, documents the value in U.S. direct investment in Belgium and Belgian direct investment in the United States on an historical cost basis at year-end for 2001 through 2005.

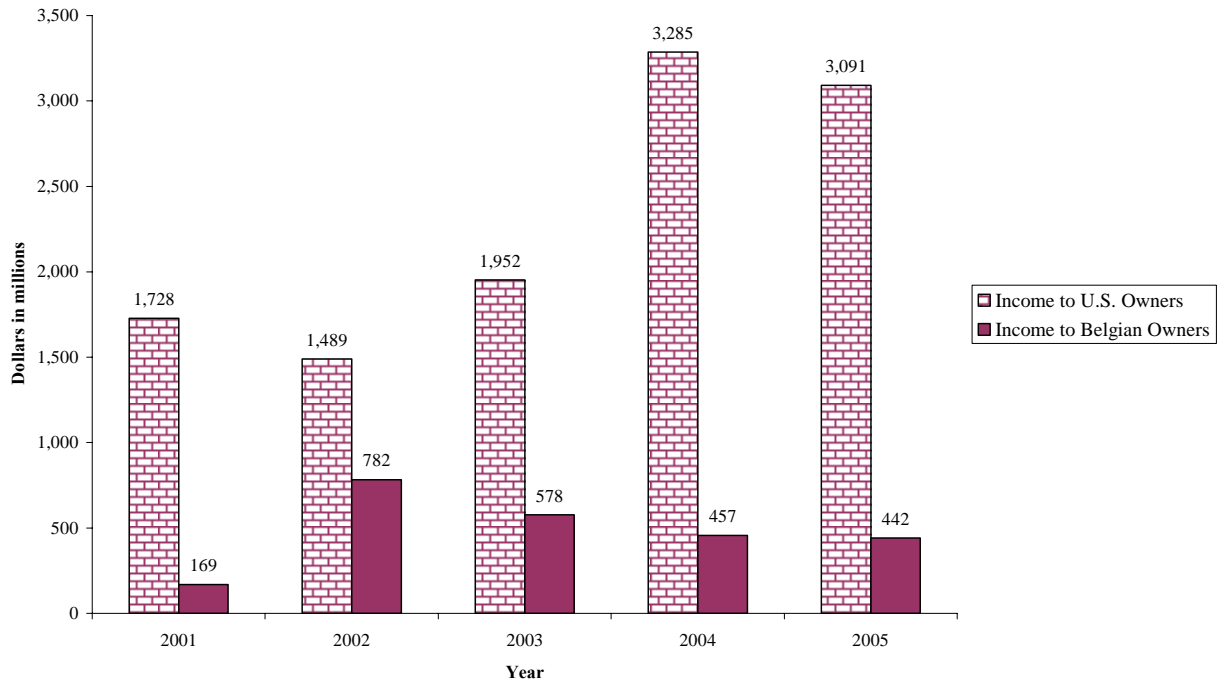
**Figure 1.—Value of U.S. Direct Investments in Belgium and Belgian Direct Investments in The United States on an Historical Cost Basis, Year-End 2001-2005**  
[millions of dollars]



Source: Bureau of Economic Analysis, U.S. Department of Commerce, May 2007.

U.S. direct investments in Belgium produced approximately \$3.1 billion in income (net of withholding taxes) to U.S. persons in 2005. Belgian direct investments in the United States produced approximately \$440 million in income (net of withholding taxes) to Belgian persons in 2005. Figure 2, below, details income from U.S. direct investments in Belgium and Belgian direct investments in the United States (net of withholding taxes) for the period 2001-2005.

**Figure 2.—Income From U.S. Direct Investments in Belgium and Belgian Direct Investments in The United States (net of withholding taxes), Year End 2001-2005**  
[millions of dollars]



Source: Bureau of Economic Analysis, U.S. Department of Commerce, May 2007.

The data presented above do not report the amount of U.S. or Belgian portfolio investment holdings of stocks and bonds (including holdings of U.S. government securities). The Bureau of Economic Analysis generally only reports portfolio holdings by country for the several largest portfolio investment countries.

### C. Income Taxes and Withholding Taxes on Cross-Border Income Flows

The data presented above report the amount of direct investment in Belgium by U.S. persons and the amount of direct investment in the United States by Belgian persons. Data from tax returns reflect the magnitudes of cross-border investment and trade and income flows reported above. In 2003, U.S. corporations with Belgian parent companies had \$1.0 billion of income subject to tax and paid \$0.3 billion in U.S. Federal income taxes.<sup>8</sup> U.S. corporations, including U.S. parent companies of Belgian controlled foreign corporations, reported the receipt of \$2.3 billion of dividends from Belgian corporations in 2002.<sup>9</sup> Of the \$2.3 billion in dividends reported, approximately \$0.4 billion reflected the grossed up value of net dividends to account for deemed taxes paid to Belgium. U.S. corporations recognized about \$2.6 billion in taxable income originating in Belgium, including the dividend amounts just cited. This income was subject to an average Belgian corporate income tax rate of approximately 17.5 percent (after allowing for apportionment and allocation of certain expenses incurred in the United States).

Data for withholding taxes from 2000 show that Belgium and the United States collected approximately the same amounts of receipts, with each country withholding under \$100 million annually, by withholding tax on respective payments to each other.<sup>10</sup> Data on withholding taxes may not be an accurate indicator of cross-border investment and income flows, because a taxpayer can often control the amount and timing of dividend payments to the home country and pays withholding tax only when these payments are made.

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<sup>8</sup> James R. Hobbs, "Foreign Controlled Domestic Corporations, 2003," *Internal Revenue Service, Statistics of Income Bulletin*, Summer 2006, pp. 67-112.

<sup>9</sup> Data Release, "Corporate Foreign Tax Credit, 2002," *Internal Revenue Service, Statistics of Income Bulletin*, Fall 2006, pp. 285-318.

<sup>10</sup> Data Release, "Foreign Recipients of U.S. Income, 2000," *Internal Revenue Service, Statistics of Income Bulletin*, Summer 2003, pp. 177-186.

#### **D. Analyzing the Economic Effects of Protocols to Income Tax Treaties**

Among other things, tax treaties often change both the amount and timing of income taxes and the country (source or residence) that has priority to impose such taxes. If the tax treaty changes increase the after-tax return to cross-border trade and investment, or to particular forms of trade or investment, in the long run there could be significant economic effects. Generally, to the extent a treaty reduces barriers to capital and labor mobility, more efficient use of resources will result and economic growth in both countries will be enhanced, although there may be negative transitional effects occurring in specific industries or geographic regions. On the other hand, tax treaties may also lead to tax base erosion if they create new opportunities for tax arbitrage. Tax treaties also often increase and improve information sharing between tax authorities. Improvements in information sharing and the limitation of benefits provision should reduce the potential for outright evasion of U.S. and Belgian income tax liabilities.

Generally, a treaty-based reduction in withholding rates will directly reduce U.S. tax collections in the near term on payments from the United States to, but will increase U.S. tax collections on payments from foreign persons to the United States because of the reduction in foreign taxes that are potentially creditable against the U.S. income tax. To the extent that the withholding rate reduction encourages more income flows between the treaty parties, this initial dampening of collections on payments to foreign persons and related decrease in foreign tax credits will begin to reverse. The present treaty's reductions in dividend withholding rates will reduce U.S. withholding tax collections on dividend payments from the United States to Belgium. Over the longer term, the withholding tax rate changes coupled with other changes in the protocol are likely to cause small revenue increases in later years as capital flows increase and from improved allocation of capital.

However, this simple analysis is incomplete. A complete analysis of a withholding change, or any other change in a treaty, would account for both tax and non-tax related factors, such as portfolio capital needs in the affected countries, and the corresponding relation between current and financial accounts. The potential for future growth in each country is an important determinant of cross-border investment decisions. In sum, even in the short run, the larger macroeconomic outlook, compared to treaty modifications, is likely to be a more important determinant of future cross-border income and investment flows and the related tax collections.

## V. EXPLANATION OF PROPOSED TREATY AND PROTOCOL

### Article 1. General Scope

#### In general

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 Belgium. The determination of whether a person is a resident of the United States or Belgium is made under the provisions of Article 4 of the treaty (Resident).

The proposed treaty provides that it does not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance accorded by internal law, by any other agreement between the United States and Belgium, or by any multilateral agreement to which the United States and Belgium are parties, except in the case of a resident of Belgium who is also a citizen, former citizen, or former long-term resident of the United States. In the case of such a person, Article 22, paragraph 4(a) provides relief from double taxation. Thus, the proposed treaty will not apply to increase the tax burden of a resident of either the United States or Belgium.

According to the Treasury Department's Technical Explanation (hereinafter referred to as the “Technical Explanation”), the fact that the proposed treaty applies only 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 Belgium 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 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.<sup>11</sup>

Notwithstanding the foregoing rules, the proposed treaty provides that, in interpreting or applying the treaty and in determining whether a taxation measure is within the scope of the treaty, the dispute resolution procedures under its mutual agreement article (Article 24) take

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<sup>11</sup> See Rev. Rul. 84-17, 1984-1 C.B. 308.

precedence over the corresponding provisions of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services (“GATS”).

The proposed treaty also provides that the provisions of Article XVII (Denial of Benefits) of GATS do not apply to any taxation measure, unless the competent authorities agree that the measure is not within the scope of the nondiscrimination provisions (Article 23) of the treaty. The Technical Explanation points out that consequently, the consultation provision of GATS may not be used to bring a dispute before the World Trade Organization unless the competent authorities of the United States and Belgium have determined that the relevant taxation measure is not within the nondiscrimination provision (Article 23) of the treaty. 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 and the U.S. Model treaty, the proposed treaty includes a “saving clause.” Under this clause, with specific exceptions described below, the proposed treaty does not affect the taxation by either treaty country of its residents or its citizens. By reason of this saving clause, unless otherwise specifically provided in the proposed treaty, the United States may continue to tax its citizens who are residents of Belgium 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 (Resident), includes corporations and other entities as well as individuals.

The proposed treaty contains a provision under which a former citizen or long-term resident of the United States may be taxed under United States law for the period of ten years following the loss of citizenship or long-term resident status. 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 long-term resident status.

Under U.S. domestic law, an individual is considered a “long-term resident” of the United States if the individual (other than a citizen of the United States) was a lawful permanent resident of the United States in at least eight of the 15 taxable years ending with the taxable year in which the individual ceased to be a long-term resident. However, an individual is not treated as a lawful permanent resident for any taxable year if such individual is treated as a resident of a foreign country for such year under the provisions of a tax treaty between the United States and the foreign country and the individual does not waive the benefits of such treaty applicable to residents of the foreign country.

The saving clause refers to provisions in paragraph 4 of Article 22 (Relief from Double Taxation) that apply in the situation in which a resident of Belgium is a citizen of the United States, or a former citizen or former long-term resident of the United States, and is therefore subject to United States tax in accordance with the saving clause. These provisions of Article 22 generally serve to mitigate double taxation by providing an exemption or deduction from Belgian tax on the income taxed in the United States, or by providing a credit against U.S. tax for tax paid or accrued to Belgium, or by treating U.S.-source income as Belgian-source solely for purposes of the credit against U.S. tax under Article 22.

Exceptions to the saving clause are provided for the following benefits conferred by the either treaty country: the allowance of correlative adjustments when the profits of an associated enterprise are adjusted by the other country (Article 9, paragraph 2); provisions for taxation of certain pension distributions, alimony and child support payments in only one of the treaty countries, and taxation of social security benefits only in the country of the recipient's residence (Article 17, paragraphs 1(b), 2, and 5); deferral of tax on income earned on pension plans that are resident in the other country, and U.S. deductibility of contributions (and excludability of benefits) under a pension plan of an employer in Belgium (Article 17, paragraphs 6 and 9); relief from double taxation through the provision of a foreign tax credit, or through exemption of income earned in the United States (Article 22); protection from discriminatory tax treatment with respect to transactions with residents of the other country (Article 23); and benefits under the mutual agreement procedures of the treaty (Article 24).

In addition, the saving clause does not apply to certain benefits conferred by either treaty country upon individuals who neither are citizens nor have immigrant status. Under this set of exceptions to the saving clause, the specified treaty benefits are available to, for example, a citizen of Belgium 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 allowance of a host-country deduction for contributions and host-country deferral of taxation of accrued benefits under pension funds that are resident in the source country (Article 17, paragraph 7), and exemptions from host country taxation for certain income for government service (Article 18), certain income received by students, trainees, teachers and researchers (Article 19), and certain income received by members of diplomatic missions and consular posts (Article 27).

#### Fiscally transparent entities

The proposed treaty contains special rules for fiscally transparent entities that are identical to those in the U.S. Model treaty. Under these rules, as explained in the Technical Explanation, income derived through an entity that is fiscally transparent under the laws of either treaty country is considered to be the income of a resident of one of the treaty countries only to the extent that the income is subject to tax in that country as the income of a resident. For example, if a Belgian company pays interest to an entity that is treated as fiscally transparent for U.S. tax purposes, the interest 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 interest income for U.S. tax purposes.

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



United States, the entity is treated as fiscally transparent. Rather, for purposes of the proposed treaty, the income is treated as derived by the U.S. entity.

The Technical Explanation generally defines fiscally transparent entities as entities in which income derived by such entities is taxed at the beneficiary, member, or participant level, under the law of either the United States or Belgium. Entities are not considered fiscally transparent if the entity tax may be relieved under an integrated system. For example, in the United States, a partnership, common investment trust under Code section 584, or grantor trust, or a limited liability company ("LLC") that is treated for tax purposes as a partnership or disregarded entity, is considered a fiscally transparent entity.

The Technical Explanation also states that the treatment of fiscally transparent entities is not an exception to the saving clause. Therefore, such treatment does not preclude a treaty country from taxing an entity that is treated as a resident of that country under its tax laws. For example, if a U.S. LLC with Belgian members elects to be taxed as a corporation for U.S. tax purposes, the United States will tax that LLC on its worldwide income on a net basis, without regard to whether Belgium views the LLC as fiscally transparent.

## **Article 2. Taxes Covered**

The proposed treaty applies to all taxes on income irrespective of the manner in which they are levied, including taxes on gains from the alienation of property. In the case of Belgium, both the present treaty and the proposed treaty apply to the individual income tax, the corporate income tax, the income tax on legal entities, and the income tax on nonresidents; they also apply to the prepayments and surcharges on these taxes. In the case of the United States, both the present treaty and the proposed treaty apply to the Federal income taxes imposed by the Code, but social security taxes are specifically excluded under the proposed treaty. The proposed treaty, like the U.S. Model treaty but unlike the present treaty, also applies to Federal excise taxes imposed with respect to private foundations.

The proposed treaty, like the present treaty, applies to any taxes that are identical or substantially similar to the taxes described in the preceding paragraph and that are imposed after the signing of the proposed treaty in addition to or in place of existing taxes. This provision generally is found in U.S. income tax treaties. The proposed treaty obligates the competent authority of each country to notify the competent authority of the other country of any changes in its internal taxation or other laws that significantly affect a country's obligations under the proposed treaty. The proposed treaty, unlike the present treaty, does not specify the manner and frequency with which such notification must be provided and does not require that the competent authorities notify each other of any official published materials concerning the application of the proposed treaty. These changes bring the proposed treaty more in line with the U.S. Model 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 that is treated as a body corporate for tax purposes under the laws of the Contracting 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 term “enterprise” applies to the carrying on of any business. The term “business” includes the performance of professional services and of other activities of an independent character.

The proposed treaty provides that the terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” also include an enterprise carried on by a resident of a Contracting State through an entity that is treated as fiscally transparent in the residence treaty country.

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, purely domestic transport within the United States does not constitute “international traffic.” Similarly, a “cruise to nowhere,” i.e., a cruise beginning and ending in a port in the same treaty country with no stops in a foreign port, would not constitute international traffic.

The Belgium “competent authority” is the Minister of Finance or his authorized representative. 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 re-delegated the authority to the Deputy Commissioner (International) LMSB. On interpretative issues, the latter acts with the concurrence of the Associate Chief Counsel (International) of the IRS.

The term “Belgium” means the Kingdom of Belgium, which, when used in a geographical sense includes the territorial sea and the seabed and subsoil and the superjacent waters of the adjacent submarine areas beyond the territorial sea over which Belgium exercises sovereign rights in accordance with international law.

The term “United States” means the United States of America (including the States thereof 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 any area beyond the territorial sea that is designated as an area within which the United States, in compliance with its legislation and in conformity with international law, exercises sovereign rights in respect of the exploration and exploitation of the natural resources of the seabed, the subsoil, and the superjacent waters. The Technical Explanation states that the extension of the term to such areas applies only if the person, property, or activity to which the proposed treaty is being applied is connected with such natural resource exploration or exploitation.

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

The term “pension fund” means any person established in a treaty country that (1) is operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements, and (2)(a) in the case of Belgium, is an entity organized under Belgian law and regulated by the Bank Finance and Insurance Commission, or (b) in the case of the United States, is generally exempt from U.S. income taxation with respect to the above-described activities. The proposed treaty follows the U.S. Model treaty in eliminating the defined term “qualified governmental entity.”

The proposed treaty also contains the standard provision that, unless the context otherwise requires or the competent authorities agree upon a common meaning pursuant to Article 24 (Mutual Agreement Procedure), all terms not defined in the proposed treaty have the meaning pursuant to the respective tax laws of the country that is applying the treaty.

#### **Article 4. Resident**

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. 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 (that is, 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.

##### Belgium

Under Belgian law, resident individuals are subject to tax on their worldwide income, while nonresident individuals generally are subject to tax only on income arising in Belgium. An individual is considered to be a resident of Belgium if he or she has his or her domicile or the seat of his or her wealth in Belgium. Domicile is considered to be the place where a person is mainly and permanently established. Seat of wealth is considered to be the place from which a

person administers his or her wealth or patrimonial interests, regardless of the location of the underlying assets. A nonresident individual is an individual who does not have his or her domicile or seat of wealth in Belgium.

Companies that are resident in Belgium are subject to tax on their worldwide income. A company is resident in Belgium if it has its statutory seat, its principal establishment, or its seat of management or administration in Belgium. Companies that are not resident in Belgium pay tax on income of their Belgian establishments and on Belgian-source income.

#### Proposed treaty rules

Article 4 provides rules to determine whether a person is a resident of the United States or Belgium under the proposed treaty. The rules generally are consistent with the rules of the U.S. Model treaty.

The proposed treaty generally defines “resident of a Contracting State” to mean any person who, under the laws of that State, is liable to tax in that State 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 who is liable to tax in that State only on income from sources in that State or on profits attributable to a permanent establishment in that State. Accordingly, although not explicitly stated in the proposed treaty, an enterprise of Belgium with a permanent establishment in the United States does not become a resident of the United States as a result of its U.S. permanent establishment: The enterprise generally is liable to tax by the United States only on income attributable to its U.S. permanent establishment, not on its worldwide income.

The proposed treaty makes explicit the generally understood practice of including in the definition of “resident of a Contracting State” the two treaty countries and any political subdivisions or local authorities of those countries.

The proposed treaty includes an exception to the general rule described above that residence under internal tax law also determines residence under the treaty. The exception applies to a U.S. citizen or an alien lawfully admitted for permanent residence in the United States (i.e., a “green card” holder). The exception requires that such a person must satisfy two conditions to be considered a resident of the United States under the treaty and thereby qualify for treaty benefits. First, the person must have a substantial presence, permanent home, or habitual abode in the United States. Second, the person must not be treated as a resident of a country other than Belgium under any tax treaty between Belgium and a third country. The U.S. Model treaty does not include this exception to the general residence rule, although recent treaties have included a similar exception.

The proposed treaty provides a special rule to treat as residents of a treaty country certain legal entities that generally are exempt from tax in that country. The provision applies to a pension fund, which is any person established in a treaty country that (1) is operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements, and (2)(a) in the case of Belgium, is an entity organized under Belgian law and regulated by the Bank Finance and Insurance Commission, or (b) in the case of the

United States, is generally exempt from U.S. income taxation with respect to the above-described activities. The provision also applies to a tax-exempt entity organized under the laws of a treaty country and established and maintained in that country (1) to provide pensions or other similar retirement benefits pursuant to a plan, or (2) exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes.

The proposed treaty provides a series of tie-breaker rules 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. These tie-breaker rules are to be applied in the order in which they are described below. 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 (that is, the individual's "center of vital interests"). If it cannot be determined in which country the individual has his or her center of vital interests, the individual is deemed to be a resident of the country in which he or she has an habitual abode. If the individual has an habitual abode in both countries or in neither country, the individual is deemed to be a resident of the country of which he or she is a national. If the individual is a national of both countries or of neither country, the competent authorities of the countries will endeavor to settle the question of residence by mutual agreement.

The proposed treaty also provides a tie-breaker rule for persons other than individuals (e.g., companies, trusts, or estates). If, under the general residence rules described above, a person other than an individual is a resident of both countries, the proposed treaty requires the competent authorities to endeavor to settle the issue of residence by mutual agreement. If the competent authorities are unable to reach mutual agreement, then that person will not be entitled to claim any benefits provided by the proposed treaty, except those provided by paragraph 1 of Article 22 (Relief from Double Taxation), by paragraph 1 of Article 23 (Non-Discrimination), and by Article 24 (Mutual Agreement Procedure).

#### Fiscally Transparent Entities

The residence treatment of items of income, profit, or gain derived through fiscally transparent entities is addressed in paragraph 6 of Article 1 (General Scope) of the proposed treaty.

#### **Article 5. Permanent Establishment**

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

The permanent establishment concept is one of the basic devices used in income tax treaties to limit the taxing jurisdiction of the host country and thus to mitigate double taxation. Generally, an enterprise that is a resident of one country is not taxable by the other country on its business profits unless those profits are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine

whether the reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties apply, or whether those items of income will be taxed as business profits.

In general, under the proposed treaty, a permanent establishment is a fixed place of business in 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 other place of extraction of natural resources. It also includes a building site or a construction or assembly project if it lasts for more than twelve months, and includes a an installation used for the exploration for natural resources if it lasts or the activity continues in the treaty country for more than twelve months. 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.

The proposed treaty provides that 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; and (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. The proposed treaty also provides that 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 does not constitute a permanent establishment. The proposed treaty provides that a combination of these activities will not give rise to a permanent establishment, if the combination results in an overall activity that is of a preparatory or auxiliary character. This rule is consistent with the OECD and the U.S. Model treaties.

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 in such first country, 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 for that enterprise. This rule does not apply where the activities are limited to the preparatory and auxiliary activities described in the preceding paragraph.

No permanent establishment is deemed to arise, under the proposed treaty, 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, and that the relevant factors in making this determination include: (1) the extent to which the agent operates on the basis of instructions from the principal; (2) the extent to which the agent bears business risk; and (3) whether the agent has an exclusive or nearly exclusive relationship with the principal.

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 in and 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 governing gains from the sale of real property are included in Article 13 (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 that other country. This rule and, in general, the other rules of this article are consistent with the rules in the U.S. and OECD Model treaties.

The term “real property” generally has the meaning that it has under the law of the country in which the property in question is situated.<sup>12</sup> The proposed treaty provides that, regardless of internal law definitions, real property also includes property accessory to real property, including 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 and aircraft are not regarded as 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 permitting source-country taxation of income from real property also apply to the income from real property of an enterprise. This latter rule, according to the Technical Explanation, clarifies that the country in which real property is situated may tax the real property income of a resident of the other treaty country even if the income is not attributable to that resident’s permanent establishment in the source state. This rule is an exception to the general rule in Article 7 (Business Profits) that income is taxable in the source country only if it is attributable to a permanent establishment in that country.

The proposed treaty provides that a resident of one treaty country that derives real property income from the other treaty country may elect for any taxable year to be subject to net-basis taxation by that other country on the real property income as if the income were attributable to a permanent establishment in that other country. This election may be terminated with the consent of the competent authority of the country in which the real property is located.

The Technical Explanation notes that the proposed treaty does not grant an exclusive taxing right to the country in which the property is situated; that country is merely given the primary right to tax. The proposed treaty does not limit the rate or form of tax that the source country may impose other than that the source country must permit a net-basis taxation election.

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<sup>12</sup> In the case of the United States, according to the Technical Explanation, the term “real property” has the meaning given to it by Treas. Reg. sec. 1.897-1(b).

## **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) that is effectively connected with the conduct of a trade or business within the United States. The performance of personal services within the United States may constitute 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).

The income of a nonresident alien individual from the performance of personal services within 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.

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)).

### Belgium

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

### Proposed treaty limitations on internal law

Under the proposed treaty, business profits of an enterprise of a treaty country are taxable in the other treaty 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 rule is one of the basic treaty limitations on a country's right to tax income of a resident of the other country. The rule is similar to the rules found in the U.S. and OECD models.

Although the proposed treaty does not provide a definition of the term "business profits," the Technical Explanation states that the term is intended to cover income derived from any trade or business. As a result of the definitions of "enterprise" and "business" in Article 3, this definition includes income from independent personal services, which, unlike the present treaty but like the U.S. and OECD models, is not addressed in a separate article. Although the proposed treaty does not include a separate article for independent personal services, this article limits the right of a treaty country to tax income from the performance of personal services by a resident of the other treaty country in a manner similar to the limitations provided in the separate article applicable to independent personal services that is included in the present treaty.

The Technical Explanation discusses significant features of the definition of "business profits." First, the inclusion in the definition of income of an enterprise from personal services is consistent with the long-standing U.S. position that an enterprise's personal services income is business profits. Accordingly, a consulting firm resident in one treaty country whose employees perform services in the other treaty country through a permanent establishment may be taxed in that other country under Article 7 (and not under Article 14 (Income from Employment) because that article applies only to individuals). Second, the term "business profits" includes income attributable to notional principal contracts and other financial instruments to the extent that the income is attributable to a trade or business of dealing in such instruments or is otherwise related to a trade or business (as in the case of a notional principal contract entered into for the purpose of hedging currency risk arising from an active trade or business). Any other income derived from financial instruments is, according to the Technical Explanation, addressed in Article 22 (Other Income), unless specifically governed by another article.

The proposed treaty provides rules for the attribution of business profits to a permanent establishment. Under these rules, the treaty countries will attribute to a permanent establishment the business profits that the permanent establishment might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions. The proposed protocol to the proposed treaty makes clear that the principles of the OECD Transfer Pricing Guidelines will apply for purposes of determining the profits attributable to a permanent establishment, taking into account the different economic and legal circumstances of a single entity. The Technical Explanation notes that this rule incorporates the arm's length standard for purposes of determining the profits attributable to a permanent establishment.

In determining the amount of attributable profits, the permanent establishment shall be treated as having the same amount of capital that it would need to support its activities if it were a distinct and separate enterprise engaged in the same or similar activities. With respect to financial institutions other than insurance companies, a Contracting State may determine the amount of capital to be attributed to a permanent establishment by allocating the institution's total equity between its various offices on the basis of the proportion of the financial institution's risk-weighted assets attributable to each of them. In the case of an insurance company, there shall be attributed to a permanent establishment not only premiums earned through the permanent establishment, but that portion of the insurance company's overall investment income from reserves and surplus that supports the risks assumed by the permanent establishment

In the case of a permanent establishment to which a treaty country attributes additional capital because the permanent establishment is undercapitalized, the Technical Explanation states that U.S. internal law prescribes the method for making such an attribution of additional capital.<sup>13</sup> However, the Technical Explanation notes that U.S. internal law does not take into account the fact that some assets are more risky than other assets, and that an independent enterprise would require less capital to support a perfectly hedged U.S. Treasury security than it would to support an equity security or other asset with significant market and/or credit risk. Thus, U.S. internal law requires taxpayers in some cases to allocate more capital to the United States (and, thus, reduces the taxpayer's interest deduction) than is appropriate. To address these cases, the Technical Explanation states that the proposed treaty permits taxpayers to apply a more flexible approach that takes into account the relative risk of its assets in the various jurisdictions in which it conducts business. However, the Technical Explanation also states that taxpayers are permitted to apply U.S. internal law, rather than risk-weighted attribution, if U.S. internal law results in less U.S. taxable income in the taxpayer's particular circumstances.

In applying the arm's-length standard to determine the taxable business profits of a permanent establishment, the Technical Explanation observes that it is necessary to draw an economic (as well as legal) distinction between operating through a single legal entity rather than through separate legal entities. For example, an entity that operates through branches rather than separate subsidiaries will have lower capital requirements because all of the assets of the entity are available to support all of the entity's liabilities (with some exceptions attributable to local

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<sup>13</sup> See Treas. reg. sec. 1.882-5.

regulatory restrictions). Thus, most commercial banks and some insurance companies operate through branches rather than subsidiaries. While the benefit that comes from such lower capital costs must be allocated among the branches in an appropriate manner, this issue does not arise in the case of an enterprise that operates through separate entities because each entity must either be capitalized separately or compensate another entity for providing capital (e.g., through a guarantee).

The Technical Explanation states that, whereas U.S. internal law does not recognize inter-branch transactions because they do not have legal significance, the rule provided by the proposed protocol to the proposed treaty is that such internal dealings may be used to allocate income in cases where the dealings accurately reflect the allocation of risk within the enterprise. For example, in the case of global dealing in securities, many banks use internal swap transactions to transfer risk from one branch to a central location (e.g., a hedge center) where traders have the expertise to manage that particular type of risk. Under the proposed treaty, such banks also are permitted to use such swap transactions as a means of allocating income between or among the branches, provided the allocation method used by the bank complies with the transfer pricing rules of U.S. internal law. However, the books of a branch will not be respected if the results are inconsistent with a functional analysis. For example, income from a transaction that is booked in a particular branch (or home office) would not be allocated to that location if the sales and risk management functions that generate such income are performed in another location.

The proposed treaty provides that in computing taxable business profits of a permanent establishment, deductions are allowed for expenses, wherever incurred, that are for the purposes of the permanent establishment. These deductions include executive and general administrative expenses so incurred. The Technical Explanation states that deductions are allowed regardless of which accounting unit of the enterprise books the expenses, so long as the expenses are incurred for the purposes of the permanent establishment; the amount of expense that must be allowed as a deduction is determined by applying the arm's length principle. The Technical Explanation states that a permanent establishment may deduct payments made to its head office or another branch in compensation for services performed for the benefit of the branch, provided the deduction comports to the arm's-length standard. The method for computing the amount of such a deduction would depend upon the terms of the arrangements between the branches and head office.

Like the U.S. and OECD Model treaties, the proposed treaty provides that 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 of which it is a part. According to the Technical Explanation, this rule applies only to an office that performs functions in addition to purchasing because purchasing does not by itself give rise to a permanent establishment under Article 5 (Permanent Establishment) to which income can be attributed. When it applies, the rule provides that business profits may be attributable to a permanent establishment for its non-purchasing activities (e.g., sales activities), but not for its purchasing activities.

The proposed treaty requires that the determination of the business profits of a permanent establishment be made using the same method year by year unless there is a good and sufficient reason to the contrary.

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, generally govern the treatment of those items of income. Thus, for example, the taxation of dividends is determined under the rules of Article 10 (Dividends), and not by the rules of Article 7 (Business Profits), except as specifically provided in Article 10 (that is, when dividends are attributable to a permanent establishment or a fixed base).

The proposed treaty provides that, for purposes of the taxation of business profits, income may be attributable to a permanent establishment (and therefore may be taxable in the source country) even if the payment of the income is deferred until after the permanent establishment or fixed base has ceased to exist. This rule incorporates into the proposed treaty the rule of Code section 864(c)(6) described above. This rule applies in the implementation of the rules for business profits (Article 7), dividends (Article 10, paragraph 8), interest (Article 11, paragraph 4), royalties (Article 12, paragraph 3), gains (Article 13) and other income (Article 20).

The Technical Explanation notes that Article 7 is subject to the savings clause of paragraph 4 of Article 1 (General Scope). Thus, in the case of the savings clause, if a U.S. citizen who is a resident of Belgium derives business profits from the United States that are not attributable to a permanent establishment in the United States, the United States may, subject to the special foreign tax credit rules of paragraph 4 of Article 22 (Relief from Double Taxation), tax those profits, notwithstanding that paragraph 1 of this article would exempt the income from U.S. tax.

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

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

The United States generally taxes the U.S.-source income of a foreign person from the operation of ships or aircraft to or from the United States. An exemption from U.S. tax is provided if the income is earned by a corporation that is organized in, or an alien individual who is resident in, a foreign country that grants an equivalent exemption to U.S. corporations and residents. The United States has entered into agreements providing such reciprocal exemptions with a number of countries, including Belgium.<sup>14</sup>

Like the present treaty, the proposed treaty provides that profits that 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

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<sup>14</sup> See Taxation: Shipping and Aircraft Agreement, effected by exchange of notes between the United States and Belgium, dated October 14, 1987 and March 21, 1988.

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

The proposed treaty provides that profits from the operation of ships or aircraft in international traffic include (but are not limited to) profits from the rental of ships or aircraft on a full (time or voyage) basis (i.e., with crew). Like the U.S. Model treaty, it also includes profits from the rental of ships or aircraft on a bareboat basis (i.e., without crew), either when such rental income is incidental to the profits from the operation of ships or aircraft in international traffic, or when the ships or aircraft are operated in international traffic by the lessee.

The proposed treaty provides that 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 (and, thus, governed by this Article) if such transport is undertaken as part of international traffic by the enterprise. For example, if a Belgian enterprise contracts to carry property from the United States to Belgium and, as part of the contract, it transports (or contracts to transport) the property by truck from its point of origin to an airport in the United States, the income earned by the Belgian enterprise from the overland leg of the journey would be taxable only in Belgium. Similarly, the Technical Explanation states that Article 8 would also apply to income from lightering undertaken as part of the international transport of goods.

As under the U.S. Model treaty, the proposed treaty provides that profits of an enterprise of a treaty country from the use, maintenance, or rental of containers (including trailers, barges, and related equipment for the transport of containers) are taxable only in that treaty country, except to the extent such containers are used for transport solely between places within the other treaty country.

As under the U.S. Model treaty, the shipping and air transport provisions of the proposed treaty apply to profits derived 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.

The Technical Explanation notes that this article is subject to the savings clause of paragraph 4 of Article 1 (General Scope), as well as Article 23 (Limitation on Benefits).

## **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 that differ from those that would be made between independent enterprises. In such a case, a country may allocate to such an enterprise the profits that it would have accrued but for the conditions so imposed. This treatment is consistent with the U.S. Model treaty.

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 the enterprises' 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, and the other country agrees with that redetermination, then that other country will make an appropriate adjustment to the amount of tax paid in that country on the redetermined income. In making such adjustment, due regard is to be given to other provisions of the proposed treaty. 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. However, the Technical Explanation states that statutory or procedural limitations cannot be overridden to impose additional tax because paragraph 2 of Article 1 (General Scope) provides that the proposed treaty cannot restrict any statutory benefit.

## **Article 10. Dividends**

### Overview

The dividends article of the proposed treaty generally allows full residence-country taxation and limited source-country taxation of dividends. The proposed treaty includes a generally applicable maximum rate of withholding at source of 15 percent and a reduced five-percent maximum rate for dividends received by a company owning at least 10 percent of the dividend-paying company. Like several other recent treaties and protocols, however, the proposed treaty provides for a zero rate of withholding tax on certain dividends received by a parent company from a subsidiary that is at least 80-percent owned by the parent. The zero-rate provision is broader than the provision in other recent treaties because the required ownership threshold is reduced to 10 percent for dividends paid by a company that is a resident of Belgium. (Certain other requirements described below also must be satisfied.) A zero rate also generally applies to dividends received by pension funds. Special rules apply to dividends received from RICs and REITs. These special rules are similar to provisions included in other recent treaties and protocols.

### 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 that case, the foreign recipient is subject to U.S. tax on the dividends on a net basis at graduated rates in the same manner in which 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 from current or accumulated earnings and profits.

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 REIT is a U.S. domestic 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. To qualify for the deduction for dividends paid, a REIT must distribute most of its income. As a result of the deduction for dividends paid, a REIT generally does not pay Federal income tax. Except for capital gain dividends, a distribution of REIT earnings is generally treated by the recipient as a dividend rather than as income of the same type as the underlying earnings.<sup>15</sup> This distribution is subject to the U.S. 30-percent withholding tax when paid to foreign owners. However, the receipt of a distribution from a REIT is generally treated as a disposition of a U.S. real property interest by the recipient to the extent that it is attributable to a sale or exchange of a U.S. real property interest by the REIT.<sup>16</sup>

A REIT generally is organized to allow investment in primarily passive real estate investments. As such, income of a REIT often includes rentals from real estate holdings or interest from loans secured by real estate mortgages. 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 the 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. When rental income (or interest income) of a REIT is distributed to a foreign shareholder as a REIT dividend, it is treated as a dividend under U.S. internal law. U.S.-source interest income of foreign persons is not subject to U.S. withholding tax in certain circumstances. A REIT dividend does not, however, pass through interest characterization of the REIT's underlying earnings.

U.S. internal law also generally treats a RIC as both a corporation and as an entity not subject to corporate tax to the extent it distributes substantially all of its income. The purpose of a RIC is to allow investors to hold diversified portfolios of securities. Dividends paid by a RIC generally are treated as dividends received by the payee, and the RIC generally pays no tax

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<sup>15</sup> Because a REIT generally does not pay corporate level tax, certain U.S. benefits of dividend treatment are not available. A U.S. corporate shareholder is not generally entitled to a dividends-received deduction for REIT dividends. REIT dividends generally are not qualified dividends eligible for the 15-percent rate available for individual shareholders.

<sup>16</sup> There is an exception for distributions to a shareholder that owns five percent or less of the REIT, if the REIT stock is regularly traded on an established securities market located in the United States. Sec. 897(h)(1). These distributions are treated as dividends under U.S. internal law.

because it is permitted to deduct dividends paid to its shareholders in computing its taxable income. However, a RIC generally may pass through to its shareholders the character of its net long-term and, before January 1, 2008, net short-term capital gains by designating a dividend it pays as a long-term or short-term capital gain dividend, to the extent that the RIC has net capital gains. Nonresident aliens and foreign corporations generally are not subject to tax on capital gains. A distribution before January 1, 2008 to a nonresident alien or foreign corporation made by a RIC that is (or, if certain exceptions were disregarded, would be) a U.S. real property holding corporation, however, is treated as gain recognized by that nonresident alien or foreign corporation from the sale or exchange of a U.S. real property interest to the extent the gain is attributable to gain from sales or exchanges of U.S. real property interests.<sup>17</sup>

Similarly, a RIC that earns interest income that would not be subject to U.S. tax if earned by a foreign person directly (“qualified interest income”)<sup>18</sup> generally may designate a dividend it pays before January 1, 2008 as derived from that interest income, to the extent of that income. Nonresident aliens and foreign corporations are not subject to tax on interest-related dividends. The aggregate amount that may be designated by a RIC as interest-related dividends generally is limited to the sum of qualified interest income less the amount of expenses of the RIC properly allocable to the interest income.

### Belgium

Dividends paid by Belgian resident companies to nonresident individuals and companies generally are subject to withholding tax at a 25-percent rate.

### Proposed treaty limitations on internal law

#### In general

Under the proposed treaty, dividends paid by a company that is a resident of a treaty country to a resident of the other country may be taxed in that other country. The dividends also may be taxed by the country in which the payor company is resident, but the rate of tax is limited. Under the proposed treaty, source-country taxation of dividends (that is, taxation by the country in which the dividend-paying company is resident) generally is limited to 15 percent of the gross amount of the dividends paid to residents of the other treaty country. A lower rate of

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<sup>17</sup> The exception described in the immediately preceding footnote also applies for distributions by RICs.

<sup>18</sup> Qualified interest income of the RIC is equal to the sum of its U.S.-source income with respect to: (1) bank deposit interest; (2) short term original issue discount that is currently exempt from the gross-basis tax under section 871; (3) any interest (including amounts recognized as ordinary income in respect of original issue discount, market discount, or acquisition discount under the provisions of sections 1271-1288, and such other amounts as regulations may provide) on an obligation that is in registered form, unless it is earned on an obligation issued by a corporation or partnership in which the RIC is a 10-percent shareholder or is contingent interest not treated as portfolio interest under section 871(h)(4); and (4) any interest-related dividend from another RIC.



five percent applies if the beneficial owner of the dividends is a company that owns directly at least 10 percent of the voting stock of the dividend-paying company.

The term “beneficial owner” is not defined in the proposed treaty and therefore is defined under the internal law of the country imposing tax (that is, the source country). The Technical Explanation states that the beneficial owner of a dividend for purposes of this article is the person to which the dividend income is attributable for tax purposes under the laws of the source country. Further, companies holding shares through fiscally transparent entities, such as partnerships, are considered to hold their proportionate interests in those shares.

The proposed treaty provides a zero rate of withholding tax for certain intercompany dividends in cases in which there is a sufficiently high (80-percent for U.S. resident payors; 10-percent for payors resident in Belgium) level of ownership (often referred to as “direct dividends”). A zero rate also applies for dividends received by a pension fund, provided that the dividends are not derived from the carrying on of a business by the fund or through an associated enterprise.

#### Zero rate for direct dividends

Under the proposed treaty, the withholding tax rate generally is zero for certain direct dividends. The requirements for the zero rate differ based on whether the dividend-paying company is a resident of the United States or of Belgium. If the company paying the dividend is a resident of the United States, the zero rate is available only if the beneficial owner of the dividend is a Belgian resident company that has owned directly or indirectly shares representing at least 80 percent of the dividend-paying company’s voting power for the 12-month period ending on the date on which entitlement to the dividend is determined. If the company paying the dividend is a resident of Belgium, the zero rate is available only if the beneficial owner of the dividend is a U.S. resident company that has owned directly shares representing at least 10 percent of the capital of the dividend-paying company for a 12-month period ending on the date the dividend is declared.

Eligibility for the benefits of the zero rate for dividends paid by a company that is resident of the United States is subject to a more stringent set of limitation-on-benefits requirements than the requirements that normally apply under the proposed treaty. Specifically, in order to qualify for the zero rate, a dividend-receiving company that is a resident of Belgium must (1) satisfy the public trading test of the limitation-on-benefits article; (2) meet the ownership and base erosion test and satisfy the active trade or business conditions of the limitation-on-benefits article with respect to the dividend in question; (3) satisfy the derivative benefits test of the limitation-on-benefits article; or (4) receive a favorable determination from the competent authority with respect to the zero-rate provision.

The Technical Explanation states that these additional restrictions are intended to prevent companies from reorganizing to become eligible for the zero rate. As an example, the Technical Explanation describes a situation in which a company resident in a third country that does not have a zero-rate treaty provision with the United States might contribute the stock of a wholly owned U.S. subsidiary to a wholly owned Belgian subsidiary to secure the benefit of the zero rate on a dividend from the U.S. subsidiary. In that case, the Technical Explanation explains that

treaty shopping could occur notwithstanding the Belgian company's satisfaction of the active trade or business test with respect to the dividend. For this reason, the proposed protocol does not allow the benefits of the zero rate to be claimed by a company that meets only the active trade or business test of the limitation-on-benefits article.

The Technical Explanation notes that, in the case of a Belgian company that receives dividends from a U.S. subsidiary, the derivative benefits test might be satisfied if the Belgian company is wholly owned, for example, by a publicly traded company resident in a European Union ("EU"), European Economic Area ("EEA"), or North American Free Trade Agreement ("NAFTA") country with which the United States has a zero-rate treaty provision.<sup>19</sup>

The proposed treaty lacks a rule that is included in the proposed protocols with Denmark, Finland, and Germany and in other recent treaties and that modifies the application of the derivative benefits test under the zero-rate provisions of those protocols and treaties. That rule provides generally that in determining whether a shareholder of a dividend-receiving company is an equivalent beneficiary, the shareholder is treated as owning shares in the dividend-paying company with the same percentage voting power as the shares held by the dividend-receiving company. According to the Technical Explanations of the proposed protocols with Denmark, Finland, and Germany, this rule is intended to ensure that certain joint ventures, and not just wholly-owned subsidiaries, are eligible for the benefits of the zero rate. Treasury Department personnel have stated that following ratification of the proposed treaty, Belgian and U.S. officials will exchange letters memorializing their shared understanding that in applying the derivative benefits test to a circumstance in which dividends are paid by a U.S. company to a Belgian company, each person that owns, directly or indirectly, shares in the Belgian company will be treated as owning the same voting power in the U.S. company as the Belgian company owns in that U.S. company.

#### Dividends paid by U.S. RICs and REITs

The proposed treaty generally denies the five-percent and zero rates of withholding tax to dividends paid by U.S. RICs and REITs.

The 15-percent rate of withholding generally is allowed for dividends paid by a RIC. The 15-percent rate of withholding is allowed for dividends paid by a REIT, provided one of three additional conditions is met: (1) the beneficial owner of the dividend is an individual or a pension fund, in either case holding an interest of not more than 10 percent in the REIT; (2) the dividend is paid with respect to a class of stock that is publicly traded, and the beneficial owner of the dividend is a person holding an interest of not more than five percent of any class of the REIT's stock; or (3) the beneficial owner of the dividend holds an interest in the REIT of not more than 10 percent, and the REIT is diversified (that is, the value of no single interest in real property held by the REIT exceeds 10 percent of the total interests of the REIT in real property).

The Technical Explanation indicates that the restrictions on availability of the lower rates are intended to prevent the use of RICs and REITs to gain inappropriate U.S. tax benefits. For

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<sup>19</sup> These countries currently are Mexico, the Netherlands, Sweden, and the United Kingdom.

example, a company resident in Belgium could directly own a diversified portfolio of U.S. corporate shares and pay a U.S. withholding tax of 15 percent on dividends on those shares. Absent the additional RIC restrictions, there is a concern that such a company instead might purchase 10 percent or more of the interests in a RIC, which could even be established as a mere conduit, and thereby obtain a lower withholding tax rate by holding the portfolio through the RIC (transforming portfolio dividends generally taxable at 15 percent into direct investment dividends taxable under the treaty at zero or five percent).

Similarly, the Technical Explanation provides an example of a resident of Belgium that directly holds real property and is required to pay U.S. tax either at a 30-percent rate on gross income or at graduated rates on the net income from the property. By placing the property in a REIT, the investor could transform real estate income into dividend income, taxable at the lower rates provided in the proposed treaty. The limitations on REIT dividend benefits are intended to protect against this result.

#### Definitions and special rules and limitations

The proposed treaty generally defines dividends as income from shares or other corporate participation rights that are not treated as debt, as well as other amounts that are subjected to the same tax treatment by the source country as income from shares (for example, constructive dividends).

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 holding in respect of which the dividends are paid is effectively connected with that permanent establishment. In this case, the dividends are taxed as business profits (Article 7).

The proposed treaty prevents each treaty country from imposing a tax on dividends paid by a resident of the other treaty country unless the dividends are paid to a resident of the first country or are attributable to a permanent establishment in that country.

The proposed treaty allows each treaty country to impose a branch profits tax on a company that has income attributable to a permanent establishment in that country, derives income from real property in that country that is taxed on a net basis under the treaty, or realizes gains taxable in that country under the treaty. In the case of the United States, the tax is limited to the "dividend equivalent amount," consistent with the branch profits tax under U.S. internal law (Code section 884). In the case of Belgium, the tax is limited to an amount that is analogous to the dividend equivalent amount. The rate of branch profits tax is generally limited to five percent, but a zero rate applies where limitation-on-benefits requirements parallel to those applicable to the zero-rate provision for dividends are satisfied.

The proposed treaty defines a pension fund as a person established in Belgium or the United States that is operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements and that is either, in the case of Belgium, an entity organized under Belgian law and regulated by the Bank Finance and Insurance Commission or, in the case of the United States, is exempt from tax in the United States with respect to its pension activities.

### Termination of zero rate for dividends paid by U.S. companies

The proposed treaty provides that the zero rate of withholding tax on dividends paid by U.S. resident companies will terminate for amounts paid or credited on or after January 1 of the sixth year following the year in which the proposed treaty enters into force unless by June 30 of the preceding year, the U.S. Treasury Secretary, on the basis of a report of the IRS Commissioner, certifies to the U.S. Senate that Belgium has satisfactorily complied with its obligations under Article 25 (Exchange of Information and Administrative Assistance).

The United States also may terminate the zero-rate provision for dividends paid by U.S. resident companies in another circumstance. Under the proposed treaty, if the United States determines that Belgium's actions under Article 24 (Mutual Agreement Procedure) and Article 25 (Exchange of Information and Administrative Assistance) have materially altered the balance of benefits of the proposed treaty, the United States may terminate the zero-rate provision for dividends paid by U.S. resident companies. To terminate the zero-rate provision, the United States must give written notice of termination to Belgium, through the diplomatic channel, on or before June 30 in any year. If the United States gives this notice, the zero-rate provision will cease to have effect for amounts paid or credited on or after January 1 of the year following the year in which the notice is given.

The Technical Explanation states that if the zero-rate provision for U.S.-source dividends terminates under the rules described above, Belgium will be relieved of certain obligations under Article 25 (Exchange of Information and Administrative Assistance) to provide information, including bank information. This rule is described in the discussion of Article 25 below.

### Relation to other Articles

The Technical Explanation notes that the saving clause of paragraph 4 of Article 1 of the treaty (Personal Scope) permits the United States to tax dividends received by its residents and citizens, subject to the special foreign tax credit rules of paragraph 4 of Article 22 (Relief from Double Taxation), as if the proposed treaty had not come into effect.

The benefits of the dividends article are also subject to the provisions of Article 21 of the treaty (Limitation on Benefits).

## **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.

### Belgium

Belgian-source interest payments to nonresidents generally are subject to withholding tax at a rate of 15 percent. However, tax is generally not required to be withheld on payments to nonresidents for interest from resident banks, interest on registered government bonds and loans, and interest on registered corporate bonds.

### Proposed treaty limitations on internal law

The proposed treaty generally exempts interest arising in one country (the source country) and beneficially owned by a resident of the other country from tax in the source country. This exemption from source country tax is similar to that provided in the U.S. model. The present treaty generally permits both treaty countries to tax interest derived from sources within the source country by a resident of the other treaty country, but limits the rate of tax imposed by the source country to not more than 15 percent.

The proposed treaty defines interest as income from debt claims of every kind, whether or not secured by 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 and debentures, including premiums or prizes attaching to such securities, bonds, or debentures. The term “interest” also includes all other income that is treated as income from money lent under the tax law of the country in which the income arises. Interest does not include income covered in Article 10 (Dividends). Penalty charges for late payment also are not treated as interest.

This exemption from source country tax does not apply if the beneficial owner of the interest carries on business through a permanent establishment in the source country and the interest paid is attributable to the permanent establishment. In that event, the interest is taxed as business profits (Article 7). Under Article 7, and as described in the Technical Explanation, interest attributable to a permanent establishment but received after the permanent establishment is no longer in existence is taxable in the country where the permanent establishment existed.

The proposed treaty provides that interest is generally considered to arise in a source country if paid by a resident of the source country. However, interest that is borne by a permanent establishment in a treaty country is considered to arise that country and not in the state of the payor's residence (if different). The Technical Explanation provides that interest is considered to be borne by a permanent establishment if it is allocable to taxable income of that permanent establishment, and is allowable as a deduction in computing taxable income.

The proposed treaty addresses the issue of non-arm's-length interest charges between related parties (or parties having an otherwise special relationship) by stating that this article applies only to the amount of arm's-length interest. Any amount of interest paid in excess of the arm's-length interest is taxable according to other provisions of the proposed treaty. For example, excess interest paid to a parent corporation may be treated as a dividend under local law and, thus, entitled to the benefits of Article 10 (Dividends). The proposed treaty does not address cases where the amount of interest paid is less than the amount of arm's-length interest. The Technical Explanation states that in those cases a transaction may be characterized to reflect its substance and interest may be imputed consistent with the definition of interest in this Article.

The proposed treaty provides two anti-abuse exceptions to the general source-country exemption from tax discussed above. The first exception relates to "contingent interest" payments. If interest is paid by a source-country resident and is determined with reference to (1) 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 laws. However, if the beneficial owner is a resident of the other country, such interest may not be taxed as a rate exceeding 15 percent (i.e., the rate prescribed in paragraph 2(b) of Article 10 (Dividends)). The proposed treaty provides that this anti-abuse rule will not apply to any interest solely because it is paid under an arrangement providing that the amount of interest payable will be reduced (or increased) in the event of improvements (or deteriorations) in the factors by reference to which the amount of interest payable. The Technical Explanation states that interest will not, for example, become contingent interest solely by virtue of a provision in an agreement that calls for an increase in the rate charged upon the deterioration of the credit position of the borrower.

The second anti-abuse exception provides that exemptions from source country tax do not apply to interest paid with respect to ownership interests in a vehicle used for the securitization of real estate mortgages or other assets, to the extent that the amount of interest paid exceeds the return on comparable debt instruments as specified by the domestic law of that country. The Technical Explanation states that this provision denies source country exemptions with respect to excess inclusions with respect to a residual interest in a REMIC. This provision, like the U.S.

model, is drafted reciprocally presumably to apply to similar Belgian securitization vehicles. 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 right to use intangible property in the United States.

#### Belgium

Royalties paid to nonresidents are generally subject to a 15-percent withholding rate.

### Proposed treaty limitations on internal law

The proposed treaty provides that royalties arising in a treaty country (the source country) and beneficially owned by a resident of the other treaty country is exempt from tax in the source country. This exemption from source country tax is similar to that provided in the U.S. Model treaty (except as noted below) and the present treaty.

The term "royalties" as used in Article 12 means payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work (including cinematographic films and computer software), any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial, or scientific experience. As in the 2006 U.S. Model treaty, the term no longer includes payments made as consideration for "any like right or property," thereby narrowing the scope of the term.

Unlike the provision in the U.S. Model treaty, the term "royalties" does not include contingent gain from the alienation of any right or property described above, that is, to the extent that the amount of such gain is contingent on the productivity, use, or disposition of the right or property. The treatment of such gain (as well as other gains from the alienation of such property) is addressed in Article 13 (Gains).

The Technical Explanation states that the term royalties does not include income from leasing personal property. The Technical Explanation further states that it is understood that a typical retail sale of "shrink wrap" computer software will not be considered as royalty income (even though for copyright law purposes it may be characterized as a license).

The exemption from source country tax does not apply if the beneficial owner of the royalties carries on a business through a permanent establishment in the source country, and the right or property with respect of which the royalties are paid is effectively connected with such permanent establishment. In that event, the royalties are taxed as business profits (Article 7). According to the Technical Explanation, royalties attributable to a permanent establishment but

received after the permanent establishment is no longer in existence is taxable in the country where the permanent establishment existed.

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 this article applies only to the amount of arm's-length royalties. Any amount of royalties paid in excess of the arm's-length interest is taxable according to 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, entitled to the benefits of Article 10 (Dividends).

## **Article 13. Gains**

### Internal taxation rules

#### United States

Generally, gain realized from the sale of a capital asset by a nonresident alien individual or a foreign corporation 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 sale by a nonresident alien individual, that individual is physically present in the United States for at least 183 days in the taxable year. A nonresident alien individual or foreign corporation generally 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 U.S. real property comprises at least 50 percent of the assets of the corporation.

#### Belgium

Belgian-source capital gains derived by nonresident individuals and companies generally are not subject to tax by Belgium. Capital gains from the sale of Belgian real property, however, may be taxed.

### Proposed treaty limitations on internal law

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

Under the proposed treaty, gains derived by a resident of one treaty country that are attributable to the alienation of real property situated in the other country may be taxed in that other country. The Technical Explanation states that the proposed treaty phrase "gains attributable to the alienation of real property" is used instead of the OECD Model treaty phrase "gains from the alienation" to clarify that the United States treats distributions made by a REIT and certain RICs as taxable under Article 13, not under Article 10 (Dividends), when those distributions are attributable to gains derived from the alienation of U.S. real property interests by the REIT or RIC.



For the purposes of this article, real property situated in the other treaty country includes real property referred to in Article 6 (Income from Real Property) – that is, an interest in the real property itself – and, in the case of the United States, a U.S. real property interest. Under U.S. internal law, a U.S. real property interest includes, among other property, shares in a U.S. corporation that owns sufficient U.S. real property interests to satisfy an asset-based test.

The proposed treaty includes a standard provision that permits a treaty country to tax gains from the alienation of movable property (that is, property other than real property) that forms a part of the business property of a permanent establishment that an enterprise of the other treaty country has in the first treaty country. This rule permits source-country taxation of gains from the alienation of the permanent establishment (alone or with the enterprise as a whole). According to the Technical Explanation, this taxation is permitted whether or not the permanent establishment exists at the time of alienation. Consequently, income that is attributable to a permanent establishment but that is deferred and is received after the permanent establishment no longer exists may nevertheless be taxed in the treaty country in which the permanent establishment was located. This rule is similar to a rule in U.S. internal law.

The Technical Explanation notes that a resident of Belgium that is a partner in a partnership doing business in the United States generally will have a permanent establishment in the United States as a result of the activities of the partnership. Under the proposed treaty, the United States may tax the partner's distributive share of income realized by the partnership on the disposition of movable property forming part of the partnership's business property in the United States.

The proposed treaty provides that gains derived by an enterprise of one treaty country from the alienation of ships or aircraft operated in international traffic or of personal property related to the operation of the ships or aircraft are taxable only in that country. This rule applies even if the gains are attributable to a permanent establishment maintained by the enterprise in the other treaty country.

Similarly, gains derived by an enterprise of a treaty country from the alienation of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise are taxable only in that country unless those containers or trailers and related equipment are used for transport solely between places in the other treaty country. The general rule of exclusive residence country taxation applies even if the gains are attributable to a permanent establishment in the other treaty country.

Gain from the alienation of any property other than the property described above is taxable under the proposed treaty only in the country in which the person alienating the property is a resident.

The Technical Explanation states that the saving clause of paragraph 4 of Article 1 (General Scope) permits the United States to tax its citizens and residents as if the proposed treaty had not come into effect. The Technical Explanation also notes that the benefits of this Article 13 are available only to a treaty country resident that satisfies one of the conditions in Article 21 (Limitation on Benefits).

## **Article 14. Income from Employment**

Under the proposed treaty, salaries, wages, and other similar remuneration derived from services performed as an employee in one treaty country (the source country) by a resident of the other treaty country are taxable only by the country of residence if three requirements are met: (1) the individual is present in the source country for not more than 183 days in any twelve-month period commencing or ending in the taxable year or year of assessment concerned; (2) the individual is paid by, or on behalf of, an employer who is not a resident of the source country; and (3) the remuneration is not borne by a permanent establishment of the employer in the source country. These limitations on source country taxation are similar to the rules of the U.S. and OECD Model treaties.

The proposed treaty contains a special rule that permits remuneration derived by a resident of one treaty country with respect to employment as a regular member of the crew of a ship or aircraft operated in international traffic by an enterprise of the other treaty country to be taxed only in the first treaty country. A similar rule is included in the U.S. and OECD Model treaties. U.S. internal law does not impose tax on such income of a person who is neither a citizen nor a resident of the United States, even if the person is employed by a U.S. entity.

The proposed protocol to the proposed treaty expressly provides that, where remuneration is derived by a resident of one of the States in respect of an employment, employment is exercised in the place where the employee is physically present when performing the activities for which the remuneration is paid, irrespective of the residence of the payer, the place in which the contract of employment was made, the residence of the employer, the place or time of payment, or the place where the results of the work were exploited.

This article is subject to the provisions of the separate articles covering directors' fees (Article 15), pensions, social security, annuities, alimony, and child support payments (Article 17), government service (Article 19), and students, trainees, teachers and researchers (Article 19).

## **Article 15. Directors' Fees**

Under the proposed treaty, director's fees and other similar payments derived by a resident of one country for services rendered in the other country in his or her capacity as a member of the board of directors of a company that is a resident of that other country is taxable in that other country. Under the proposed treaty, as under the U.S. Model treaty, the country of the company's residence may tax the remuneration of nonresident directors, but only with respect to remuneration for services performed in that country.

The proposed protocol elaborates on Article 15 in several ways. First, the proposed protocol states that the article also applies to fees received by a "*gerant*" / "*zaakvoerder*" of a company, other than a company with share capital, in his or her capacity as such. Second, the proposed protocol states that remuneration derived by a person referred to in Article 15 from a company that is a resident of treaty country in respect of the discharge of day-to-day functions of a managerial or technical, commercial or financial nature is taxable in accordance with the provisions of Article 14 (Income from Employment) and not Article 15; to the extent that the

company is a Belgian company, Article 14 is applied as if such remuneration were remuneration derived by an employee in respect of employment and as if references to the “employer” were references to the company. Third, the proposed protocol states that remuneration received by a resident of a treaty country in respect of his or her day-to-day activity as a partner of a company that is a resident of Belgium, other than a company with share capital, is taxable in accordance with the provisions of Article 14, as if such remuneration were remuneration derived by an employee in respect of employment and as if references to the “employer” were references to the company. Finally, the proposed protocol states that Article 7 (Business Profits), and not Article 14 or 15, applies to a partner’s distributive share of the income of an entity that is treated as fiscally transparent, such as a U.S. partnership.

### **Article 16. Entertainers and Sportsmen**

Like the U.S. and OECD Model treaties, 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. The article applies both to the income of an entertainer or sportsman who performs services on his own behalf and one who performs services on behalf of another person, either as an employee of that person, or pursuant to any other arrangement. These rules apply notwithstanding the other provisions of the proposed treaty dealing with the taxation of business profits and income from employment (Articles 7 and 14) 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. This article applies only with respect to the income of entertainers and sportsmen. Others involved in a performance or athletic event, such as producers, directors, technicians, managers, coaches, etc., remain subject to the provisions of Articles 7 (Business Profits) and 14 (Income from Employment). In addition, except as provided in paragraph 2 of this article, income earned by legal persons is not covered by this article.

Under paragraph 1 of Article 16 of the proposed treaty, income derived by an entertainer or sportsman who is a resident of one country from his or her personal activities as such in the other country may be taxed in the other country if the amount of the gross receipts derived by him or her from such activities exceeds \$20,000 or its equivalent in euro for the taxable year. The \$20,000 threshold includes expenses that are reimbursed to the entertainer or sportsman or borne on his or her behalf. Under this rule, if a Belgian entertainer does not have a permanent establishment in the United States and performs (as an independent contractor) in the United States for total compensation of \$19,000 during a taxable year, the United States would not tax that income. If, however, that entertainer’s total compensation were \$21,000, the full amount would be subject to U.S. tax. On the other hand, if such an entertainer earned \$19,000 during a taxable year in the United States, but that income is attributable to a U.S. permanent establishment, the United States could tax him under the provisions of Article 7 (Business Profits). The proposed treaty’s taxation threshold of \$20,000 is the same as the U.S. Model treaty’s threshold.

As described in the Technical Explanation, Article 16 of the proposed treaty applies to all income connected with a performance by the entertainer, such as appearance fees, award or prize money, and a share of the gate receipts. Income derived from a treaty country by a performer who is a resident of the other treaty country from other than actual performance, such as royalties

from record sales and payments for product endorsements, is not covered by this article, but is covered by other articles, such as Article 12 (Royalties) or Article 7 (Business Profits). For example, if an entertainer receives royalty income from the sale of live recordings, the royalty income would be subject to source-country tax under Article 12 if the requirements of that article are met. In addition, the entertainer would be taxed under this article by the source country with respect to income from the performance itself if the dollar threshold is exceeded.

The Technical Explanation states that if an individual fulfills a dual role as performer and nonperformer (such as a player-coach or an actor-director), but his role in one of the two capacities is negligible, the predominant character of the individual's activities should control the characterization of those activities. In other cases there should be an apportionment between the performance-related compensation and other compensation.

Consistent with Article 14 (Income from Employment), Article 16 also applies regardless of the timing of actual payment for services. Thus, a bonus paid to a resident of a treaty country with respect to a performance in the other country occurring in a particular taxable year would be subject to Article 16 even if it was paid after the close of the year.

Paragraph 2 of this article provides that where income in respect of activities performed by an entertainer or sportsman in his or her capacity as such accrues not to the entertainer or sportsman but to another person, that other person's income may be taxable in the country in which the activities are performed, notwithstanding the provisions of Articles 7 (Business Profits) and 14 (Income from Employment). However, paragraph 2 applies only if the contract pursuant to which the personal activities are performed designates the entertainer or sportsman or allows someone other than the entertainer or sportsman or the person to whom the income accrues to designate the individual who is to perform the personal activities.<sup>20</sup> This provision is intended to prevent 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 personal holding company (a "star company") located in the residence country that does not have a permanent establishment in the source country. At the same time, the provision is intended to protect a performer's rights under the treaty when there is a legitimate employer-employee relationship between the performer and the person providing his or her services. If the star company is not a resident of the United States or Belgium, then the treaty (and this provision) does not apply. If the star company passes the residency threshold, however, this provision applies notwithstanding the articles governing business profits and income from employment (Articles 7 and 14). The effect of this provision is that the star company may be taxed in the treaty country in which the performer's services are exercised. The income taxable by virtue of this paragraph is reduced to the extent of salary payments taxed to the performer.

This article is subject to the provisions of the saving clause of paragraph 4 of Article 1 (General Scope). Thus, if an entertainer or sportsman who is resident of Belgium is a citizen of

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<sup>20</sup> This rule is based on the U.S. domestic law provision characterizing income from certain personal service contracts as foreign personal holding company income in the context of the foreign personal holding company provisions. *See* sec. 954(c)(1)(I).

the United States, the United States may tax all of his income from performances in the United States without regard to the provisions of this article, subject, however, to the special foreign tax credit provisions of paragraph 4 of Article 22 (Relief from Double Taxation). In addition, the benefits of this article are subject to the provisions of Article 21 (Limitation on Benefits).

### **Article 17. Pensions, Social Security, Annuities, Alimony, and Child Support**

This article deals with the taxation of private pensions and annuities, social security benefits, alimony, child support payments, and pension funds. This article does not cover payments of government pensions covered under Article 18 (Government Service), but covers government pension funds, as well as private pension funds.

#### Pensions

Under the proposed treaty, pensions and other similar remuneration derived and beneficially owned by a resident of either country is taxable only in the recipient's country of residence. The proposed treaty also requires the individual's country of residence not to tax the portion of pension income arising in the other country to the extent such income would have been exempt if the beneficiary were a resident of the other country. According to the Technical Explanation, the term "pensions and other similar remuneration" includes both periodic and lump sum payments. These rules are the same as those in the U.S. Model treaty.

The phrase "pensions and other similar remuneration" is intended to encompass payments made by qualified private retirement plans. According to the Technical Explanation, in the United States, the plans encompassed by Paragraph 1 include: 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 and section 408(p) accounts), section 403(a) qualified annuity plans, and section 403(b) plans. Distributions from section 457 plans may also fall under Paragraph 1 if they are not paid with respect to government services covered by Article 18. However, pensions in respect of government services covered by Article 18 are not covered by this paragraph. They are covered either by paragraph 2 of this Article, if they are in the form of social security benefits, or by paragraph 2 of Article 18 (Government Service). Thus, Article 18 generally covers section 457, 401(a), 403(b) plans established for government employees, and the Thrift Savings Plan (section 7701(j)).

#### Social security benefits

The proposed treaty, like the present treaty and the U.S. Model treaty, provides for exclusive source-country taxation of payments made under provisions of social security or "similar legislation." This provision is an exception to the saving clause of paragraph 4 of Article 1 (General Scope) by virtue of subparagraph 5(a) of Article 1. Thus, only Belgium and not the United States, may tax Belgian social security benefits paid to a U.S. citizen. The provision under the proposed treaty applies to both private sector and government employees. Article 5 of the proposed protocol provides that the term "similar legislation" is intended to refer to United States tier 1 Railroad Retirement benefits.

## Annuities

The proposed treaty also provides that annuities (other than those paid for services rendered) derived and beneficially owned by a resident of either country are taxable only in the recipient's country of residence. This is similar to the rule in the U.S. Model treaty. The term "annuities" is defined for purposes of this provision as a stated sum paid periodically at stated time during a specified number of years, or for life, under an obligation to make the payments in return for adequate and full consideration (other than services rendered). The Technical Explanation states that an annuity received in consideration for services rendered would be treated either as deferred compensation and generally taxable in accordance with Article 14 (Income from Employment) or as a pension subject to the pension rules of this article.

## Alimony and child support

The proposed treaty addresses the treatment of alimony and child support payments. Both are generally defined as certain periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support. If the payment is taxable to the recipient under the laws of the treaty country of which he or she is a resident, it is a payment of alimony. If not, it is a payment of child support. Under the proposed treaty, alimony paid by a resident of a treaty country to a resident of the other treaty country is taxable only in the country in which the recipient is a resident. This rule is the same as under the U.S. Model treaty. Child support payments, however, are taxable only in the resident country of the payor. The U.S. Model treaty provides that child support payments are exempt from tax in both treaty countries.

## Pension fund income

### In general

Article 17 also deals with cross-border pension contributions and taxation of pension funds. It is intended to remove barriers to the flow of personal services between the two countries that could otherwise result from discontinuities under the laws of each country regarding the deductibility of pension contributions and the taxation of a pension fund's earnings and accretions in value. These rules are similar to new rules that were recently added to the corresponding articles of the Netherlands and United Kingdom treaties, and the proposed U.S.-Belgium treaty; the proposed rules are also similar to the rules of Article 18 of the U.S. Model treaty.

The term "pension fund" is defined in paragraph 1(k) of Article 3 (General Definitions) and means any person established in a treaty country that (1) is operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements, and (2)(a) in the case of Belgium, is an entity organized under Belgian law and regulated by the Bank Finance and Insurance Commission, or (b) in the case of the United States, is generally exempt from U.S. income taxation with respect to the above-described activities.

The proposed treaty provides that neither country may tax a resident on pension income earned through a pension fund that is a resident of the other country until such income is distributed. When a resident receives a distribution from a pension fund, such distribution is

subject to taxation in accordance with the provisions of Article 17 (or if relevant, Article 18). For example, if a U.S. citizen contributes to a U.S. qualified plan while working in the United States and then establishes residence in Belgium, Belgium is prevented from taxing currently that fund's earnings and accretions with respect to that individual. For purposes of this provision, rollovers to another pension fund in the same country are not treated as distributions.

#### Cross-border employment

Under the proposed treaty, as under the U.S. Model treaty, if an individual who is a member or beneficiary of, or participant in, a pension fund established under the law of one treaty country performs personal services in the other country, or in a similar fund that is a resident of a comparable third country, whether or not the individual is resident in that other country, contributions made by or on behalf of the individual to the plan during the period he or she performs such personal services are deductible in computing his or her taxable income in the other country. Similarly, contributions made to the plan by or on behalf of his or her employer during such period, and benefits accrued under the plan, are not treated as part of his or her taxable income, and such contributions are allowed as a deduction in computing the employer's profits in the other country. For example, if a participant in a U.S. qualified plan goes to work in Belgium for a period of time, contributions made by the participant and his or her employer during that period are not included in the participant's income in Belgium, and the employer may deduct its contributions from its business profits in Belgium. The relief provided under these rules by the other country will not exceed the relief that would be allowed by that country to its residents for contributions to, or benefits accrued under, a pension plan established in that country, in the case of the United States, or recognized for tax purposes in that country, in the case of Belgium.

The rules of the immediately preceding paragraph apply only if the following three conditions apply: (a) contributions by or on behalf of the individual, or by or on behalf of the individual's employer were made under the pension plan or under a similar pension plan for which the first pension plan was substituted) before he or she began to exercise employment or self-employment in the other country; (b) the individual has performed personal services in the other treaty country for a cumulative period not exceeding ten calendar years; and (c) the competent authority of the other country has agreed that the pension plan "generally corresponds" to a pension plan recognized for tax purposes by that country. Conditions (a) and (c) above are found in the U.S. Model treaty. The rationale for condition (b), which is not found in the U.S. Model treaty, is that a host country should not be required to grant benefits under the immediately preceding paragraph in cases of very long visits to the host country.

For purposes of condition (c) above, the U.S. pension funds eligible for these benefits (i.e., that generally correspond to a pension plan recognized for tax purposes in Belgium) include 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, section 403(b) plans, section 457(b) plans, and the Thrift Savings Plan (section 7701(j)).

### U.S. citizens resident in Belgium

The proposed treaty also provides special rules applicable to certain U.S. citizens who are resident in Belgium. Under these rules, a U.S. citizen who is resident in Belgium may exclude or deduct for U.S. tax purposes contributions to a pension fund that is a resident of Belgium, or is a similar fund that is a resident of a comparable third country, provided such contributions are made during the period the U.S. citizen exercises taxable employment in Belgium and are attributable to such employment, and the contribution is borne by a Belgian employer or Belgian permanent establishment. Similarly, employer contributions to, or benefits accrued under, such a pension plan are not treated as part of the employee's taxable income in the United States.

The U.S. tax benefits under these rules of the immediately preceding paragraph are limited to the lesser of: (1) the amount of relief allowed for the contributions or benefits in Belgium; and (2) the amount of relief that would be allowed by the United States for contributions to, or benefits accrued under, a generally corresponding pension plan recognized for tax purposes in the United States.

To the extent relief is available to the individual under this provision, the contributions made to (and benefits accrued under) a pension plan recognized for tax purposes in Belgium are counted when determining the individual's eligibility for benefits and contribution limits under a generally corresponding pension plan established in the United States.

The benefits under these rules do not apply unless the U.S. competent authority has agreed that the pension plan generally corresponds to a pension plan recognized for tax purposes in the United States.

### Similar fund that is a resident of a comparable third country

For purposes of the rules relating to cross-border employment and the special rules relating to U.S. citizens resident in Belgium, a fund will be considered to be a similar fund that is a resident of a comparable third country if the fund is a resident of a country (other than a treaty country) that (1) is a member state of the European Union or any other European Economic Area country, is a party to the North American Free Trade Agreement, or is Switzerland; (2) provides, under a tax treaty or otherwise, comparable favorable treatment for contributions to a pension fund that is a resident of the treaty country providing benefits under one of these two sets of rules; and (3) has an information exchange provision in a tax treaty or other arrangement with the treaty country that is providing benefits under one of these two sets of rules, and such information exchange provision is satisfactory to such treaty country.

### Pension plan recognized for tax purposes in a treaty country

For purposes of the rules relating to cross-border employment and the special rules relating to U.S. citizens resident in Belgium, a pension plan is recognized for tax purposes in a treaty country if contributions to that plan would qualify for tax relief in that treaty country.



### Saving clause

Paragraphs 1(a), 3, and 4 of Article 17 are subject to the saving clause of paragraph 4 of Article 1 (General Scope). Thus, for example, a U.S. citizen who is a resident of Belgium and receives a pension, annuity, or alimony payment from the United States may be subject to U.S. tax on the payment, notwithstanding the rules in those three paragraphs that give the recipient's country of residence the exclusive taxing right. Paragraphs 1(b), 2, 5, 6, and 9 of Article 17 are excepted from the saving clause by virtue of subparagraph 5(a) of Article 1. Thus, the United States will not tax U.S. citizens and residents on the income described in those paragraphs even if such amounts otherwise would be subject to tax under U.S. law. Paragraph 7 of Article 17 is excepted from the saving clause by subparagraph 5(b) of Article 1, but only with respect to persons who are neither citizens of the host state nor admitted for permanent residence there. Accordingly, a person who becomes a U.S. citizen or permanent resident will no longer receive a deduction for contributions to a pension fund established in Belgium.

### Article 18. Government Service

Under paragraph 1 of Article 18 of the proposed treaty, remuneration, other than a pension, paid to an individual for services rendered to a treaty country (or political subdivision or local authority) is taxable only in that country. However, the remuneration is taxable only in the other country if the services are rendered there and the individual is a resident of that other country who is either a national of that other country or who did not become a resident of that other country solely for the purpose of rendering the services. According to the Technical Explanation, the provision applies to government employees and to independent contractors and employees of independent contractors engaged by governments to perform services for them.

Paragraph 2 covers any pension and other similar remuneration that is not in the form of social security benefits and is in respect of government service rendered to a treaty country (or subdivision or authority) by an individual. Such a pension is taxable only in that country. However, such a pension is taxable only in the other country if the individual is both a resident and a national of the other country. Pensions paid to retired civilian and military employees of the government of either country are intended to be covered under paragraph 2.

When benefits paid by a treaty country in respect of services rendered to that country (or subdivision or authority) are in the form of social security benefits, however, those payments are covered by paragraph 2 of Article 17 (Pensions, Social Security, Annuities, Alimony, and Child Support). As a general matter, the result will be the same whether Article 17 or 18 applies, since both social security benefits and government pensions are taxable exclusively by the source country. According to the Technical Explanation, the result differs only when the payment is made to a citizen and resident of the other country, who is not also a citizen of the paying country. In such a case, social security benefits continue to be taxable at source while government pensions are taxable only in the residence country.

The treatment of payments described in paragraphs 1 and 2 of this article are subject to the provisions of those paragraphs and not to those of Articles 14 (Income from Employment), 15 (Directors' Fees), 16 (Entertainers and Sportsmen) or, except as noted above for social security payments, 17 (Pensions, Social Security, Annuities, Alimony, and Child Support). If,

however, the remuneration or pension is paid for services performed in connection with a business carried on by a treaty country (or subdivision or authority), those other articles, and not this article, apply.

This article is generally not subject to the saving clause of the proposed treaty, Article 1, paragraph 4 (applicable to treaty country residents and its citizens). However, in the case of benefits conferred by the United States, the saving clause will apply to U.S. citizens and permanent residents. Thus, for example, a resident of Belgium who, in the course of rendering services to the government of Belgium, becomes a resident of the United States (but not a permanent resident) would be entitled to the exemption from taxation by the United States. In addition, an individual who receives a pension paid by the government of Belgium in respect of services rendered to that government is taxable on that pension only in Belgium unless the individual is a U.S. citizen or acquires a U.S. green card.

### **Article 19. Students, Trainees, Teachers and Researchers**

The proposed treaty modifies the present treaty to address the tax treatment of students, trainees, teachers, and researchers under one article.

#### **Students and business trainees**

The treatment provided to students and business trainees under the proposed treaty generally corresponds to the treatment provided under the present treaty and the U.S. Model treaty, with certain modifications, and is similar to the provision of the OECD Model treaty.

Under the proposed treaty, a student or business trainee who visits a treaty country (“host country”) and who is, or was immediately prior to visiting the host country, a resident of the other treaty country will be exempt from income tax in the host country on certain payments received if the purpose of the visit is to engage in full-time education or full-time training. The exempt payments are limited to those payments the individual may receive for his or her maintenance, education, or training as long as such payments are from sources outside the host country. In the case of business trainees, the exemption from income tax in the host country applies only for a period of two years from the time the visitor first arrives in the host country for training.

The proposed treaty provides students and business trainees with an exemption for income from personal services performed in the host country up to a total of \$9,000 U.S. dollars or its equivalent in euro annually. This amount will be adjusted every five years to take into account changes in the U.S. personal exemption and standard deduction and the Belgian basic allowance.

As similarly defined in the U.S. Model treaty, a business trainee is an individual who is in the host country temporarily either (1) for the purpose of securing training required to qualify the individual to practice a profession or professional specialty or (2) as an employee of, or under contract with, a resident of the other treaty country for the primary purpose of acquiring technical, professional, or business experience from a person other than that resident or a person related to such resident.

## Teachers and researchers

The treatment provided to teachers and researchers under the proposed treaty corresponds to the treatment provided under the present treaty, with certain modifications. Such a provision is not part of either the U.S. Model treaty or the OECD Model treaty.

Under the proposed treaty, an individual who visits a host country for the purpose of teaching or engaging in research at a university, college, school, or other educational or research institution, and who at the beginning of that visit is a resident of the other treaty country, generally is exempt from tax in the host country on any remuneration received for such teaching or research. Income from research undertaken not in the public interest but primarily for the private benefit of a specific person or persons, however, is not tax exempt. The exemption applies only for a period of two years from the time the visitor first arrives in the host country.

## **Article 20. 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 Belgium. As a general rule, items of income not otherwise “dealt with” in the proposed treaty 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.

In general, this rule 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. However, in determining whether an item of income is “dealt with” in another article (and therefore not subject to Article 20), its source may or may not be relevant, depending on the type of income. For example, profits derived in the conduct of a business are “dealt with” in Article 7 (Business Profits) whether or not they have their source in one of the treaty countries, so income sourced in a third country that is attributable to a permanent establishment of a Belgian resident in the United States is subject to Article 7 and not Article 20. In contrast, Article 11 (Interest) addresses only the taxation of interest arising in a treaty country. Interest arising in a third country that is not attributable to a permanent establishment is subject to Article 20.

According to the Technical Explanation, examples of types of items of income covered by Article 20 include income from gambling, punitive (but not compensatory) damages and covenants not to compete. Article 20 also applies to income from a variety of financial transactions, where such income does not arise in the course of the conduct of a trade or business. For example, income from notional principal contracts and other derivatives fall within Article 20 if derived by persons not engaged in the trade or business of dealing in such instruments, unless such instruments are being used to hedge risks arising in a trade or business.

The general rule stated above 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 situated therein, and the income is attributable to such permanent establishment. In such a case, the provisions of Article 7 (Business Profits) will apply.

This article is subject to the saving clause, so U.S. citizens who are residents of Belgium will continue to be taxable by the United States on income to which this article applies, including relevant third-country income.

## **Article 21. Limitation on Benefits**

### In general

Article 21 of the proposed treaty includes rules that are similar to the limitation-on-benefits provisions included in other recent U.S. income tax treaties and protocols. These rules are intended to prevent the indirect use of the treaty by persons who are not entitled to its benefits by reason of residence in Belgium or the United States.

The proposed treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and Belgium as they apply to residents of the two countries. At times, however, residents of third countries attempt to benefit from a treaty by engaging in treaty shopping. Treaty shopping by a third-country resident may involve organizing in a treaty country a corporation that is entitled to the benefits of the treaty. Alternatively, a third-country resident eligible for favorable treatment under the tax rules of its country of residency may attempt to reduce the income base of a treaty country resident by having that treaty country resident pay to it, directly or indirectly, interest, royalties, or other amounts that are deductible in the treaty country from which the payments are made. Limitation-on-benefits provisions are intended to deny treaty benefits in certain cases of treaty shopping or income stripping engaged in by third-country residents.

Generally, a resident of either treaty country is entitled to all the benefits accorded by the proposed treaty if the resident has any one of six listed attributes. The six attributes are that the resident is (1) an individual; (2) one of the two treaty countries or a political subdivision or local authority of one of the two countries; (3) a company that satisfies a public company test or that is a subsidiary of a public company; (4) a pension fund that satisfies a beneficiaries test or a sponsor test; (5) an organization that is established and maintained in its country of residence exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes, even if all or part of its income or gains are exempt from tax under the residence country's domestic law; or (6) an entity that satisfies an ownership test and a base erosion test. A resident that has none of these six attributes may be entitled to treaty benefits with respect to certain items of income under the derivative benefits test or the active business test.

Special rules apply to treaty country residents that function as headquarters companies for multinational corporate groups.

Special anti-abuse rules govern certain items of income derived from the United States by an enterprise resident in Belgium in so-called "triangular cases."

A person that does not satisfy any of the requirements described above may be entitled to the benefits of the treaty if the source country's competent authority so determines.

## Six attributes for qualification for all treaty benefits

### Individual

Under the proposed treaty, an individual resident of the United States or Belgium is entitled to all treaty benefits. If, however, such an individual receives income as a nominee on behalf of a third-country resident, and thus is not the beneficial owner of the income, benefits may be denied.

### Governments

The proposed treaty provides that the United States and Belgium, and any political subdivision or local authority of either of the two countries are entitled to all treaty benefits.

### Publicly traded companies and subsidiaries

A company that is a resident of Belgium or the United States is entitled to all treaty benefits if the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges (the "regular trading test") and either (1) the company's principal class of shares is primarily traded on a recognized stock exchange in its country of residence or, in the case of a Belgian company, on a recognized stock exchange in the European Union or in any other European Economic Area country or, in the case of a U.S. company, on a recognized stock exchange located in another state that is a party to the North American Free Trade Agreement (the "primary trading test"), or (2) the company's primary place of management and control is in its country of residence (the "management and control test"). Certain key elements of the regular trading test, primary trading test, and management and control test are described below.

The term "principal class of shares" means the ordinary or common shares of a company representing the majority of the aggregate voting power and value of that company. If the company does not have a single class of ordinary or common shares representing the majority of the aggregate voting power and value, then the "principal class of shares" means that class or those classes of shares that in the aggregate represent a majority of the aggregate voting power and value of the company.

A company that is resident in one treaty country has a "disproportionate class of shares" if any outstanding class of shares is subject to terms or other arrangements that entitle a shareholder to a larger portion of the company's income, profit, or gain in the other treaty country than that to which the shareholder would be entitled in the absence of those terms or arrangements. For example, a company resident in Belgium meets this test if it has outstanding a class of tracking stock that pays dividends based upon a formula that approximates the company's return on its assets employed in the United States.

The term "shares" includes depository receipts for shares.

A class of shares is considered to be "regularly traded" in a taxable year if the aggregate number of shares of that class traded on one or more recognized exchanges during the preceding taxable year is at least six percent of the average number of shares outstanding in that class

during that preceding taxable year. The Technical Explanation notes that trading on one or more recognized stock exchanges may be aggregated for purposes of meeting the "regularly traded" requirement.

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

The term "primarily traded" is not defined in the proposed treaty and therefore has the meaning it has under the laws of the relevant treaty country, usually the source country. In the United States, the term has the same meaning as it does under Treas. Reg. section 1.884-5(d)(3). Based on that provision, the Technical Explanation states that stock of a corporation is primarily traded if the number of shares in the company's principal class of shares that are traded during the taxable year on all recognized stock exchanges in the treaty country of which the company is a resident exceeds the number of shares in the company's principal class of shares that are traded during that year on established securities markets in any other single foreign country.

A company the principal class of shares (and any disproportionate class of shares) of which is regularly traded on a recognized stock exchange but which does not satisfy the primary trading test (that is, the requirement that a company's principal class of shares be primarily traded on a recognized stock exchange in the required area) may claim treaty benefits if it satisfies the management and control test – that is, if the company's primary place of management and control is in the treaty country of which it is a resident. According to the Technical Explanation, a company's primary place of management is located in the treaty country in which the company is a resident only if the executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial, and operational policy decision making for the company (including direct and indirect subsidiaries) in that country than in the other treaty country or any third country, and if the staff that support the management in making those decisions are also based in that residence country.

The Technical Explanation notes that the management and control test should be distinguished from the "place of effective management" test used by many countries and in the OECD Model treaty to establish residence. The place of effective management test often has been interpreted to mean the place where the board of directors meets. Under the proposed treaty, by contrast, the primary place of management and control test looks to where day-to-day responsibility for the management of the company (and its subsidiaries) is exercised.

A company that does not satisfy the regular trading test and either the primary trading test or the management and control test (because, for example, its shares are not publicly traded) may be entitled to treaty benefits if shares representing at least 50 percent of its aggregate voting power and value (and at least 50 percent of any disproportionate class of its shares) are owned, directly or indirectly, by five or fewer companies that satisfy the regular trading test and either the primary trading test or the management and control test, provided that, in the case of indirect

ownership, each intermediate owner is a resident of the United States or Belgium. This rule allows certain subsidiaries of publicly-traded companies to be eligible for all benefits under the treaty.

#### Pension funds

A pension fund is entitled to all the benefits of the proposed treaty if more than 50 percent of the fund's beneficiaries, members, or participants are individuals resident in either the United States or Belgium or if the organization sponsoring the fund is entitled to benefits under the proposed treaty. According to the Technical Explanation, for purposes of this provision, the term "beneficiaries" should be understood to refer to the persons receiving benefits from the organization.

#### Tax-exempt organizations

An organization established and maintained in its country of residence exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes is entitled to treaty benefits notwithstanding that all or part of its income or gains may be exempt from tax under the domestic law of that country. The Technical Explanation notes that a tax-exempt organization other than a pension fund qualifies for benefits without regard to the residence of its beneficiaries or members.

#### Ownership and base erosion tests

An entity that is a resident of one of the treaty countries is entitled to treaty benefits if it satisfies both an ownership test and a base erosion test.

An entity that is a resident of a treaty country satisfies the ownership test if on at least half the days of the taxable year at least 50 percent of each class of the entity's shares or other beneficial interests is owned, directly or indirectly, by residents of that treaty country who are entitled to treaty benefits under the limitation-on-benefits article as individuals, governments, parent companies that meet the public company test, pension funds, or tax-exempt organizations.

The base erosion test is satisfied only if less than 50 percent of the person's gross income for the taxable year, as determined in that person's country of residence, is paid or accrued, directly or indirectly, in the form of payments deductible in the person's country of residence, to persons who are not residents of either treaty country entitled to treaty benefits under this article as individuals, governments, parent companies that meet the public company test, tax-exempt organizations, or pension funds. Arm's-length payments made in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank that is not related to the entity making the payment do not count against the entity in determining whether the 50-percent threshold is reached.

The Technical Explanation states that trusts may be entitled to the benefits of this provision if they are treated as residents under Article 4 (Residence) and they otherwise satisfy the ownership and base erosion tests.

### Derivative benefits rule

The proposed treaty includes derivative benefits rules that are generally intended to allow a treaty-country company treaty benefits for an item of income if the company's owners would have been entitled to the same benefits for the income had those owners derived the income directly. Under these derivative benefits rules, a treaty country company is eligible for treaty benefits for an item of income only if the company satisfies both an ownership requirement and a base erosion requirement.

A company satisfies the ownership requirement if shares representing at least 95 percent of the company's aggregate voting power and value, and at least 50 percent of any of the company's disproportionate class of shares, are owned directly or indirectly by seven or fewer persons who are equivalent beneficiaries. The term "disproportionate class of shares" has the same definition as the definition previously described.

A company satisfies the base erosion requirement for an item of income only if, in the taxable year in which the income item arises, the amount of the deductible payments or accruals the company makes, directly or indirectly, to persons who are not equivalent beneficiaries is less than 50 percent of the company's gross income for the year, as determined in the company's country of residence. Deductible payments do not include arm's-length payments in the ordinary course of a business for services or tangible property and payments in respect of financial obligations to a bank that is not related to the company making the payment. The Technical Explanation notes that the base erosion requirement under the derivative benefits rule is the same as the base erosion test described previously (that is, the test that is included in the rules for determining whether a treaty country resident has one of the six attributes for qualification for all treaty benefits), except that, for the derivative benefits rule, deductible payments made to equivalent beneficiaries, not just to residents of a treaty country entitled to treaty benefits, are excluded from the payments that count toward the 50-percent limitation.

An equivalent beneficiary must be a resident of a European Union member state, a European Economic Area state, a North American Free Trade Agreement party, or Switzerland (together, "qualifying countries") and must satisfy either of two criteria described below.

The first criterion includes two requirements. First, the person must be entitled to all treaty benefits under a comprehensive income tax treaty between a qualifying country and the country from which the benefits of the U.S.-Belgium treaty are being claimed (an "applicable treaty"), and this entitlement to treaty benefits must result from satisfaction of limitation-on-benefits provisions analogous to the proposed treaty's rules, described above, for individuals, governments, publicly-traded companies, pension funds, and tax-exempt organizations. If the applicable treaty does not include a comprehensive limitation-on-benefits article, this first requirement is satisfied only if the person would meet the proposed treaty's requirements for entitlement to treaty benefits as an individual, a government, a publicly-traded company, a tax-exempt organization, or a pension fund. Second, for insurance premiums and income from dividends, interest, or royalties, the person must be entitled under an applicable treaty to a rate of tax on that income that is at least as low as the rate applicable under the proposed treaty (the "tax rate test").



The Technical Explanation gives the following example to illustrate the operation of the tax rate test. A U.S. company is wholly owned by a Belgian company that in turn is wholly owned by a French company. Assume the Belgian company otherwise satisfies the requirements of the zero-rate dividend provision, and assume that if the French company received a dividend directly from the U.S. company, the applicable dividend withholding tax rate under the U.S.-France treaty would be five percent. Under these facts, the French company would not be an equivalent beneficiary under the rules described above because it would not be entitled to a withholding tax rate at least as low as the applicable rate (zero) under the U.S.-Belgium tax treaty as modified by the proposed treaty.

For dividend, interest, or royalty payments arising in Belgium and beneficially owned by a resident of the United States, the proposed treaty includes a special rule for determining whether a company that is a resident of an EU member state satisfies the tax rate test for purposes of determining whether the U.S. resident is entitled to treaty benefits for the payments. The special rule provides that the EU member state resident satisfies the tax rate test if a dividend, interest, or royalty payment arising in Belgium and paid directly to that EU member state resident would be exempt from withholding tax under an EU directive even though the income tax treaty between Belgium and that EU member state would permit imposition of a higher withholding tax rate on that payment than is permitted by the U.S.-Belgium tax treaty as amended by the proposed treaty. The Technical Explanation states that this special rule takes account of the fact that withholding taxes on many inter-company dividend, interest, and royalty payments are exempt within the EU under various EU directives. The special rule is necessary, according to the Technical Explanation, because many EU member countries have not renegotiated their tax treaties to reflect the EU directives' elimination of withholding tax.

Under the second criterion for determining whether a resident of a qualifying country is an equivalent beneficiary, the resident must be a Belgian or U.S. resident that is entitled to treaty benefits under one of the rules described previously for individuals, governments, publicly-traded companies, pension funds, and tax-exempt organizations. Under this rule, according to the Technical Explanation, a Belgian individual is an equivalent beneficiary for an item of income received by another treaty country resident regardless of whether the individual would have been entitled to receive the same benefits if it had received the income directly. The Technical Explanation states that this criterion was included to clarify that ownership by certain residents of a treaty country does not disqualify a U.S. or Belgian company from treaty benefits under the derivative benefits rules. If, for example, 90 percent of a Belgian company is owned by five companies that are residents of EU member states and that satisfy the first criterion described previously (the applicable treaty rules and the tax rate test), and 10 percent of the Belgian company is owned by a U.S. or a Belgian individual, the Belgian company still can satisfy the requirements of the ownership test of the derivative benefits rules.

#### Active business test

Under the proposed treaty, a resident of one treaty country is entitled to treaty benefits with respect to an item of income derived from the other country if (1) the resident is engaged in the active conduct of a trade or business in its residence country and (2) the income from the other country is derived in connection with or is incidental to that trade or business. The proposed treaty provides that the business of making or managing investments for the resident's

own account does not constitute an active trade or business unless the business is banking, insurance, or securities activities carried on by a bank, an insurance company, or a registered securities dealer.

The term “trade or business” is not defined in the current treaty or in the proposed treaty. According to the Technical Explanation, under paragraph 2 of Article 3 (General Definitions) of the current treaty, when determining whether a resident of Belgium is entitled to the benefits of the treaty under the active business test with respect to an item of income derived from sources within the United States, the United States will ascribe to this term the meaning that it has under the law of the United States. Accordingly, the Technical Explanation states, the U.S. competent authority will refer to the regulations issued under section 367(a) for the definition of the term “trade or business.” In general, a trade or business will be considered to be a specific unified group of activities that constitute or could constitute an independent economic enterprise carried on for profit. Furthermore, a corporation generally will be considered to carry on a trade or business only if the officers and employees of the corporation conduct substantial managerial and operational activities.

The Technical Explanation elaborates on the requirement that an item of income from the source country be derived “in connection with” or be “incidental to” the resident’s trade or business in its residence country. The Technical Explanation provides that an item of income is derived in connection with a trade or business if the income-producing activity in the source country is a line of business that “forms a part of” or is “complementary to” the trade or business conducted in the residence country by the income recipient.

According to the Technical Explanation, a business activity generally will be considered to form part of a business activity conducted in the country of source 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 line of business in the country of residence may be upstream, downstream, or parallel to the activity conducted in the country of source. Thus, the line of business may provide inputs for a manufacturing process that occurs in the source country, may sell the output of that manufacturing process, or simply may sell the same sorts of products that are being sold by the trade or business carried on in the country of source.

The Technical Explanation states that for two activities to be considered to be “complementary,” the activities need not relate to the same types of products or services but should be part of the same overall industry and should be related in the sense that the success or failure of one activity will tend to result in success or failure for the other. Where more than one trade or business is conducted in the country of source and only one of the trades or businesses forms a part of or is complementary to a trade or business conducted in the country of residence, it is necessary, according to the Technical Explanation, to identify the trade or business to which an item of income is attributable. Royalties generally are considered to be derived in connection with the trade or business to which the underlying intangible property is attributable. Dividends are deemed to be derived first out of earnings and profits of the treaty-benefited trade or business and then out of other earnings and profits. Interest income may be allocated under any reasonable method consistently applied. A method that conforms to U.S. principles for expense allocation will be considered a reasonable method.

The Technical Explanation further states that an item of income derived from the country of source is “incidental to” the trade or business carried on in the country of residence if production of the item facilitates the conduct of the trade or business in the country of residence. An example of incidental income is the temporary investment of working capital of a person in the country of residence in securities issued by persons in the country of source.

The proposed treaty provides that if a resident of a treaty country or any of its associated enterprises carries on a trade or business activity in the other country that gives rise to an item of income, the active business test applies to the item of income only if the trade or business activity in the residence country is substantial in relation to the trade or business activity in the source country. The determination is made separately for each item of income derived from the source country.

The Technical Explanation explains that the substantiality requirement is intended to prevent a narrow case of treaty-shopping abuses in which a company attempts to qualify for benefits by engaging in de minimis connected business activities in the treaty country in which it is resident (that is, activities that have little economic cost or effect with respect to the company business as a whole). The determination of substantiality is made based upon all the facts and circumstances and takes into account the comparative sizes of the trades or businesses in each treaty country, the nature of the activities performed in each country, and the relative contributions made to that trade or business in each country. According to the Technical Explanation, in making each determination or comparison, due regard will be given to the relative sizes of the U.S. and Belgian economies.

The proposed treaty provides that, in determining whether a person is engaged in the active conduct of a trade or business in a treaty country, activities conducted by persons “connected” to that first person are deemed to be conducted by that first person. A person is “connected” to another person if one possesses at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate voting power and at least 50 percent of the aggregate value of the shares in the company or of the beneficial equity interest in the company), or another person possesses, directly or indirectly, that requisite interest in each of the two entities. A person is also considered to be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

#### Rules for headquarters companies

Under the proposed treaty, a resident of the United States or Belgium is entitled to treaty benefits if that person functions as a headquarters company for a multinational corporate group. A person is considered a headquarters company for this purpose only if each of several criteria is satisfied.

#### Overall supervision and administration

To be considered a headquarters company, a person must provide a substantial portion of the overall supervision and administration of the multinational corporate group. This supervision and administration may include, but cannot be principally, group financing.

The Technical Explanation states that a person will be considered to engage in supervision and administration only if it engages in a number of the following activities: group financing (but, as mentioned above, not as its principal activity), pricing, marketing, internal auditing, internal communications, and management. In determining whether a substantial portion of the overall supervision and administration of the group is provided by the headquarters company, that company's headquarters-related activities must be substantial in relation to the same activities for the same group performed by other entities.

#### Active trade or business

Under the active trade or business requirement, the multinational corporate group must consist of companies that are resident in, and engaged in an active business in, at least five countries, and the business activities carried on in each of the five countries (or five groupings of countries) must generate at least 10 percent of the gross income of the group. The Technical Explanation states that this active trade or business rule is the first of several requirements intended to ensure that the relevant group is truly multinational. According to the Technical Explanation, so long as there are at least five individual countries or groupings that satisfy the 10-percent requirement, the income from multiple countries may be aggregated into non-overlapping groupings in determining whether the 10-percent gross income requirement is satisfied. If the gross income requirement is not satisfied for a taxable year, the taxpayer may satisfy the requirement by applying the 10-percent gross income test to the average of the gross incomes for the four years preceding the taxable year.

The Technical Explanation gives the following example of the operation of the active trade or business requirement. BHQ is a Belgian resident that functions as a headquarters company for a group of companies resident in the United States, Canada, New Zealand, the United Kingdom, Malaysia, the Philippines, Singapore, and Indonesia. In 2008, the total gross income of the multinational corporate group is \$137, of which \$40 is generated in the United States, \$25 in Canada, \$10 in New Zealand, \$30 in the United Kingdom, \$10 in Malaysia, \$7 in the Philippines, \$10 in Singapore, and \$5 in Indonesia. Ten percent of the group's gross income in 2008 is \$13.70; only the United States, Canada, and the United Kingdom satisfy the 10-percent requirement by themselves. Together, the New Zealand and Malaysia members generate \$20 of gross income, and the Philippines, Singapore, and Indonesia members together generate \$22 of gross income. These two groupings therefore may be treated as the fourth and fifth members of the group (in addition to the United States, Canada, and the United Kingdom) under the active trade or business requirement, and the requirement is satisfied in 2008.

#### Single-country limitation

The business activities carried on in any one country other than the residence country of the headquarters company must generate less than 50 percent of the gross income of the group. If this less-than-50-percent requirement is not satisfied for a taxable year, it will be satisfied if the percentage for the four years preceding the taxable year is less than 50 percent. The Technical Explanation provides an example of the application of this rule:

Example:—BHQ is a corporation resident in Belgium. BHQ functions as a headquarters company for a group of companies. BHQ derives dividend income from a U.S. subsidiary in the

2008 taxable year. The states of residence of the companies in the group, the sites of their activities, and the amounts of gross income attributable to the companies for the years 2008 through 2012 are set forth below:

<b>Company</b>	<b>Situs</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
United States	U.S.	\$100	\$100	\$95	\$90	\$85
Mexico	U.S.	10	8	5	0	0
Canada	U.S.	20	18	16	15	12
United Kingdom	U.K.	30	32	30	28	27
New Zealand	N.Z.	40	42	38	36	35
Japan	Japan	35	32	30	30	28
Singapore	Singapore	25	25	24	22	20
<b>TOTAL</b>		<b>\$260</b>	<b>\$257</b>	<b>\$238</b>	<b>\$221</b>	<b>\$207</b>

Because the U.S. situs companies' total gross income of \$130 in 2012 is not less than 50 percent of the gross income of the group, the provision is not satisfied with respect to dividends derived in 2012. However, the U.S. situs companies' average gross income for the preceding four years may be used in lieu of the preceding year's average. The United States' average gross income for the years 2008 through 2011 is \$111.00 (\$444/4). The group's total average gross income for these years is \$230.75 (\$923/4). Because \$111.00 represents 48.1 percent of the group's average gross income for the years 2008 through 2011, the United States satisfies the single-country limitation.

#### Other country gross income limitation

No more than 25 percent of gross income of a headquarters company that is a resident of one treaty country may be derived from the other treaty country. Thus, according to the Technical Explanation, if the headquarters company's gross income for the taxable year is \$200, no more than \$50 of gross income may be derived from the other country. If this gross income requirement is not met for the taxable year, it may be satisfied based on the average percentage for the four preceding years.

#### Independent Discretionary Authority

The headquarters company must have and exercise independent discretionary authority to carry out the overall supervision and administration functions described above for the overall supervision and administration requirement. The Technical Explanation states that this determination is made separately for each function. Thus, if a headquarters company is nominally responsible for group financing, pricing, marketing, and internal auditing functions, and another entity is actually directing the headquarters company as to the group financing function, the headquarters company would not be deemed to have independent discretionary authority for group financing, but it may have such authority for the other functions.

### Income taxation rules

The headquarters company must be subject to the generally applicable income taxation rules in its country of residence. The Technical Explanation states that this reference should be understood to mean that the company must be subject to the income taxation rules to which a company engaged in the active trade or business would be subject. Thus, if one of the countries has or introduces special taxation legislation that imposes a lower rate of income tax on headquarters companies than is imposed on companies engaged in the active conduct of a trade or business, or provides for an artificially low taxable base for headquarters companies, a headquarters company subject to these rules is not entitled to treaty benefits under the headquarters company rules.

The Technical Explanation states that in accordance with paragraph 3 of Article 28 (Entry into Force), this provision does not have effect until January 1, 2011.

### In connection with or incidental to a trade or business

The income that a headquarters company resident in one treaty country derives in the other treaty country must be derived in connection with or be incidental to the active business activities described in the active trade or business requirement above. For example, according to the Technical Explanation, if a Belgian company that satisfied the other requirements of the headquarters company rules acted as a headquarters company for a group that included a United States corporation, and the group was engaged in the design and manufacture of computer software, but the U.S. company was also engaged in the design and manufacture of photocopying machines, the income that Belgium company derived from the United States would have to be derived in connection with or be incidental to the income generated by the computer business in order to be entitled to treaty benefits under the headquarters company rules. The Technical Explanation similarly states that interest income received from the U.S. company also would be entitled to treaty benefits as long as the interest was attributable to the computer business supervised by the headquarters company. Interest income derived from an unrelated party, however, normally would not satisfy the in-connection-with-or-incidental requirement.

### The triangular case

The proposed treaty provides a special anti-abuse rule that, according to the Technical Explanation, addresses a Belgian resident's use of the following structure to earn interest income from the United States. The Belgian resident (who is otherwise qualified for benefits under this article) organizes a permanent establishment in a third country that imposes a low rate of tax on the income of the permanent establishment. The Belgian resident then lends funds into the United States through the permanent establishment. The permanent establishment is an integral part of the Belgian resident. Consequently, the interest income that the permanent establishment earns on the loan is entitled to exemption from U.S. withholding tax under the treaty. Under the tax treaty between Belgium and the third country, Belgium does not tax the income earned by the permanent establishment. Consequently, the income is not taxed in Belgium or the United States, and is only lightly taxed in the third country.

Under the proposed treaty, the United States may impose withholding tax on the interest payments if the tax actually paid on the income in the third country is less than 60 percent of the tax that would have been payable to Belgium if the income were earned in Belgium and were not attributable to the permanent establishment in the third country.

Although the example in the Technical Explanation involves interest income, the triangular provision also applies to royalties. Any interest or royalties to which the provision applies may be subject to a maximum withholding tax rate of 15 percent.

According to the Technical Explanation, the principles of the U.S. subpart F rules are employed to determine whether the profits of the permanent establishment are subject to an effective rate of tax that is above the specified threshold.

The triangular provision does not apply to a person's interest income derived from the United States if the income is derived in connection with or is incidental to the active conduct of a trade or business carried on by the permanent establishment in the third state (other than the business of making, managing, or holding investments for the person's own account, unless the business is banking or securities activities carried on by a bank or a registered securities dealer). The triangular provision does not apply to royalties that are received as compensation for the use of, or the right to use, intangible property produced or developed by the permanent establishment itself.

#### Grant of treaty benefits by the competent authority

Under the proposed treaty, a resident of a treaty country that is not otherwise entitled to treaty benefits under this article may nonetheless be granted treaty benefits if the competent authority of the other treaty country determines that the establishment, acquisition, or maintenance of the resident and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the treaty. The competent authority of the source country is required to consult with the competent authority of the residence country before denying treaty benefits under this provision.

According to the Technical Explanation, the competent authority's discretion under this provision is broad. The competent authority, for example, may grant all treaty benefits, may grant benefits only with respect to a particular item of income, and may set time limits on the duration of any relief granted.

## **Article 22. 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.

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

### Belgium

Belgian double tax relief depends upon the type of income that is earned abroad, and can take the form of an exemption, credit, or reduction of taxes. For example, Belgian resident individuals are taxed at one-half the normal tax rate on certain income from property situated abroad and for professional income earned and taxed abroad. However, this 50 percent reduction does not apply to income derived from capital investments and movable property used for business purposes in Belgium; instead a foreign tax credit is available if the income has been subject to a foreign tax similar to the Belgian income tax, subject to certain limitation rules.

### Proposed treaty limitations on internal law

#### Overview

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 Belgium 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 Belgium. The present treaty generally provides for relief from double taxation of U.S. residents and citizens by requiring the United States to permit a credit against its tax for taxes paid to Belgium. The determination of this credit is made in accordance with U.S. law. In the case of Belgium, the present treaty generally provides relief from double taxation by a



combination of exemption and credit: for instance, Belgium exempts certain income from taxation (but Belgium may take the excluded income into account for purposes of determining the rate of tax on the remainder of income, i.e., Belgium reserves the right to apply an exemption with progression regime), while other income (including certain dividends, interest and royalties) is subject to tax in Belgium but eligible for a credit for taxes paid to the United States. Dividends paid by a U.S. corporation to a Belgian corporate shareholder, however, are exempt from tax in Belgium to the extent that the dividends would have been exempt from tax if the two corporations had both been Belgian corporations.

#### U.S. tax relief for Belgian taxes paid

The proposed treaty generally provides that the United States will allow a U.S. citizen or resident a foreign tax credit for the income taxes imposed by Belgium. The proposed treaty also requires the United States to allow a deemed-paid credit, with respect to Belgian income tax, to any U.S. company that receives dividends from a Belgian company if the U.S. company owns 10 percent or more of the voting stock of such Belgian 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 treaty many U.S. treaties.

The proposed treaty provides that the taxes referred to in paragraphs 3(a) and 4 of Article 2 (Taxes Covered) will be considered creditable income taxes for purposes of the proposed treaty. This includes the Belgian individual and corporate income taxes, the income tax on legal entities, and the income tax on non-residents.

The proposed treaty contains a resourcing rule for these purposes. Under the proposed treaty, an item of gross income (as defined under U.S. law) that is derived by a U.S. resident and that is taxed by Belgium under the proposed treaty will be deemed to be Belgian-source income for U.S. foreign tax credit purposes. The Technical Explanation states that this resourcing rule is intended to ensure that a U.S. resident can obtain a U.S. foreign tax credit for Belgian taxes paid when the proposed treaty assigns primary taxing jurisdiction to Belgium. The Technical Explanation further states that in the case of a U.S.-owned foreign corporation, the resourcing rules under Code section 904(g)(10) may apply for purposes of determining the amount of the U.S. foreign tax credit with respect to such income (including rules applying separate foreign tax credit limitations to such resourced income). This rule is consistent with the U.S. Model treaty.

#### Belgian tax relief for U.S. taxes paid

The proposed treaty provides that Belgium will provide relief from double taxation through a mixture of the credit and exemption methods. Where a resident of Belgium derives income other than dividends, interest and royalties which is taxed in the U.S. in accordance with the proposed treaty, Belgium will exempt such income from taxation, but Belgium may take the excluded income into account for purposes of determining the rate of tax on the remainder of income (i.e., Belgium reserves the right to apply exemption with progression).

The proposed treaty contains a special rule for residents of Belgium deriving income described above through a so-called hybrid entity, i.e., an entity which is fiscally transparent for U.S. tax purposes but viewed as a company under Belgian law. As described in the Technical Explanation, a resident of Belgium deriving income described above from participation in such an entity will generally be subject to tax in the United States on his proportional share of the income of such entity. However, since Belgian tax law views such an entity as not fiscally transparent, Belgian tax law will not see income at the investor level until there is a distribution of the earnings of such entity. Under Belgian tax law, this distribution is viewed as a dividend. If and when such a distribution occurs, there would (absent a special provision) be double taxation on the investor with respect to such income, first in the United States when it was earned by the enterprise and passed through to the investor, and later in Belgium when the earnings were distributed to the investor. According to the Technical Explanation, subparagraph b) is designed to permit a Belgian investor in such circumstances to claim an exemption from Belgian tax with respect to the income out of which the income (treated as a dividend under Belgian law) is paid

The proposed treaty retains the rule contained in the present treaty providing that dividends paid by a U.S. corporation to a Belgian corporate shareholder are exempt from tax in Belgium to the extent that the dividends would have been exempt from tax if the two corporations had both been Belgian corporations. The proposed treaty adds a provision that with respect to dividends not eligible for exemption under the above rule, the Belgian company will be entitled to deduct from its Belgian corporate income tax the U.S. tax levied on such dividends in accordance with Article 10 (Dividends) of the proposed treaty, subject to certain limitations.

The proposed treaty also adds a provision under which Belgium will generally permit a resident of Belgium to claim a credit against Belgian income tax liability for the U.S. tax levied on such interest or royalties (subject to provisions of Belgian law concerning the deduction of taxes paid in a foreign country).

Finally, the proposed treaty provides that if a Belgian resident has a U.S. permanent establishment, and losses from the activity have effectively been deducted from the resident's income for purposes of determining Belgian tax liability, then the exemption from Belgian tax which the proposed treaty otherwise provides will not apply to the profits of other taxable periods attributable to that permanent establishment to the extent those profits have also been exempted from tax in the United States by reason of such offsetting losses.

#### Special rules for citizens, former citizens and former long-term residents of the U.S.

The proposed treaty contains special rules designed to provide relief from double taxation for U.S. citizens who are Belgian residents. Unlike the U.S. Model treaty, the rules also apply to former U.S. citizens or long-term residents who are Belgian residents. Under the proposed treaty, Belgium is not required to provide a credit to such Belgian residents for U.S. tax on profits, income, or chargeable gains from sources outside the United States (as determined under the laws of Belgium). The Technical Explanation notes that, as a result of this provision, no agreement is reached under the proposed treaty for relieving double taxation with respect to such income; the Technical Explanation suggests that the provisions of Article 24 (Mutual Agreement Procedure) could be used to alleviate double taxation in such cases.

In addition, under the proposed treaty, Belgium will allow a foreign tax credit to a U.S. citizen, former U.S. citizen, or former U.S. resident who is a Belgian resident by taking into account only the amount of U.S. taxes, if any, that may be imposed pursuant to the proposed treaty on a Belgian resident who is not a U.S. citizen. The Technical Explanation states that these rules apply to items of U.S.-source income that would either be exempt from U.S. tax or subject to reduced rates of U.S. tax under the proposed treaty if they had been received by a Belgian resident who is not a U.S. citizen. The Technical Explanation further states that the Belgian tax credit allowed with respect to such items need not exceed the U.S. tax that may be imposed under the proposed treaty, other than taxes imposed solely by reason of the U.S. citizenship of the taxpayer under saving clause of paragraph 4 of Article 1 (General Scope). The United States will then credit the income tax and capital gains tax actually paid to Belgium, determined after application of the preceding rule. The proposed treaty recharacterizes the income that is subject to Belgian taxation as foreign-source income for purposes of this computation, but only to the extent necessary to avoid double taxation of such income.

### **Article 23. Non-Discrimination**

The proposed treaty contains a comprehensive nondiscrimination article. It is similar to the nondiscrimination article in the U.S. Model treaty 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 on nationals of the other country than it would impose on its own comparably situated nationals in the same circumstances.<sup>21</sup> Not all instances of differential treatment are discriminatory. Differential treatment is permissible in some instances under this rule on the basis of tax-relevant differences (e.g., the fact that one person is subject to worldwide taxation in a treaty country and another person is not, or the fact that an item of income may be taxed at a later date in one person's hands but not in another person's hands).

Under the proposed treaty, neither country may tax a permanent establishment of an enterprise of the other country less favorably than it taxes its own enterprises carrying on the same activities.

Similar to the U.S. and OECD Model treaties, 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.

Subject to the anti-avoidance rules described in paragraph 1 of Article 9 (Associated Enterprises), paragraph 6 of Article 11 (Interest), and paragraph 4 of Article 12 (Royalties), each treaty country is required 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

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<sup>21</sup> A national of one treaty country may claim protection under this article even if the national is not a resident of either treaty country. For example, a U.S. citizen who is resident in a third country is entitled to the same treatment in Belgium as a comparably situated Belgian national.

Technical Explanation states that the exception with respect to paragraph 6 of Article 11 (Interest) would include the denial or deferral of certain interest deductions under section 163(j) of the Code, thus preserving for the United States the ability to apply its earnings stripping rules.

In addition, any debts of a resident of one treaty country to a resident of the other treaty country shall, for purposes of determining the taxable capital of the obligor, be deductible under the same conditions as if they had been owed to a resident of the same treaty country.

The nondiscrimination 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) that is more burdensome than the taxation (or connected requirements) that the first country imposes or may impose on other similar enterprises. As noted above, some differences in treatment may be justified on the basis of tax-relevant differences in circumstances between two enterprises. In this regard, the Technical Explanation provides examples of Code provisions that are understood by the two countries not to violate the nondiscrimination provision of the proposed treaty, including the rules that tax U.S. corporations making certain distributions to foreign shareholders in what would otherwise be nonrecognition transactions, the rules that impose a withholding tax on non-U.S. partners of a partnership, the rules that prevent foreign persons from owning stock in subchapter S corporations, and the rules that prevent foreign corporations from joining in filing consolidated returns with domestic corporations.

The proposed treaty provides that nothing in the nondiscrimination article may be construed as preventing either of the countries from imposing a branch profits tax as described in paragraph 10 of Article 10 (Dividends).

In addition, notwithstanding the definition of taxes covered in Article 2 (Taxes Covered), this article applies to taxes of every kind and description imposed by either country, or any political subdivision or local authority thereof. The Technical Explanation states that customs duties are not regarded as taxes for this purpose.

The saving clause does not apply to the nondiscrimination article. Thus, a U.S. citizen who is resident in Belgium may claim benefits with respect to the United States under this article.

## **Article 24. Mutual Agreement Procedure**

### General procedures

The proposed treaty contains the U.S. Model treaty mutual agreement provision, with some variations, 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.

Under this article, a resident of one country who considers that the action of one or both of the countries cause him or her to be subject to tax which is not in accordance with the provisions of the proposed treaty may (irrespective of internal law remedies) present his or her

case to the competent authority of either treaty country. Similar to the OECD Model treaty, but unlike the U.S. Model treaty, the proposed treaty provides that the case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty. The proposed protocol provides that the term “first notification of the action resulting in taxation not in accordance with the provisions of the [treaty]” means in the case of Belgium, the date on which the notice of assessment containing an assessment or supplementary assessment is sent to the person who considers that the taxation provided for in such assessment or supplementary assessment is contrary to the provisions of the treaty; and in the case of the United States, the date on which the taxpayer receives a notice of proposed adjustment or of assessment, whichever is earlier.

The proposed treaty provides that if the objection appears to be justified and that competent authority is not itself able to arrive at a satisfactory solution, that competent authority must 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. During the period that any mutual agreement proceeding is pending, any collection procedures are to be suspended.

The competent authorities of the treaty countries are to 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: (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 treaty country; (2) the same attribution of income, deductions, credits, or allowances between permanent establishments located in the treaty countries, even if the enterprise is not located in a treaty country; (3) the same allocation of income, deductions, credits, or allowances between persons; (4) the same characterization of particular items of income; (5) the same characterization of persons; (6) the same application of source rules with respect to particular items of income; (7) a common meaning of a term; (8) advance pricing arrangements; and (9) the application of the provisions of each country’s domestic law regarding penalties, fines, and interest in a manner consistent with the purposes of the proposed treaty. The Technical Explanation clarifies that this list is a non-exhaustive list of examples of the kinds of matters about which the competent authorities may reach agreement.

To the extent necessary to facilitate the resolution of a case subject to a mutual agreement procedure, the tax authorities of each treaty country are authorized under Article 24 to request the disclosure of information relevant to the mutual agreement procedure from any person who may have such information. In addition, each may conduct investigations and hearings notwithstanding any time limits in their domestic laws that would otherwise bar such requests for information. Consistent with the U.S. Model treaty, the proposed treaty also provides that any agreement is to be implemented even if such implementation otherwise would be barred by the statute of limitations or other procedural limitations under the domestic law of the treaty countries.

The proposed treaty provides that the competent authorities may agree on administrative measures to carry out the provisions of the proposed treaty, particularly with respect to documentation to be furnished by a resident to support a claim for reduced tax under the proposed treaty.

The proposed treaty authorizes the competent authorities to communicate with each other directly, including through a joint commission, for purposes of reaching an agreement. 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.

### Arbitration procedures

The current treaty does not provide for arbitration. Paragraphs 7 and 8 of Article 24 of the proposed treaty introduce a mandatory arbitration procedure that is sometimes referred to as “last best offer” or “final offer” arbitration.<sup>22</sup> Unless a taxpayer or other “concerned person” (in general, a person whose tax liability is affected by the arbitration determination) does not accept the arbitration determination, it is binding on the treaty countries with respect to the case. Paragraph 6 of the proposed protocol provides detailed rules regarding the new arbitration procedures.<sup>23</sup>

The proposed arbitration procedures raise a number of issues, which are discussed in Part VI of this pamphlet.

New paragraph 7 of Article 24 sets forth the basic rule of the mandatory arbitration that requires the competent authorities to invoke the arbitration procedures if they have endeavored but are unable to reach a complete agreement in the case, and if three conditions are met. The first condition is that tax returns have been filed with at least one of the treaty countries with respect to the taxable years at issue in the case. The second condition is that the case is not a particular case that the competent authorities agree, before the date on which arbitration proceedings (“proceedings”) would otherwise have begun, is not suitable for determination by arbitration. The third condition is that the taxpayer and all “concerned persons” agree to certain nondisclosure conditions, as discussed below. Under the proposed treaty, all articles of the treaty are eligible for arbitration.<sup>24</sup>

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<sup>22</sup> The new arbitration procedure is also informally called “baseball arbitration” because it is similar to the procedure used to resolve major league baseball salary disputes. In this type of arbitration, each of the parties proposes one and only one figure for settlement, and the arbitrator must select one of those figures as the award.

<sup>23</sup> A similar arbitration procedure is introduced in the proposed protocol to the U.S.-Germany income tax treaty. The few differences between the proposed Belgium and Germany treaty provisions are footnoted in the discussion below.

<sup>24</sup> Under the proposed protocol to the U.S.-Germany treaty, only issues arising under certain articles are automatically eligible. These articles are: Article 4 (Residence), insofar as it relates to the residence of a natural person, Article 5 (Permanent Establishment), Article 7 (Business Profits), Article 9 (Associated Enterprises), and Article 12 (Royalties). Under the proposed protocol to the U.S.-Germany treaty, the competent authorities may agree that a particular case arising under these articles is not suitable for determination by arbitration. The competent authorities may also agree that other particular cases are suitable for arbitration.

The third condition is met when both competent authorities have received from each concerned person a statement agreeing that the concerned person and each person acting on the concerned person's behalf (i.e., their authorized representatives or agents) will not disclose to any other person any information received during the course of the proceedings from either treaty country or the board, other than the determination of the board (the "nondisclosure agreement"). A concerned person that has the legal authority to bind any other concerned person on this matter may do so in a comprehensive statement. A concerned person is defined as the presenter of a case to a competent authority for consideration under Article 24 (i.e., the taxpayer), and any other persons whose tax liability to either treaty country may be directly affected by a mutual agreement arising from that consideration. For example, in the case of a U.S. corporation that brings a transfer pricing case for resolution to the U.S. competent authority with respect to a transaction with its Belgian subsidiary, both the U.S. corporation and its Belgian subsidiary (that may have a correlative adjustment as a result of the resolution of the case) are concerned parties.

Meeting the third condition may trigger the beginning of arbitration proceedings. Paragraph 8(c) of Article 24 provides that the proceedings begin on the later of (i) two years after the "commencement date" of the case, unless the competent authorities have previously agreed to a different date, and (ii) the earliest date upon which both competent authorities have received the nondisclosure agreement. Paragraph 8(b) provides that the commencement date of a case is the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by both competent authorities.

Paragraph 6(p) of the proposed protocol requires that each competent authority shall confirm in writing to the other competent authority and to the concerned person or persons the date of its receipt of the information necessary to undertake substantive consideration for a mutual agreement. With respect to the United States, that information is the information required to be submitted to the U.S. competent authority under Revenue Procedure 2002-52, section 4.05, (or any applicable successor provisions), and for cases initially submitted as a request for an Advance Pricing Agreement, the information required to be submitted to the Internal Revenue Service under Revenue Procedure 2006-9, section 4 (or any applicable successor provisions). With respect to Belgium, that information is any information that would be required under instructions or commentaries published by the Federal Public Service Finance. In any event, the information is not considered received until both competent authorities have received copies of all materials submitted to either treaty country by every concerned person in connection with the mutual agreement procedure. Thus, the competent authorities must have exchanged copies of all of the submitted materials before the commencement date of the case is deemed to arrive, triggering the two-year period.

Paragraph 6 of the proposed protocol provides for several procedural rules once arbitration proceedings have begun, but paragraph 6(q) provides that the competent authorities may modify or supplement any of the rules or procedures of paragraph 6 as necessary to more effectively implement the intent of paragraph 7 of Article 24 to eliminate double taxation. In addition, paragraph 6(f) provides that the arbitration board may adopt any procedures necessary for the conduct of its business provided that such procedures are not inconsistent with any provision of Article 24 or paragraph 6 of the proposed protocol.

Paragraph 6(e) of the proposed protocol provides that within 60 days from the date on which the proceeding begins, each treaty country is required to send a written communication to the other appointing one member of the board. Within 60 days from the date that the second such communication is sent, the two appointed board members are required to appoint a third member to serve as Chair of the board. If either treaty country fails to appoint a board member, or if the appointed members fail to appoint a third member, the remaining member or members are to be appointed by the highest ranking member of the Secretariat at the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Development (“OECD”)<sup>25</sup> who is not a citizen of either treaty country, by written notice to both treaty countries within 60 days of the date of such failure. The competent authorities are required to develop a list of individuals with familiarity in international tax matters who may potentially serve as Chair of an arbitration board. However, the Chair may not be a citizen of either treaty country.

Paragraph 6(g) of the proposed protocol prescribes the submission procedures in detail. Each of the treaty countries is permitted to submit to the board a proposed resolution describing its proposed disposition of the specific amounts of income, expense or taxation at issue in the case, and a supporting position paper. These submissions are due within 60 days of the appointment of the Chair of the board.<sup>26</sup> The board is required to provide copies of these submissions to the other treaty country on the date on which the later of the two submissions are received by the board. If only one treaty country submits a timely proposed resolution, that proposed resolution is deemed to be the determination of the board in that case and the arbitration proceeding is terminated. Each of the treaty countries may submit a reply submission to the board within 120 days of the appointment of the Chair,<sup>27</sup> to address any points raised by the other country’s proposed resolution or position paper. Additional information may be submitted to the board only at its request, and copies of any such request and the treaty country’s response is to be provided to the other treaty country on the date on which the request or response is submitted. Except for certain logistical matters, all communications between the treaty countries and the arbitration board is required to be in writing between the designated competent authorities and the Chair of the board.

Any meetings of the board are required to be held in facilities provided by the treaty country whose competent authority initiated the mutual agreement proceeding in the case. Fees and expenses of the arbitration, including language translation fees, are generally to be borne equally by the treaty countries. The fees of members of the arbitration board are, in general, fixed at \$2,000 per day (or the equivalent amount in euros), subject to modification by the competent authorities. The expenses of the board members are set, in general, in accordance with the International Centre for Settlement of Investment Disputes Schedule of Fees for arbitrators, as in effect on the date on which the proceedings begin, subject to modification by the competent authorities. Meeting facilities, related resources, financial management, other

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<sup>25</sup> That position is currently occupied by Jeffrey Owens.

<sup>26</sup> The proposed protocol to the U.S.-Germany treaty allows 90 days.

<sup>27</sup> The proposed protocol to the U.S.-Germany treaty allows 180 days.



logistical support, and general administrative coordination of the arbitration proceeding are to be provided, at its own cost, by the treaty country whose competent authority initiated the mutual agreement proceedings in the case. Any other costs are to be borne by the treaty country that incurs the costs.

New paragraph 8(f) of Article 24 provides that the members of the board and their staffs are considered persons or authorities to whom information may be disclosed under Article 25 (Exchange of Information and Administrative Assistance). Paragraph 6(n) of the proposed protocol provides that all members of the board and their staffs must submit statements to each of the treaty countries in confirmation of their appointment to the board in which they agree to abide by and be subject to the confidentiality and nondisclosure provisions of Article 25 and the applicable domestic laws of the treaty countries. In the event these provisions conflict, the most restrictive condition applies. All materials prepared in the course of the proceeding, or relating to the proceeding, are considered to be information exchanged between the treaty countries under Article 25. In addition, no information relating to the arbitration proceeding, including the board's determination, may be disclosed by the members of the arbitration board or their staffs or by either competent authority, except as otherwise permitted by the treaty and the domestic laws of the treaty countries.

Paragraph 6(h) of the proposed protocol provides that the arbitration board will deliver its determination in writing to the treaty countries within six<sup>28</sup> months of the appointment of the Chair. The board is required to adopt as its determination one of the proposed resolutions submitted by the treaty countries. In making its determination, the arbitration board is required to apply the following authorities, in the following order of priority: (a) the provisions of the treaty; (b) any agreed commentaries or explanations of the treaty countries concerning the treaty; (c) the laws of the treaty countries to the extent not inconsistent with each other; and (d) any OECD commentary, guidelines, or reports regarding relevant analogous portions of the OECD Model treaty.

New paragraph 8(e) of Article 24 provides that unless any concerned person does not accept the determination of the arbitration board, the determination shall constitute a resolution by mutual agreement under Article 24 and is binding on both treaty countries in the case. Paragraph 6(j) of the proposed protocol also provides that the determination of the board is binding upon the treaty countries, but adds that the determination will not state a rationale and will have no precedential value. Paragraph 6(b) provides that the determination by the board in a proceeding is limited to a determination regarding the amount of income, expense, or tax reportable to the relevant treaty country. Paragraph 6(m) provides that the treatment of any associated interest or penalties will be determined by applicable domestic law of the treaty country concerned.

Paragraph 6(k) of the proposed protocol provides that within 30 days of receiving the determination of the board from the competent authority to which the case was first presented, each concerned person must advise that competent authority whether that concerned person

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<sup>28</sup> The proposed protocol to the U.S.-Germany treaty allows nine months.

accepts the determination of the board. If the case is in litigation, each concerned person who is a party to the litigation must also advise, within the same time frame, the relevant court of its acceptance of the determination of the board as the resolution by mutual agreement and withdraw from the consideration of the court the issues resolved through the arbitration proceeding.<sup>29</sup> If any concerned person fails to so advise both the relevant competent authority and any relevant court within that time frame, the determination of the board will be considered not to have been accepted in that case. If the board's determination is not accepted, the case may not subsequently be the subject of an arbitration proceeding.

Paragraph 6(c) of the proposed protocol provides that notwithstanding the initiation of an arbitration proceeding, the competent authorities may reach a mutual agreement to resolve a case and terminate the proceeding, but only before a decision of the board has been accepted by all concerned persons. In addition, any concerned person may withdraw a request for the competent authorities to engage in the mutual agreement procedure under Article 24, thereby terminating the arbitration proceeding (as well as the mutual agreement procedure generally).

#### **Article 25. Exchange of Information and Administrative Assistance**

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 domestic laws of the two countries concerning all taxes covered by the treaty insofar as the taxation thereunder is not contrary to the proposed treaty. This exchange of information is not restricted by Article 1 (General Scope).

Any information exchanged under the proposed treaty is 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 applies, or the oversight of such taxes (e.g., the tax-writing committees of Congress and the General Accounting Office). Such persons or authorities must use the information for such purposes only. Exchanged information may be disclosed in public court proceedings or in judicial decisions.

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

If information is requested by a country in accordance with this article, the proposed treaty provides that the other country will obtain the requested information, notwithstanding that such other country may not need such information at that time.

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<sup>29</sup> The proposed protocol to the U.S.-Germany treaty does not provide a litigation clause.

The proposed treaty provides that a country may not refuse to supply information because the information is held by a bank, or other financial institution, nominees or person acting in an agency or fiduciary capacity, or because it relates to ownership interests in a person. In order to obtain such information, the tax administration of a country shall have the power to ask for the disclosure of information and to conduct investigations and hearings.

Notwithstanding general limitations on the exchange of information, in order to obtain requested information, the tax administration of a country shall have the power to ask for the disclosure of information and to conduct investigations and hearings outside any time limits imposed under domestic law.

The proposed treaty provides that any penalties imposed under the domestic laws of a requested country for failing to give information necessary for carrying out the domestic tax laws of such country shall apply as if the obligation to provide information was an obligation provided under the domestic tax laws of such country.

Under the proposed treaty, where a person refuses to give information requested or fails to give such information within the time required by the tax administration of the requested country, the requested country may bring appropriate enforcement proceedings against such person. Such person may be compelled to give such information under penalty of such civil or criminal penalties as may be available under the laws of the requested country.

The proposed treaty provides that if specifically requested by the competent authority of a country, the competent authority of the other country must provide information under this article in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, and writings).

Under the proposed treaty, the requested country shall allow representatives of the requesting country to enter the requested country to interview individuals and examine books and records. Such interview or examination shall take place under the conditions and within the limits agreed upon by the competent authorities of both treaty countries.

The proposed treaty provides that the competent authorities of the treaty countries shall agree upon the mode of application of the exchange of information under this article, including agreement to ensure comparable levels of assistance to each of the treaty countries.

The proposed treaty provides that if the United States terminates paragraph three of Article 10 (Dividends) as permitted under the proposed treaty, Belgium will not be required to provide information held by a bank, or other financial institution, nominees or person acting in an agency or fiduciary capacity, or because it relates to ownership interests in a person as of the date that paragraph three of Article 10 is no longer effective.

## **Article 26. Assistance in Collection**

Under the proposed treaty, a treaty country shall endeavor to collect on behalf of the other treaty country, but only to the extent necessary to ensure that any exemption or reduced rate of tax at source granted under the proposed treaty is not enjoyed by persons not entitled to those benefits. The proposed treaty provides that a country is not required to carry out

administrative measures at variance with the regulations and practices of either country or which would be contrary to a treaty country's sovereignty, security, or public policy.

### **Article 27. Members of Diplomatic Missions and Consular Posts**

The proposed treaty contains the rule found in the U.S. Model treaty, the present treaty, and other U.S. tax treaties that its provisions do not affect the fiscal privileges of members of diplomatic missions or consular posts 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 that 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, Belgian diplomats who are considered residents of the United States may be protected from U.S. tax.

### **Article 28. Entry into Force**

The proposed treaty provides that the treaty is subject to ratification in accordance with the applicable procedures of each country. Each country shall notify the other in writing through the diplomatic channel, accompanied by an instrument of ratification, when it has completed the required procedures. The proposed treaty will enter into force upon the exchange of instruments of ratification.

With respect to withholding taxes, the provisions of the proposed protocol will have effect 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 provisions of the proposed treaty will have effect for taxable periods beginning on or after the first day of January next following the date on which the proposed treaty enters into force.

Notwithstanding the general effective date of the proposed treaty, subparagraph (f) of paragraph 5 of Article 21 (Limitation on Benefits) is not effective until January 1, 2011. That subparagraph requires that a headquarters company be subject to taxation in its state of residence in the same manner that a company that is a resident of that same state and which engages in the active conduct of a trade or business in such state is subject to tax. The Technical Explanation states that Belgium law is in transition and as of January 1, 2011, this subparagraph will be met.

The proposed treaty provides that the prior treaty generally ceases to have effect with respect to any tax or exchange of information as of the date the proposed treaty takes effect. Notwithstanding this provision, taxpayers may elect temporarily to continue to claim benefits under the present treaty with respect to a period after the proposed protocol takes effect if they would have been entitled to greater benefits under the present treaty. For such a taxpayer, the present treaty would continue to have effect in its entirety for a twelve-month period from the date on which the provisions of the proposed protocol would otherwise take effect.

The proposed treaty provides that the provisions of Article 26 (Exchange of Information and Administrative Assistance) will have effect from the date of entry into force of the proposed treaty, without regard to the taxable period to which the matter relates.

For purposes of the arbitration provisions of Article 24 (Mutual Agreement Procedure), the proposed treaty is effective with respect to: (1) cases that are under consideration by the competent authorities as of the date the proposed treaty enters into force and (2) cases that come under consideration after that time. For cases that are under consideration as of the date the proposed treaty enters into force, the commencement date for such cases shall be the date the proposed treaty enters into force.

### **Article 29. Termination**

The article provides that the proposed treaty is to remain in effect indefinitely, unless terminated by one of the treaty countries. The treaty may be terminated at any time after five years from the date on which the treaty enters into force (as determined under Article 28). In addition, if notice of termination is given, the provisions of the treaty with respect to withholding at source will cease to have effect after the expiration of a period of six months beginning with the date notice of termination was given. For other taxes, the treaty will cease to have effect for taxable periods beginning on or after the expiration of this six-month period.

## VI. ISSUES

### A. Arbitration

#### **In general**

Paragraphs 7 and 8 of Article 24 of the proposed treaty introduce a mandatory arbitration procedure under which each of the competent authorities proposes one (and only one) figure for settlement and the arbitrator must select one of those figures as the award. Unless a taxpayer (or other concerned person) does not accept the arbitration determination, it is binding on the treaty countries with respect to the case. The current treaty does not provide for arbitration.

New paragraph 7 of Article 24 requires the competent authorities to invoke the binding arbitration procedures if they have endeavored, but are unable, to reach a complete agreement in the case, and if three conditions are met. The first condition is that tax returns have been filed with at least one of the treaty countries with respect to the taxable years at issue in the case. The second condition is that the case is not a particular case that the competent authorities agree, before the date on which arbitration proceedings (“proceedings”) would otherwise have begun, is not suitable for determination by arbitration. The third condition is that the taxpayer and all “concerned persons” agree to certain nondisclosure conditions. Under the proposed treaty, all articles of the treaty are eligible for arbitration.<sup>30</sup>

The proposed treaty provides detailed procedural rules governing the arbitration proceedings, including strict time limits for submissions and the final determination of the board.

#### **Overview of issues**

In general, it is beneficial to resolve tax disputes effectively and efficiently. The new arbitration procedures are intended to ensure that the mutual agreement procedures proceed according to a schedule and that all cases will be resolved within a time period not exceeding approximately 35 months. However, the proposed mandatory and binding arbitration procedures are new to the United States’ treaty network. It will take time to ascertain if these procedures are effective in meeting these objectives or if unexpected problems arise. Meanwhile, the Treasury Department may seek to negotiate treaty provisions with current or future treaty partners that are similar, in whole or in part, to the arbitration procedures of the proposed treaty. It is appropriate, therefore, to address issues or potential issues that may arise under the procedures, while

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<sup>30</sup> A similar arbitration procedure is introduced in the proposed protocol to the U.S.-Germany income tax treaty. Under the proposed protocol to the U.S.-Germany treaty (Article XVI, paragraph 22), only issues arising under certain articles are automatically eligible for arbitration. These articles are: Article 4 (Residence), insofar as it relates to the residence of a natural person, Article 5 (Permanent Establishment), Article 7 (Business Profits), Article 9 (Associated Enterprises), and Article 12 (Royalties). Under the proposed protocol to the U.S.-Germany treaty, the competent authorities may agree that a particular case arising under these articles is not suitable for determination by arbitration. The competent authorities may also agree that other particular cases are suitable for arbitration.

considering the place of arbitration within the framework of the mutual agreement procedures of the U.S. treaty system.

### **Other mandatory arbitration proposals and conventions**

There have been other recent developments in the area of arbitration. On January 30, 2007, the OECD adopted proposed changes to its Model treaty and commentary, incorporating a mandatory and binding arbitration procedure (the “OECD mandatory arbitration procedure”), some elements of which are generally similar to those of the proposed treaty.<sup>31</sup> The OECD mandatory arbitration procedure allows a taxpayer whose case has any issues that remain unresolved after the case has been in a mutual agreement procedure for two years to require the issues to be submitted to arbitration. However, the details of the OECD mandatory arbitration procedure are not to be specified in the OECD Model treaty, but are, instead, left to an agreement, governing all arbitration cases, between the competent authorities. A proposed Annex to the proposed Commentary contains a Sample Mutual Agreement on Arbitration (“Sample Agreement”) that may be varied by the treaty countries (the Annex discusses a number of possible variations in a separate commentary on the issues raised by the Sample Agreement (the “Sample Agreement Commentary”).

The European Union has adopted certain mandatory and binding arbitration procedures that are applicable to transfer pricing disputes between the “EU-15” countries (the “EU mandatory arbitration procedure”).<sup>32</sup> Under these procedures, two years after the case is submitted to one of the relevant competent authorities, the relevant competent authorities must set up an “advisory commission” charged with delivering an opinion within six months on the elimination of double taxation in the case under the arm’s-length principle. The competent authorities must either reach an agreement to eliminate double taxation within six months of the advisory commission’s opinion, or must accept and implement that opinion.

Due to the implementation procedures employed by the EU, there was an interim period from January 1, 2000 through October 2004 in which the EU mandatory arbitration procedure was not in effect. Beginning November 1, 2004, the EU mandatory arbitration procedure was extended retroactively back to January 1, 2000. Due in part to these timing issues and in part to other reasons, a number of cases are currently awaiting arbitration under the EU mandatory

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<sup>31</sup> OECD Centre for Tax Policy and Administration (Report adopted by the Committee on Fiscal Affairs), *Improving the Resolution of Tax Treaty Disputes* (Jan. 30, 2007). Paragraph 7 of this report states that the changes will be included in the next update to the OECD Model treaty, which will be published in 2008.

<sup>32</sup> See Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC), 1990 O.J. (L 225) 10 (extended by Protocol amending the Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, 1999 O.J. (C 202) 1). The EU-15 countries are: Belgium, Denmark, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Sweden, and the United Kingdom. A process is under way to extend those arbitration rules to newer members of the EU.

arbitration procedure. The European Commission recently expressed its concern with the procedure:

The Commission considers that the number of long outstanding transfer pricing double tax cases means that, for reasons that need to be further explored, the Arbitration Convention is not eliminating transfer pricing related double taxation in the EU as well as it is supposed to. The proper functioning of the single market is therefore impaired. The Commission intends to consider how this failing can be addressed. It might well be that an instrument that ensures a more timely and effective elimination of double taxation, is necessary from the perspective of the single market.<sup>33</sup>

## **Mandatory arbitration and issues covered**

### Mandatory arbitration

The proposed treaty generally requires arbitration of qualifying cases that are unresolved two years after submission to both competent authorities, unless both competent authorities agree that the case is not suitable for arbitration. One objective of the new procedures is the more efficient resolution of these cases by the competent authorities prior to the running of the two-year deadline triggering referral to arbitration. Another objective is the resolution of cases by arbitration within a guaranteed time period, notwithstanding the difficulty of one or both of the treaty countries in reaching agreement through the general mutual agreement process.

However, if one competent authority is able to slow down the mutual agreement process in a number of cases with the expectation that the arbitrators will resolve difficult issues, the proposed arbitration procedures may not yield the expected favorable results for the mutual agreement process. The Committee may wish to inquire how the Treasury Department and the U.S. competent authority will monitor the competent authority function to determine the overall effects of the new arbitration procedures on the mutual agreement process.

### Issues covered

Another set of questions relates to the circumstances, treaty partners, and types of issues for which the mandatory resolution of cases would benefit the United States. The Committee may wish to inquire whether mandatory and binding arbitration will generally favor the United States or its treaty partner, whether particular types of issues would be more likely than others to be resolved adversely to the position of the United States, and whether it is appropriate for arbitration to cover all of the issues arising under this treaty (and future treaties). For example, the Committee may wish to consider the potential effects of including a mandatory and binding

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<sup>33</sup> Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU, COM(2007) 71 final, at para. 28 (Feb. 26, 2007).



arbitration provision in U.S. tax treaties with developing countries as well as the appropriateness of including such a provision in the U.S. Model treaty.

## **Taxpayer participation in arbitration proceedings and consent to initiation and decision**

### Taxpayer participation

Taxpayers have an important role to play under the mutual agreement procedure of most U.S. tax treaties, including the U.S.-Belgium treaty. Under the existing treaty, as well as the proposed treaty and most other treaties, the taxpayer initiates the mutual agreement procedure and presents its case to the competent authorities.<sup>34</sup> Once initiated, however, the general framework for mutual agreement proceedings is that they are a government-to-government activity.<sup>35</sup> The arbitration procedures of the proposed treaty do not provide for direct taxpayer input to, or appearance before, the board (although such participation is not precluded).

Some believe that the proposed arbitration procedures do not give due regard to the effect of the arbitration process upon taxpayers, and assert that the board might benefit from a direct understanding of taxpayers' positions. Others fear that too much taxpayer involvement in the arbitration process could result in a more lengthy, expensive, and complicated set of procedures than those currently proposed. These persons believe that taxpayers' primary concern in the competent authority process is that their cases are resolved expeditiously. It is also important to note that a taxpayer need not accept the board's determination (as more fully discussed below). The Committee may wish to consider whether the proposed arbitration procedures strike the appropriate balance between efficiency of the deliberative process and taxpayer involvement.<sup>36</sup>

### Taxpayer consent to initiation and decision

Under the proposed treaty, although the taxpayer does not have the formal right to consent to the arbitration process, the third required condition for arbitration is not met until both competent authorities have received from each concerned person (generally, taxpayers and related parties affected by the case) a statement agreeing that the concerned person and each person acting on the concerned person's behalf (i.e., their authorized representatives or agents) will not disclose to any other person any information received during the course of the proceedings from either treaty country or the board, other than the determination of the board

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<sup>34</sup> The EU mandatory arbitration procedure also permits each of the associated enterprises, at its request, to appear before the advisory commission. EU mandatory arbitration procedure, Article 11, paragraph 2. *See also* Sample Agreement, paragraph 11, which allows the taxpayer to present its position to the arbitrators in writing to the same extent as would be allowed during mutual agreement procedures generally, and which also allows for oral presentation by the taxpayer with the permission of the arbitrators.

<sup>35</sup> *See, e.g.*, Rev. Proc. 2006-54, sec. 12.02(4), 2006-49 I.R.B. 1035.

<sup>36</sup> A number of alternative means could be devised to balance efficiency and greater taxpayer involvement, if desired. For example, a taxpayer could be permitted to submit one brief to the board at its request, limited to five or 10 pages, if such taxpayer agrees to be bound by the board's determination.

(the “nondisclosure agreement”). Accordingly, a taxpayer can prevent the initiation of arbitration proceedings by failing to enter into a nondisclosure agreement. Thus, the nondisclosure agreement has the effect of a consent and triggers the process initiating arbitration. In addition, a taxpayer or other concerned person can reject the determination of the board (including simply by failing to accept it within 30 days of receiving it from the competent authority). In that event, the case may not be the subject of further arbitration.

Under the OECD mandatory arbitration procedure, the taxpayer must request arbitration, but has the option not to accept the mutual agreement between the competent authorities implementing the arbitration decision.<sup>37</sup> In contrast, under the EU mandatory arbitration procedure, the taxpayer has no right to request or refuse arbitration in advance, or to accept or reject an arbitration decision.

The Committee may wish to consider whether providing the taxpayer with the option to reject the arbitration decision is a necessary attribute of the type of arbitration adopted by the proposed treaty. In addition, the Committee may wish to inquire whether rejecting an arbitration determination could render uncreditable foreign taxes that would otherwise be creditable, due to the taxpayer’s failure to exhaust its remedies.<sup>38</sup>

### **“Last best offer” vs. “independent opinion” arbitration**

#### In general

Under the EU mandatory arbitration procedure, the advisory commission must base its opinion on the arm’s-length principle. The competent authorities’ decision must also be based on that principle, and they may agree to publish their decision, if the taxpayer consents.

Under paragraph 6(g) of the proposed protocol, each of the treaty countries submits to the board a proposed resolution describing its proposed disposition of the specific amounts of income, expense, or taxation at issue in the case, and a supporting position paper. The board is required to adopt as its determination one of the proposed resolutions submitted by the treaty countries, limited to a determination regarding the amount of income, expense, or tax reportable to the relevant treaty country. This method may be referred to as the “last best offer” or “final offer” approach.<sup>39</sup> Paragraph 6(j) of the proposed protocol provides that the determination of the board is binding upon the treaty countries, but adds that the determination will not state a rationale and will have no precedential value.

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<sup>37</sup> Proposed paragraph 5 of Article 25 of the OECD Model treaty.

<sup>38</sup> The exhaustion of remedies rule requires the exhaustion of “all effective and practical remedies, including invocation of competent authority procedures available under applicable tax treaties.” Treas. Reg. sec. 1.901-2(e)(5)(i).

<sup>39</sup> The method is also informally called “baseball arbitration” because it is similar to the arbitration method used to revolve major league baseball salary disputes.

The OECD Sample Agreement Commentary describes the various options open to treaty partners in structuring the arbitral process. One method is the “independent opinion” approach, under which the arbitrators are presented with the facts and arguments of the parties based on applicable law, and then reach their own independent decision based upon a written, reasoned analysis of the facts involved and applicable legal sources. The Sample Agreement Commentary explains that there are a number of variations between the independent opinion and the last best offer approaches. For example, the arbitrators could reach an independent decision but would not be required to submit a written decision, but simply their conclusions. The Sample Agreement Commentary states that “to some extent, the appropriate method depends on the type of issue to be decided.” Although the Sample Agreement takes as its starting point the independent opinion approach, the Sample Agreement Commentary suggests that the last best offer approach may be better suited to factual questions rather than questions of law, and, alternatively, that competent authorities may agree to use this more “streamlined” process on a case-by-case basis.<sup>40</sup>

The use of the last best offer approach for decision making is intended to cause the negotiators to moderate their positions, on the theory that the arbitrators are more likely to accept a position that they view as reasonable or moderate. Consequently, the potential use in a particular case of the last best offer approach may induce the competent authorities to reach a voluntary agreement at some point in the mutual agreement process, prior to the issuance of the final arbitration decision or even before the case advances to arbitration.

#### Precedent, feedback, or neither

Under the proposed treaty, the board provides only a determination regarding the amount of income, expense, or tax reportable to the relevant treaty country. The OECD mandatory arbitration procedure does not take a position on this issue, but the Sample Agreement provides that unless otherwise provided in the terms of reference to the arbitrators, the decision of the arbitrators is required to indicate the sources of law relied upon and the reasoning that led to its result.<sup>41</sup> The Sample Agreement Commentary states that “showing the method through which the decision was reached is important in assuring acceptance of the decision by all relevant participants.”<sup>42</sup> It is far less important, and perhaps undesirable, to disclose such reasoning if it only represents a position of one of the competent authorities which must be chosen by the board, as in the proposed treaty.

Under last best offer arbitration, it is possible that interpretations of similar law (e.g., the arm’s-length principle) might vary widely across different arbitration proceedings. Moreover, no one would know that fact because the board’s rationale would never be disclosed. However, the

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<sup>40</sup> Sample Agreement Commentary, paragraphs 2-4.

<sup>41</sup> Sample Agreement, paragraph 15. Article 11 of the EU mandatory arbitration procedure requires the board to issue an “opinion,” which could be published with the consent of the enterprises concerned, implying that the board’s reasoning is stated in the opinion.

<sup>42</sup> Sample Agreement Commentary, paragraph 36.

question of whether the arbitration determination should be a reasoned opinion, and, if so, should be published, involves several considerations. A “judicial” model of published precedent, as some have recommended, might require the submission of more formalized legal briefs to the board and, therefore, more board resources, perhaps including staff, to interpret those briefs and devise a written opinion. The resulting body of bilateral international tax treaty law might, or might not, extend to other tax treaties in the U.S. tax treaty network. Overall, this might result in a much more expensive and time-consuming arbitration process than that proposed. Moreover, many competent authority cases are based on disputes that are factual in nature, or at least on disputes perceived as factual in nature by one of the competent authorities; the creation of precedent might be of limited usefulness in resolving factual disputes. On the other hand, it might be useful to the competent authorities and the taxpayers to understand the rationale for the board’s determination. Under a last best offer arbitration procedure, no such feedback is available.

Given these considerations, the Committee may generally wish to inquire regarding the rationale for selecting the last best offer approach instead of the independent opinion approach or a more hybrid approach. More specifically, the Committee may wish to consider whether the lack of feedback from the board to the competent authorities of the rationale for the board’s determination is an essential and desirable feature of the mandatory and binding last best offer arbitration procedure.<sup>43</sup>

#### Sources of authority for decision of the board

Under the proposed treaty, the board is required to apply the following authorities in making its determination, in the following order of priority: (a) the provisions of the treaty; (b) any agreed commentaries or explanations of the treaty countries concerning the treaty; (c) the laws of the treaty countries to the extent not inconsistent with each other; and (d) any OECD commentary, guidelines, or reports regarding relevant analogous portions of the OECD Model treaty.

With regard to (b) above, the Committee may wish to inquire regarding precisely what is meant by “any agreed commentaries or explanations of the treaty countries concerning the treaty,” and whether the Treasury Department has a process in place for obtaining agreement from treaty partners with respect to the technical explanations of the Treasury Department.

The IRS has stated that the U.S. competent authority is to be guided in part by certain OECD pronouncements, as well as U.S. law:

With respect to requests for competent authority assistance involving the allocation of income and deductions between a U.S. taxpayer and a related

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<sup>43</sup> There could be a number of ways to obtain such feedback without materially altering the proposed arbitration procedure. For example, the competent authorities could meet with the arbitration board after the board’s determination has been accepted (or not accepted) by the taxpayer to learn the board’s rationale for its determination. Such a “back-end” procedure might be of assistance in measuring the effectiveness of the arbitration procedure.

person, the U.S. competent authority and its counterpart in the treaty country will be bound by the arm's length standard provided by the applicable provisions of the relevant treaty. The U.S. competent authority will also be guided by the arm's length standard consistent with the regulations under section 482 of the Code and the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations as published from time to time by the Organisation for Economic Co-operation and Development.<sup>44</sup>

Although the OECD mandatory arbitration procedure does not take a firm position on the authorities to be used, the Sample Agreement and Sample Agreement Commentary provide that the arbitrators must decide the issues in accordance with the applicable provisions of the treaty and, subject to those provisions, of the domestic laws of the treaty countries.<sup>45</sup> Beyond that, the Sample Agreement and Sample Agreement Commentary allow for a certain degree of flexibility with respect to interpretation. They invoke Articles 31 to 34 of the Vienna Convention on the Law of Treaties, “having regard to the Commentaries of the OECD Model Tax Convention.”<sup>46</sup> The Sample Agreement also states that “issues related to the application of the arm’s length

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<sup>44</sup> Rev. Proc. 2006-54, sec. 3.03, 2006-49 I.R.B. 1035.

<sup>45</sup> Sample Agreement, paragraph 14, and Sample Agreement Commentary, paragraphs 33-35.

<sup>46</sup> The Vienna Convention on the Law of Treaties (“Vienna Convention”) permits a wide access to supplementary means of interpretation. Article 31 of the Vienna Convention states that “a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context, and in the light of its object and purpose.” The “context” comprises, in addition to the text of the treaty (including its preamble and annexes), agreements made between all the parties in connection with the conclusion of the treaty and instruments made by one party in connection with the conclusion of the treaty and accepted by the other party as an instrument related to the treaty. There shall be taken into account, together with the context, any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions, any subsequent practice in the application of the treaty that establishes the agreement of the parties regarding its interpretation, and any relevant rules of international law applicable in the relations between the parties. Article 32 of the Vienna Convention states that under certain circumstances recourse may also be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion. The Committee may wish to inquire whether the nonprecedential nature of the arbitration methodology adopted by the proposed treaty will restrict the future interpretation of the treaty by the competent authorities, with regard to the broad interpretive means adopted in the Vienna Convention.

Although the Vienna Convention has not been ratified by the United States, it has been “generally recognized as the authoritative guide to current treaty law and practice.” Message from the President of the United States Transmitting the Vienna Convention on the Law of Treaties Signed for the United States on April 24, 1970 (quoting from Letter of Submittal of Secretary of State to the President), S. Exec. Doc. L, 92<sup>nd</sup> Cong., 1<sup>st</sup> Sess. 1 (1971).

principle should similarly be decided having regard to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.”<sup>47</sup>

In the case of a difference in opinion as to the appropriate interpretation of applicable law, that is, where the authorities listed above as priorities (a), (b), and (c) are inconsistent or not agreed by the treaty countries, it is possible that the OECD authorities referenced in (d) above could rise in importance, even with respect to issues or articles that the United States has reserved its rights to treat in a different manner. On the other hand, it may be useful to specify the hierarchy of authorities to foreign-trained arbitrators. The Committee may wish to inquire whether the listing and priority of authorities to be invoked by the arbitrators, when coupled with the requirement that the arbitrators decide the case, will result in giving excessive deference in certain circumstances to OECD commentaries, guidelines, and reports.

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<sup>47</sup> Sample Agreement, paragraph 14. The arbitration board under the EU mandatory arbitration procedure must base its opinion on the arm’s length method. EU mandatory arbitration procedure, Article 11, paragraph 1.

## **B. Treaty Shopping**

### **In general**

The proposed treaty includes limitation on benefits rules that are similar to the limitation on benefits rules in other recent U.S. income tax treaties; in the proposed protocols with Denmark, Finland, and Germany; and in the U.S. Model treaty. These rules are intended to prevent the indirect use of the U.S.-Belgium income tax treaty by persons who are not entitled to its benefits by reason of residence in Belgium or the United States.

When a resident of one country derives income from another country, the internal tax rules of the two countries may cause that income to be taxed in both countries. One purpose of a bilateral income tax treaty is to allocate taxing rights for cross-border income and thereby to prevent double taxation of residents of the treaty countries. Although a bilateral income tax treaty is intended to apply only to residents of the two treaty countries, residents of third countries may attempt to benefit from a treaty by engaging in treaty shopping. This treaty shopping may involve organizing in a treaty country a corporation that is entitled to the benefits of the treaty or engaging in income-stripping transactions with a treaty-country resident. Limitation on benefits provisions are intended to deny treaty benefits in certain cases of treaty shopping.

Although the limitation on benefits rules in the proposed treaty are similar to the rules in other recent and proposed U.S. income tax treaties and protocols and in the U.S. Model treaty, they are not identical, and the Committee may wish to inquire about certain differences. In particular, the Committee may wish to examine the rules for publicly-traded companies, derivative benefits, and certain triangular arrangements. The Committee also may wish to ask the Treasury Department about the special limitation on benefits rules applicable to headquarters companies.

### **Publicly traded companies**

A company that is a resident of a treaty country is eligible for all the benefits of the proposed treaty if it satisfies a regular trading test and either a management and control test or a primary trading test. A company satisfies the regular trading test if its principal class of shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges. Under the management and control test, the company's primary place of management and control must be in the treaty country of which the company is a resident. The primary trading test requires that a company's principal class of shares be primarily traded on a recognized stock exchange located in the treaty country of which the company is a resident or, in the case of a Belgian company, on a recognized stock exchange in another EU or EEA country, or in the case of a U.S. company, in another NAFTA country. A recognized stock exchange specifically includes, in addition to the U.S. and Brussels exchanges, the Irish Stock Exchange

and the stock exchanges of Amsterdam, Frankfurt, Hamburg, Lisbon, London, Madrid, Milan, Paris, Toronto, and Zurich.<sup>48</sup>

The Committee may wish to inquire about the primary trading test in the proposed treaty. That test is similar to the primary trading test in the proposed protocols with Denmark and Finland and the recent protocol with Sweden but differs from the test in the U.S. Model treaty and the test included in the proposed protocol with Germany. Under the primary trading test in the U.S. Model treaty and in the proposed protocol with Germany, the required trading must occur on a stock exchange in the treaty country of which the relevant company is a resident; trading on a stock exchange in another country may not be used to satisfy the test. A possible rationale for this narrower primary trading test, and for the management and control test that may be satisfied instead of the primary trading test, is that a publicly-traded company should be eligible for treaty benefits only if it has a nexus with its country of residence. A company that is a resident of the United States or Belgium may not have this nexus if it satisfies the proposed treaty's primary trading test because of trading on an exchange in a third country. The Committee may wish to ask the Treasury Department about the circumstances that justify allowing trading on third country exchanges to be used to satisfy the primary trading test. In particular, the Committee might ask when it is more appropriate to consider trading in the economic areas of the treaty countries (for example, NAFTA, EU, and EEA countries) than to consider only trading in the treaty countries of which companies are resident. The Committee also may wish to inquire whether trends toward greater or lesser integration in Europe might affect Treasury Department considerations when negotiating about primary trading rules.

Although the proposed treaty's primary trading test is similar to the tests in the recent protocol with Sweden and the proposed protocols with Denmark and Finland, the stock exchanges specifically included in the definition of "recognized stock exchange" (under both the regular trading test and the primary trading test) differ among the three protocols and the treaty. The Committee may wish to inquire about the criteria the Treasury Department considers when negotiating over the definition of a recognized stock exchange.

### **Derivative benefits**

Like the proposed protocols with Denmark, Finland, and Germany, and like other recent treaties, the proposed treaty includes derivative benefits rules that are generally intended to allow a treaty-country company treaty benefits for an item of income if the company's owners (referred to in the proposed treaty as equivalent beneficiaries) would have been entitled to the same benefits for the income had those owners derived the income directly.

The derivative benefits rules may grant treaty benefits to a treaty country resident company in circumstances in which the company would not qualify for treaty benefits under any of the other limitation on benefits provisions. The U.S. Model Treaty does not include derivative

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<sup>48</sup> Trading on only recognized stock exchanges located in the United States, Belgium, or (for Finnish companies) an EEA or EU country, or (for U.S. companies) a NAFTA country may be used to satisfy the primary trading test. Trading on recognized stock exchanges located in any country may be used to satisfy the regular trading test.



benefits rules. The Committee may wish to inquire about the circumstances that justify inclusion of these rules in new treaties notwithstanding their absence from the U.S. Model treaty.

### **Triangular arrangements**

The proposed treaty includes special anti-abuse rules intended to deny treaty benefits in certain circumstances in which a Belgian resident company earns U.S.-source income attributable to a third-country permanent establishment and is subject to little or no tax in the third jurisdiction and Belgium. Similar anti-abuse rules are included in other recent treaties and in the proposed protocols with Denmark, Finland, and Germany. The U.S. Model treaty, however, does not include rules addressing triangular arrangements. The Committee may wish to ask the Treasury Department about the circumstances that justify inclusion of the anti-abuse rules notwithstanding their absence from the U.S. Model treaty. In particular, the Committee may wish to inquire whether the Treasury Department will insist on inclusion of anti-abuse rules whenever a treaty partner's internal tax rules provide an exemption for the income of a third-country permanent establishment of a treaty partner resident.

### **Headquarters companies**

The proposed treaty includes special rules intended to allow treaty country benefits for a resident of a treaty country that functions as a headquarters company and that satisfies certain requirements intended to ensure that the headquarters company performs substantial supervisory and administrative functions for a group of companies; that the group of companies is genuinely multinational; that the headquarters company is subject to the same income tax rules in its country of residence as would apply to a company engaged in the active conduct of a trade or business in that country; and that the headquarters company has independent authority in carrying out its supervisory and administrative functions. U.S. income tax treaties with Australia and the Netherlands include similar rules for headquarters companies. The U.S. Model treaty, however, does not include headquarters company rules.

The requirement that a headquarters company be subject to the same income taxation rules in its country of residence as would apply to a company engaged in an active trade or business in that country has a different effective date from the general effective dates of the proposed treaty. The general effective dates are (1) for withholding taxes, for amounts paid or credited on or after the first day of the second month following the date on which the proposed treaty enters into force and (2) for other taxes, for taxable periods beginning on or after the first day of the first January after the proposed treaty enters into force. The special income tax requirement for headquarters companies, by contrast, is not effective until January 1, 2011. According to the Technical Explanation, Belgian law applicable to headquarters companies is in transition, and the proposed treaty's income taxation requirement for headquarters companies will be satisfied by 2011.

The Committee may wish to ask the Treasury Department about the policies that justify deviating from the U.S. Model treaty and including rules in a treaty that grant headquarters companies treaty benefits when those headquarters companies would not be eligible for treaty benefits under any other limitation-on-benefits provision. The Committee also may wish to

inquire about the basis for the Treasury Department's agreement to a delayed effective date for the income taxation requirement for headquarters companies.

## C. Zero Rate of Withholding Tax on Direct Dividends

### **In general**

When certain conditions are met, the proposed treaty eliminates withholding tax on dividends (“direct dividends”) paid by a company that is resident in one treaty country to a company that is a resident of the other treaty country and that satisfies an ownership requirement. A Belgian company that receives dividends from a U.S. company must own at least 80 percent of the stock of the U.S. company to qualify for the zero rate. A U.S. company that receives dividends from a Belgian company must own at least 10 percent of the stock of the Belgian company to qualify for the zero rate. The elimination of withholding tax on direct dividends is intended to reduce the tax barriers to direct investment between the two treaty countries.

Under the present treaty, direct dividends may be taxed by the source country at a maximum rate of five percent. Both Belgium and the United States impose withholding tax on direct dividends under their internal tax laws. The principal effects of the zero-rate provision on U.S. taxpayers and the U.S. tax base would be (1) to relieve U.S. companies of the burden of Belgian withholding tax on dividends qualifying for the zero rate; (2) to increase the U.S. tax base by eliminating foreign tax credits for Belgian withholding tax that would be imposed in the absence of the zero-rate provision; and (3) to decrease the U.S. tax base by eliminating the U.S. withholding tax on dividends paid by U.S. companies to Belgian companies eligible for the zero rate.

Until 2003, no U.S. income tax treaty provided for a complete exemption from dividend withholding tax, and the U.S. and OECD Model treaties do not provide an exemption. By contrast, many bilateral income tax treaties of other countries eliminate withholding taxes on direct dividends between treaty countries, and the EU Parent-Subsidiary Directive repeals withholding taxes on intra-EU direct dividends. Recent U.S. income tax treaties and protocols with Australia, Japan, Mexico, the Netherlands, Sweden, and the United Kingdom include zero-rate provisions. The Senate ratified those treaties in 2003 (Australia, Mexico, United Kingdom), 2004 (Japan, Netherlands), and 2006 (Sweden). The zero-rate provisions in those treaties are similar to the provision in the proposed treaty.<sup>49</sup>

### **Description of provision**

Under the proposed treaty, the withholding tax rate is reduced to zero on dividends paid by a treaty country resident company and beneficially owned by a company that is a resident of the other treaty country and that has satisfied an ownership requirement for a 12-month period. A Belgian company that receives a dividend from a U.S. company is eligible for the zero rate only if it has owned at least 80 percent of the voting power of the U.S. company for a 12-month period ending on the date on which entitlement to the dividend is determined. This 80-percent ownership requirement may be satisfied by either direct or indirect ownership. A U.S. company

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<sup>49</sup> The treaty with Japan provides a zero-percent rate at a lower ownership threshold than the threshold in the proposed treaty and the other treaties (more than 50 percent as opposed to at least 80 percent).

that receives a dividend from a Belgian company is eligible for the zero rate only if it has owned at least 10 percent of the capital of the Belgian company for the 12-month period ending on the date the dividend is declared. This 10-percent ownership requirement may be satisfied only by direct stock ownership.

A Belgian company's eligibility for the benefits of the zero-rate provision for dividends received from a U.S. company is subject to a more stringent set of limitation-on-benefits requirements than normally apply under the proposed treaty. To qualify for the zero rate, the dividend-receiving company must: (1) satisfy the public trading test of the limitation-on-benefits article; (2) meet the ownership and base erosion test and satisfy the active trade or business conditions of the limitation-on-benefits article with respect to the dividend in question; (3) satisfy the derivative benefits test of the limitation-on-benefits article; or (4) receive a favorable determination from the competent authority.

The proposed treaty provides that the zero-rate provision for paid by U.S. companies will terminate for amounts paid or credited on or after January 1 of the sixth year following the year in which the proposed treaty enters into force unless by June 30 of the preceding year, the U.S. Treasury Secretary, on the basis of a report of the IRS Commissioner, certifies to the U.S. Senate that Belgium has satisfactorily complied with its obligations under Article 25 (Exchange of Information and Administrative Assistance). The United States also may terminate the zero-rate provision for dividends paid by U.S. resident companies if it determines that Belgium's actions under Article 24 (Mutual Agreement Procedure) and Article 25 (Exchange of Information and Administrative Assistance) have materially altered the balance of benefits of the proposed treaty. To terminate the zero-rate provision, the United States must give written notice of termination to Belgium, through the diplomatic channel, on or before June 30 in any year. If the United States gives this notice, the zero-rate provision will cease to have effect for amounts paid or credited on or after January 1 of the year following the year in which the notice is given.

## **Issues**

### **In general**

The proposed protocols with Denmark, Finland, and Germany and the proposed treaty with Belgium would bring to ten the number of U.S. income tax treaties that provide a zero rate for direct dividends. Because zero-rate provisions are a relatively recent but now prominent development in U.S. income tax treaty practice, the Committee may wish to consider the costs and benefits of zero-rate provisions; the Treasury Department's criteria for determining when a zero-rate provision is appropriate; and certain specific features of zero-rate provisions such as ownership thresholds, holding-period requirements, the treatment of indirect ownership, heightened limitation-on-benefits requirements, and termination provisions.

### **Costs and benefits of adopting a zero rate with Belgium**

Tax treaties mitigate double taxation by resolving potentially conflicting source and residence country claims of taxing rights for a particular item of income. Under most income tax treaties, source countries wholly or partly yield to residence countries the right to tax most dividends (other than dividends attributable to a permanent establishment that a company has in

the source country). Thus, the residence country preserves its right to tax the dividend income of its residents, and the source country agrees either to limit its withholding tax to a low rate (five percent, for example) or to forgo it entirely.

Treaties that permit a positive rate of dividend withholding tax allow the possibility of double taxation. If the residence country allows a foreign tax credit for source-country withholding tax, double taxation may be mitigated or eliminated, but the effect of a credit is to violate the residence country's primary right to tax dividend income. If a residence country imposes limitations on its foreign tax credit (as the United States does with its overall and basket limitations), withholding taxes may not be fully creditable and some double taxation may remain. For these reasons, dividend withholding taxes are commonly viewed as barriers to cross-border investment. Removing a barrier to cross-border investment is a principal argument for the proposed treaty's zero-rate provision.

Direct dividends may present an appropriate circumstance for eliminating withholding tax. A company deriving business income in the United States or Belgium generally is subject to net-basis income tax in that country on the business income, and when it pays a dividend out of the income to a company in the other country, the dividend income generally is taxed in that other country (subject to allowable foreign tax credits). If the dividend-paying company is at least 10-percent owned by the dividend-receiving company, the dividend-receiving company may be viewed as a direct investor (and taxpayer) in the source country rather than as a portfolio investor. A portfolio investor would be less likely to be subject to net-basis taxation in the source country; a source-country withholding tax on dividends paid to a portfolio investor therefore might be viewed as more appropriate than a withholding tax on direct dividends.

Under domestic laws, both the United States and Belgium generally impose withholding tax on cross-border dividends. The zero-rate provision, therefore, would benefit direct investment in Belgium by U.S. companies and direct investment in the United States by Belgian companies. Stated differently, the zero-rate provision would provide benefits both when the United States is exporting capital and when it is importing capital. The zero-rate provision may be more widely applicable when the U.S. is exporting capital than when it is importing capital because the ownership requirement in the former case (Belgian-source dividends) is 10 percent and in the latter case (U.S.-source dividends) is 80 percent. The revenue effect of the zero-rate provision is unclear: the revenue loss to the United States from the elimination of withholding tax on U.S.-source dividends might be offset in whole or part by reduced foreign tax credit claims related to Belgian-source dividend payments.

Many countries have included zero-rate dividend provisions in their income tax treaties for longer than the United States has. These countries include OECD members Austria, Denmark, Finland, France, Germany, Iceland, Ireland, Japan, Luxembourg, Mexico, the Netherlands, Norway, Sweden, Switzerland, and the United Kingdom, and non-OECD-members Belarus, Brazil, Cyprus, Egypt, Estonia, Israel, Latvia, Lithuania, Mauritius, Namibia, Pakistan, Singapore, South Africa, Ukraine, and the United Arab Emirates. The EU Parent-Subsidiary Directive also eliminates withholding tax on direct dividends between EU companies. Many countries have eliminated withholding taxes on dividends as a matter of internal law. Thus, although the zero-rate provision in the proposed treaty is part of a relatively recent development in U.S. income tax treaties, there is substantial international precedent. This international

precedent may be a reason in itself why the zero-rate provision in the proposed treaty is appropriate: by eliminating withholding tax on direct dividends between the United States and Belgium, the proposed treaty joins many existing income tax treaties and domestic and international tax rules in reducing tax barriers to foreign direct investment.

#### General direction of U.S. tax treaty policy

Because zero-rate provisions are common in U.S. income tax treaties that have entered into force since 2003, the Committee may wish to examine the Treasury Department's criteria for determining the circumstances under which a zero-rate provision may be appropriate. Although zero-rate provisions are common in recent U.S. treaties, recent treaties with Bangladesh, France, and Sri Lanka do not include zero-rate rules. The U.S. Model also does not provide a zero dividend withholding tax rate. In previous testimony before the Committee, the Treasury Department has indicated that zero-rate provisions should be allowed only under treaties that have restrictive limitation-on-benefits rules and that provide comprehensive information exchange. Even in those treaties, according to previous Treasury Department statements, dividend withholding tax should be eliminated only based on an evaluation of the overall balance of benefits under the treaty. The Committee may wish to ask what overall balance considerations might prompt the Treasury Department not to seek a zero-rate provision in a treaty that has limitation-on-benefits and information-exchange provisions meeting the highest standards.

#### Specific design features

The Committee also may wish to examine certain specific design features of zero-rate provisions, features such as ownership thresholds, holding-period requirements, the treatment of indirect ownership, heightened limitation-on-benefits requirements, and the termination provisions.

The Committee may wish to ask the Treasury Department why the ownership requirements are different for Belgian-source dividends (10 percent) than for U.S.-source dividends (80 percent). One question might be under what circumstances is an ownership requirement below 80 percent appropriate. Another question might be what circumstances justify different ownership requirements based on the source of the dividend.

The Committee also may wish to ask the Treasury Department why a 12-month holding period strikes a proper balance between the competing considerations of, on the one hand, preventing short-term shifting of ownership to claim the zero rate and, on the other hand, of allowing the zero rate in connection with ordinary, non-abusive structures.

The Committee may wish to inquire about the proposed treaty's rules that (1) the 80-percent ownership requirement for U.S.-source dividends may be satisfied by taking into account direct and indirect ownership and (2) the 10-percent ownership requirement for Belgian-source dividends may be satisfied by taking into account only direct stock ownership. The Committee may wish to ask what considerations determine whether zero-rate treaty provisions should permit indirect ownership to be taken into account in testing whether ownership rules are satisfied. It

may also wish to ask what circumstances justify different stock ownership rules for dividends paid by U.S. companies than for dividends paid by companies resident in another treaty country.

The Committee may wish to ask whether the proposed treaty's special limitation-on-benefits conditions for qualification for the zero rate for U.S.-source dividends -- for example, the active trade or business and ownership and base erosion tests -- are likely to be included in future treaties, and how these special provisions might change as zero-rate provisions become more widespread in the U.S. income tax treaty network. Because the proposed treaty does not impose special limitation-on-benefits conditions for qualification for the zero rate for Belgium-source dividends, the Committee may wish to ask whether the Treasury Department foresees similar disparities between the zero-rate limitation-on-benefits rules for U.S.-source dividends and the rules for dividends sourced in other treaty countries.

The Committee may wish to inquire about the rules permitting termination of the zero-rate provision for dividends paid by U.S. companies. No other U.S. income tax treaty that provides exemption from dividend withholding tax includes provisions allowing the exemption to be terminated. The Committee may wish to ask the Treasury Department whether the termination provisions represent a precedent that may be followed in future treaty negotiations. More generally, the Committee might ask about the circumstances that could justify inclusion of termination provisions.

## **D. Students, Trainees, Teachers and Researchers**

### **Treatment under proposed treaty**

The proposed treaty modifies the present treaty's treatment of income taxes for students, business trainees, teachers, and researchers but maintains the general exemptions of the present treaty.

Under the proposed treaty (Article 19), teachers and researchers who are residents of one treaty country and who visit the other treaty country (host country) are entitled to an exemption from host country taxation on certain remuneration for a period not exceeding two years from the date of arrival. The exempt remuneration is that received for teaching or research so long as the visit is for the purpose of teaching or carrying on research at a school, university, college, or other educational or research institution.

The proposed treaty's treatment of students and business trainees (Article 19) corresponds to the U.S. Model treaty. Under the proposed treaty, students and business trainees are exempt from host country income tax on payments arising from outside the host country received for maintenance, education, and study if the purpose of the visit is to engage in full-time education or full-time training. Business trainees are defined as individuals visiting the host country to secure training to practice a profession or professional specialty or individuals who are employed by a resident of the other country and whose purpose is to acquire technical, professional, or business experience from someone other than their employers or relatives of their employers. While the payments received by students are exempt so long as the purpose of their visit is to engage in full-time education, the exemption for business trainees is limited to a period not exceeding two years from the date of arrival in the host country for the purpose of training.

Under the proposed treaty, students and business trainees may also exempt an aggregate amount of \$9,000 or its euro equivalent of income from personal services performed in the host country. The exemption for the personal service income of business trainees is limited to a period of two years from the date of arrival in the host country.

### **Issues**

#### **Teachers and researchers**

Unlike the U.S. Model treaty, the proposed treaty provides an exemption from host country income tax for income an individual receives from teaching or research in the host country. Under section 911, a U.S. citizen or resident may elect to exclude up to \$85,700 of non-U.S. source earned income attributable to personal services performed by the citizen or resident.<sup>50</sup> Additionally, such an individual may exclude or deduct from gross income certain foreign housing costs paid or incurred by or on behalf of the individual. Section 911 in conjunction with the proposed treaty provision allows a teacher or researcher to receive

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<sup>50</sup> The \$85,700 exemption amount for 2007 is indexed for inflation. Sec. 911(b)(2)(D).



remuneration of up to \$85,700, plus certain housing costs, tax free. Likewise, under the proposed treaty a Belgian teacher or researcher is exempt for a period of two years or less from U.S. income tax on income earned while visiting the United States for the purpose of engaging in teaching or research.

The effect of the proposed treaty is to make cross-border visits for the purpose of teaching or research financially attractive. Ignoring relocation expenses, a U.S. citizen or permanent resident may receive more net, after-tax remuneration by visiting Belgium as a teacher or researcher than by remaining in the United States. Likewise, a Belgian resident may receive more net, after-tax remuneration by visiting the United States as a teacher or researcher than by remaining in Belgium. Increasing the financial reward may serve to encourage cross-border visits by academics for teaching and research, which in turn may foster the advancement of knowledge and redound to the benefit of residents of both countries.

On the other hand, complete exemption from income tax in both the United States and Belgium may be seen as unfair when compared to other persons who must temporarily relocate abroad for their occupation or employment. The income of a U.S. citizen or permanent resident who is not a teacher or researcher and who temporarily takes up residence and employment in Belgium is subject to Belgian income tax; the income may also be subject to U.S. income tax to the extent it is in excess of the section 911 limitation. Likewise, the income of a Belgian resident who is not a teacher or researcher and who temporarily takes up residence and employment in the United States is subject to U.S. income tax. Thus, the proposed treaty could be viewed as violating the principle of horizontal equity by treating otherwise similarly economically situated taxpayers differently.

The U.S. Model treaty includes no exemption for the remuneration of visiting teachers or researchers. An exemption for visiting teachers and professors has been included in many bilateral tax treaties. The Committee may wish to satisfy itself that the inclusion of an exemption for a limited class of individuals is appropriate.

#### Full-time students and trainees

The proposed treaty generally has the effect of exempting from the income tax of both treaty countries certain payments. The exempt payments are those arising outside the host country that are received for the maintenance, education, and training of full-time students and full-time trainees as visitors from one treaty country to the other. This exemption conforms to the U.S. Model treaty and the OECD Model treaty provisions. Under the proposed treaty, full-time students and trainees may also earn up to \$9,000 or its equivalent in euro annually in tax-free personal services income in the host country. This personal service income exemption is similar to a provision in the U.S. Model treaty but departs from the OECD Model treaty. This provision generally would have the effect of reducing the cost of the education and training received by visitors, which may encourage individuals to consider study abroad in the other treaty country. Such cross-border visits by students and trainees may foster the advancement of knowledge and redound to the benefit of residents of both countries.

In the case of business trainees, the proposed treaty limits the exemption for such payments to a period of two years or less. By potentially subjecting such payments to host

country income tax, the cost for cross-border visitors of engaging in such longer duration training programs would be increased. This increased cost may discourage visitors to such programs in either country. It could be argued that the training of a business trainee relates primarily to specific job skills of value to the individual or the individual's employer rather than enhancing general knowledge and cross-border understanding, as may be the case in the education of a full-time student. This could provide a rationale for providing more open-ended treaty benefits in the case of students as opposed to business trainees. However, this rationale raises a question as to why training requiring two years or less is preferred to training that requires a longer visit to the host country. As such, the proposed treaty would favor certain types of training arrangements over others. The OECD Model treaty does not limit the duration of exemption for payments for maintenance, education, and training for business trainees; the U.S. Model treaty limits the exemption to a period not exceeding one year.