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

PREPARED FOR THE USE OF THE

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BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This pamphlet describes the proposed protocol to the income tax treaty between the United States and the Kingdom of Norway signed at Oslo, Norway, on December 3, 1971. The protocol was signed at Oslo, Norway, on September 19, 1980. A public hearing on the proposed protocol is scheduled for September 24, 1981, by the Senate Committee on Foreign Relations.

The proposed protocol deals with issues that have arisen since the treaty was signed. In particular, it deals with problems raised by the exploitation of oil in the Norwegian sector of the North Sea. Norway has enacted a special tax to apply to income from the exploitation of oil in its sector of the North Sea. Questions have arisen as to its creditability for U.S. tax purposes, and to the effect of its enactment on preexisting Norwegian corporate taxes paid by oil producers. In addition, there are questions regarding the tax treatment of U.S. drillers who are involved in the exploration for or exploitation of oil and gas in Norwegian waters.

Other technical problems with the existing treaty have arisen. These are dealt with in the proposed protocol.

The first part of the pamphlet is a summary of the principal provisions of the proposed protocol. This is followed by a detailed, article-by-article explanation of the proposed protocol.

I. SUMMARY

The proposed protocol contains the following modifications to the tax treaty between the United States and the Kingdom of Norway:

(1) ***Submarine Petroleum Resource Tax.***—The proposed protocol would provide that the special tax imposed by Norway on submarine petroleum resources by the Petroleum Tax Act of 1975 (the "PTA") is a covered tax and is creditable for U.S. purposes. The proposed protocol limits the amount of the Norwegian taxes paid by persons subject to the PTA which is allowable under the treaty as a tax credit so that the PTA imposed on extraction income from Norwegian sources may only offset U.S. tax on that income. In addition, the PTA which is imposed on certain oil transportation, treatment, and storage income may only offset U.S. tax on that income.

(2) ***Offshore drilling operations.***—Under the proposed protocol, each country will be allowed to tax under its domestic laws persons engaged in activities in connection with the exploration for or exploitation of, for more than 30 days in a 12-month period, seabed mineral resources situated in that country. This provision will primarily affect U.S. independent drilling contractors who are using movable drilling rigs to undertake exploratory drilling for oil in the Norwegian sector of the North Sea and other service companies carrying on ancillary services in connection with drilling.

In addition, individuals performing services in connection with the exploration or exploitation of seabed natural resources would be allowed to exclude their first 60 days wages from tax in each year. Furthermore, the competent authorities would be authorized to exempt from Norwegian tax wages of a person earned for services performed in connection with petroleum reserves extending between Norway and another country where the services are performed in both countries.

(3) ***Transportation income.***—Under the proposed protocol international shipping and aircraft income derived by a United States resident would be exempt from Norwegian tax regardless of where the ship or aircraft is registered.

(4) ***Dividends.***—The proposed protocol would increase the maximum rate of withholding on dividends from 10 to 15 percent on all dividends. Under the present provision the rate is 10 percent on certain direct investment dividends and 15 percent on all others. Also, the U.S. would be permitted to impose its so-called second withholding tax on certain dividends paid by Norwegian companies doing business in the United States. However, the provision is narrower than the code provision.

(5) ***Interest.***—The complete exemption from tax at source on interest would be replaced with a provision permitting a 10 percent withholding tax. However, interest on bank loans, commercial credit, cer-

tain government obligations, and obligations outstanding at the signing of the Protocol remain exempt. Also, interest will be exempt in the source country unless the other country imposes a tax on interest paid to nonresidents. As Norway does not now impose such a tax all interest would remain exempt from tax.

(6) ***Capital gains.***—The protocol would permit the United States to tax gains derived by Norwegian residents from the sale of an interest in an entity the property of which consists primarily of United States real property. Also, Norway would be permitted to tax certain U.S. residents on the gain from the sale of stock in a Norwegian company if more than half of its business assets are located in Norway.

(7) ***Entertainers and athletes.***—The protocol would adopt the U.S. model income tax treaty regime for taxing entertainers and athletes. A country could tax an artists or athlete if he was present there for more than 90 days during a year or he earns more than $10,000 from entertainment related services there during the year. Also, special anti-abuse rules would apply where the income from services of an entertainer accrues to another person.

(8) ***Social security.***—Social Security and other similar payments would be taxable only by the State making the payment, even if the recipient is a U.S. citizen.

(9) ***Taxation of former citizens.***—The treaty would be conformed to the U.S. model by specifically providing that the United States will retain its jurisdiction to tax former citizens as citizens for ten years following loss of citizenship.

(10) ***Administrative provisions.***—The proposed protocol specifically allows refunds to be made regardless of the statutes of limitations of the countries. It also permits the competent authorities to adjust the dollar figures in the convention and modernizes the exchange of information provision.

II. EXPLANATION OF PROPOSED PROTOCOL

A detailed, article-by-article explanation of the proposed protocol to the income tax treaty between the United States and the Kingdom of Norway is presented below.

Article I. Petroleum Revenue Tax

The present treaty generally applies to U.S. Federal income taxes imposed under the Internal Revenue Code. In the case of Norway, the treaty applies to the national and municipal taxes on income and capital, the national dues on salaries of nonresident artists, the special tax in aid of developing countries, the municipal tax on real property, and the seaman's tax. In addition, the treaty contains a provision generally found in U.S. income tax treaties to the effect that it will apply to substantially similar taxes which either country may subsequently impose.

The proposed protocol is similar to the third protocol to the income tax treaty between the United States and the United Kingdom. That treaty specifically provides that the United Kingdom tax on offshore petroleum revenue is to be treated as a creditable income tax for U.S. foreign tax credit purposes. Also, in response to a threatened reservation, it provides for a per-country limitation on the credit granted by the treaty. The proposed protocol would provide similar treatment for the Norwegian petroleum tax.

Norway's national and municipal taxes on income and capital are governed principally by the Act of 18 August, 1911, No. 8, as amended. This Act contains detailed rules covering income taxation in Norway for individuals and corporations, including generally accepted notions concerning concepts of income as well as rules concerning deduction of expenses and recovery of capital. Under Norwegian law, the municipal income tax is currently imposed upon corporations at a 23 percent rate and the national income tax is imposed at a 27.8 percent rate. In computing the national tax a deduction is allowed for dividends paid. The present treaty provides that the national and municipal taxes on income, the national dues on salaries of nonresident artists, the special tax in aid of developing countries, and the seaman's tax are income taxes for U.S. foreign tax credit purposes. See Article 23(1).

By Act of 13 June 1975 No. 35 relating to the Taxation of Petroleum Resources, etc. (as amended, referred to as the Petroleum Tax Act or PTA), Norway imposed an additional tax on the exploration for and exploitation of submarine petroleum resources and activities and work related thereto, including pipeline transport of petroleum produced, in defined areas offshore Norway. The current rate of tax is 35 percent. The Petroleum Tax Act of 1975 incorporated into the national and municipal taxes a more definitive mechanism for determining income from petroleum activities. This Act enabled the Norwegian Government to integrate into its tax system concepts necessary to deal with more precision with the complex petroleum industry. In addition, the Act provided a means to capture more of the income earned as a result of dramatic escalations in world prices of crude oil during the period immediately preceding its enactment.

The PTA provides, generally, for assessments of tax on assets connected with and income derived from offshore petroleum activities and work conducted in defined offshore areas to be made according to general legislation concerning the taxation of capital and income, subject, however, to such exceptions and reservations as are provided in the PTA or by the Storting. In addition, the PTA imposes a special national tax (Special Tax) on income earned from production and pipeline transportation in the defined offshore areas.

The PTA contains certain rules for the determination of income and capital of, and for the payment of tax by, taxpayers subject to the national and municipal taxes as modified by it, and to the Special Tax added by it. These rules, applicable for national, municipal, and Special Tax purposes supplement or override the general tax legislation.

Under the PTA, depreciation of most offshore assets is allowed, straight line, over six years from the date an asset is placed in service. Losses may be carried forward for fifteen years instead of the normal 10 years. Only 50 percent of any losses incurred in activities outside the scope of the PTA are deductible against income subject to PTA; losses incurred in activities within the scope of PTA are allowed in full against other income; and no losses from foreign activities may be deducted against income within the scope of PTA. Also, onshore losses are not deductible for purposes of computing the PTA. Deductions for sales commissions, discounts or costs in connection with the sales of petroleum between enterprises permanently associated with each other are not allowed. Gross income from petroleum is determined under a norm price system, established for the purpose of avoiding excessive administrative burdens associated with determining a fair market value transfer price in a multitude of commercial contexts. The norm price is to be established as equivalent to the price at which petroleum could have been sold between independent parties in a free market. The norm price is periodically stipulated by a Norwegian government appointed board after interested parties are notified and given the opportunity to comment. As stipulated it is subject to administrative and judicial review. Rules also exist for the time for payment of income and capital taxes on income derived from and capital connected with petroleum production and pipeline transport.

Income for Special Tax purposes is calculated in the same manner as income subject to the national tax (including rules outlined above). However, no deduction is allowed for dividends distributed or for losses incurred in activities other than petroleum production and pipeline transport. In addition, a special allowance equal to 6⅔ percent of the cost of depreciable assets is allowed for a period of 15 years commencing in the year after the year the asset is placed in service.

The Special Tax is not deductible from income subject to municipal or national tax; municipal tax is not deductible from income subject to national or Special Tax; and national tax is not deductible from income subject to municipal or Special Tax. Accordingly, the PTA is an additional tax of 35 percent of the taxpayer's income computed under the Norweigan tax law.

No determination has been made by the U.S. Treasury or Internal Revenue Service concerning the creditability or noncreditability of Norway's national or municipal income taxes or the Special Tax as such under the PTA. Questions such as whether the Special Tax is a creditable income tax under general U.S. Internal Revenue Code concepts or whether it is a substantially similar tax to those creditable taxes enumerated in paragraph (1)(b) of Article 1 of the present treaty or whether the national and municipal taxes as modified and applied under the PTA remain creditable under Article 23 have not been resolved administratively or judicially. However, under the Treasury's proposed and temporary foreign tax credit regulations, as presently drafted, it would appear that at least certain of these taxes would not be creditable. The protocol provides that these taxes are creditable, subject to the limitations contained in the proposed protocol.

The proposed protocol contains the general rule found in the present treaty with Norway and many other U.S. tax treaties under which the United States agrees that it will continue to allow its citizens and residents to claim a foreign tax credit (Code secs. 901 and 902) against the U.S. tax for the appropriate amount of income taxes paid to Norway. The credit allowed is subject to the limitations and in accordance with the provisions of U.S. law (as it may be amended from time to time without changing the general principles of allowing a foreign tax credit) applicable to the year in question.

The proposed protocol, also, provides that the treaty applies to the Special Tax imposed under the PTA and to the national and municipal income taxes as administered under the PTA and to substantially similar taxes that may be enacted later. Such taxes are specifically included as creditable income taxes for purposes of the treaty.

The proposed protocol contains a series of limitations with respect to taxpayers subject to the Special Tax, the effects of which are to restrict the use of Norwegian taxes as credits in a "per country" manner similar to the recent United Kingdom protocol. With respect to income taxes on oil and gas extraction income from oil or gas wells in Norway, the amount of credit allowed may not exceed the maximum U.S. corporate income tax rate for the year (currently 46 percent) times the amount of such income. Similar limitations are imposed with respect to Norwegian taxes on Norwegian source oil related income and other Norwegian source income.

The proposed protocol permits a limited carryback or carryover of taxes that cannot be credited in the year paid. With respect to taxpayers subject to Special Tax and Norway taxes on oil and gas extraction income from oil or gas wells in Norway, the amount which can be carried over or back to the preceding two or succeeding five taxable years is limited to the lesser of the amount of taxes paid or accrued to Norway on oil and gas extraction income from oil or gas well in Norway not allowed as a credit during the taxable year or 2 percent of the oil and gas extraction income from oil or gas wells in Norway for the taxable year. These limitations are similar to U.S. domestic law. The amount of the carryover or carryback of Norway taxes on Norwegian source oil related income and other Norwegian source income is further limited to taxes paid or accrued to Norway on such income and which are not allowed as a credit during the taxable year.

Under Article 23(1) of the treaty as amended by the proposed protocol, limitations on creditability imposed by U.S. domestic law (other than the requirement that the tax constitute an income tax or a tax in lieu thereof), as they are now in force or as they may be changed without changing the general principle of the foreign tax credit, will continue to apply in determining the amount of the foreign tax credit the taxpayer will ultimately receive as a result of payment of taxes to Norway.

Article I of the proposed protocol imposes treaty limitations in determining Norway taxes paid or accrued by taxpayers subject to the Special Tax which qualify as creditable foreign tax only if the taxpayer uses the provisions of the treaty to obtain the credit. The proposed protocol will not reduce the foreign tax credit which may be claimed for the Special Tax or the national and/or municipal income taxes as administered under the P.T.A. to the extent any of them are otherwise creditable income taxes under U.S. statutory law.

Article II. Offshore Activities

The proposed protocol adds a new Article 4A to the treaty covering offshore activities. It is intended to deal primarily with the activities of certain U.S. independent drilling contractors and their employees in the Norwegian sector of the North Sea. This provision would amend the treaty to clarify the right of Norway to tax the activities of these drilling contractors or their employees under its domestic laws. Although the contractors would be allowed a credit against U.S. tax liability for Norwegian income taxes, the credit may be less than the full Norwegian tax paid. Also, to the extent Norwegian taxes are increased, the drilling contractors may not be able to get the benefit of the investment tax credit. While the protocol provisions were added primarily to deal with activities of U.S. persons in the North Sea, they also make it clear that Norwegian activities in connection with activities on the U.S. continental shelf are subject to U.S. tax.

Under the treaty, the terms "Norway" and "United States" are defined to include the seabed and subsoil and their natural resources over which the countries exercise rights. Oil companies have entered into contracts with U.S. drilling companies and service and supply companies with respect to mineral exploration and exploitation in the North Sea through the use of movable drilling rigs. The treaty limits Norway's right to tax business profits of a U.S. company to profits that are attributable to a permanent establishment in Norway. The term "permanent establishment" includes "a building or construction or installation project which exists for more than 12 months" but it is not clear whether this language would encompass these drilling rigs. Furthermore, the activities of independent drilling contractors with respect to any one project are frequently completed in less than 12 months. In addition, individuals performing independent services in the North Sea who could establish that they did not themselves have a fixed base in Norway might, under certain circumstances, be exempt from Norwegian tax on their income from the performance of services (Article 13).

The proposed protocol provides that a person who is a resident of one country and carries on activities for more than 30 days in a 12-month period in the other country in connection with the exploration or exploitation of the seabed and subsoil and their natural resources situated in that other country is deemed to be carrying on in respect of those activities a business in that other country through a permanent establishment or fixed base therein. This rule would permit such income, whether business profits or income from independent personal services, to be taxed by the country in which the activities are performed under the business profits or independent personal services articles. Thus, for example, a U.S. drilling company drilling in the Norwegian sector of the North Sea for 9 months would be taxable by Norway.

This provision does not apply where the activities are carried on for 30 days or less in the aggregate in any 12-month period. However, for purposes of the 30-day threshold, activities carried on by a person related to another person are to be regarded as carried on by the second person if the activities in question are substantially the same as those carried on by that second person.

The proposed protocol also provides that the provisions of Article 6 ("Shipping and Air Transport") will apply to profits derived by a resident of one country from the transportation by ship or aircraft of supplies or personnel to a location where exploration or exploitation of the seabed and subsoil and their natural resources are being carried on in the other country. It would also apply to income from the operation of tugboats and similar vessels in connection with those exploration or exploitation activities. The proposed protocol further provides that the wages of a resident of a country for labor or services performed on such a ship or aircraft are covered by Article 14(3) ("Dependent Personal Services"). Accordingly, Norway would be specifically granted the right to tax those wages earned by a U.S. resident aboard such a ship or aircraft if the ship or aircraft is operated by a resident of Norway, and if the individual is a member of the regular complement of the ship or aircraft.

Under Article 14 of the existing treaty, remuneration from labor or personal services derived by a nonresident employee from sources within one country may be taxed by that country unless the employee is present in the country for less than 183 days, he is an employee of a resident of the other country or a permanent establishment maintained in the other country by a nonresident of that other country, and the remuneration is not borne by a permanent establishment which the employer has in the country in which the remuneration has its source. The insertion of Article 4A(1) and (2) in Article II of the proposed protocol indirectly affects the status of employees. Since the employer will be deemed to be carrying on a business through a permanent establishment or a fixed base situated in the country in which the labor or personal services of the employee are performed, any remuneration borne by such permanent establishment will prevent the exemption of Article 14(2) from applying. The remuneration of employees of drilling contractors therefore will be subject to tax in Norway unless otherwise exempted.

In recognition of the fact that Norwegian individual tax rates are substantially higher than U.S. rates and that, because of amendments to the permanent establishment definition, more individual U.S. residents will become subject to tax in Norway, the protocol inserts a new Article 4A(4) which provides a standard exclusion for the first 60 days' wages of employees of drilling contractors and others subject to it. Individual residents of one country who derive remuneration from labor or personal services in connection with the exploration and exploitation of the seabed and subsoil and their natural resources situated in the other country may exclude from income subject to tax in the other country remuneration attributable to labor or personal services for a period of 60 days in the taxable year, regardless of the length of stay in the other country.

An additional problem has arisen for U.S. residents who perform services in the North Sea for U.S. drilling contractors. At times the work may be done on a reservoir that extends between Norway and a neighboring country. The individual may therefore perform services in two countries and be taxed by both. The proposed protocol provides that Norway will not tax income from labor or personal services performed on behalf of an employer who is a resident of the United States with respect to petroleum reservoirs which extend between Norway and another State if Norway and the other country have an agreement for joint exploitation of the reservoir and the exploitation is performed simultaneously in both countries. At present, Norway has such an agreement with the United Kingdom. The exemption will come into effect only after the U.S. and Norwegian competent authorities have agreed that the exclusion should come into force.

Article III. Transportation Income

The proposed protocol revises the rules of the existing treaty which govern taxation by Norway of income which a U.S. resident earns from international shipping and air transport. The change would conform the treaty to the U.S. model income tax treaty.

Under the current treaty, income which a U.S. resident derives from the operation in international traffic of ships or aircraft is exempt from Norwegian tax but only if the ship or aircraft is registered in the United States or Norway, or in a country with which Norway has an income tax treaty exempting shipping or air transportation income from tax. Residents of Norway, however, are exempt from U.S. tax regardless of where the ship or aircraft is registered.

The proposed protocol removes the domestic or Norwegian registration, or "flag" requirement, that applies to a U.S. resident. Thus, income of a U.S. resident from a ship flying, for example, the Liberian flag would not be subject to Norwegian tax. This amendment does not affect gains from the disposition of ships or aircraft operated in international traffic. They continue to be governed by the provisions of Article 12(2) ("Capital Gains").

Article IV. Dividends

The proposed protocol would increase the maximum rate of tax that a country can impose on dividends derived by a resident of the other country from 10 percent to 15 percent in all cases. At present, the treaty generally permits a 15 percent rate of tax. However, the limit is 10 percent if the recipient of the dividend is a corporation that owns at least 10 percent of the outstanding voting stock of the distributing corporation during the entire taxable year prior to distribution and up to the time of distribution, and not more than 25 percent of the gross income of the paying corporation in the taxable year prior to distribution consists of interest or dividends other than interest derived in the conduct of a banking, insurance or financing business or interest or dividends received from a corporation in which the paying corporation owns, at the time of receipt of the interest or dividends, 50 percent or more of the outstanding voting stock. The effect of the proposed protocol would be to raise to 15 percent the 10 percent rate for so-called direct investment dividends.

Both the United States and the Organization for Economic Cooperation and Development ("OECD") models provide for a lower rate of tax on direct investment dividends. The change is being made primarily at the request of Norway. The dividend deduction allowed under Norway's national tax computation coupled with reserve fund rules adopted in the Norwegian Companies Act of 1976 have reduced the attainable effective tax rate on distributions abroad below that considered desirable by Norway.

The proposed protocol would, also, amend the treaty to permit the United States to impose its withholding tax on certain dividends paid by Norwegian companies doing business in the United States. The United States imposes its withholding tax on part or all of dividends paid to foreign shareholders by foreign corporations if 50 percent or more of the distributing corporation's gross income for the 3-year period ending with the close of the taxable year preceding the year of declaration was effectively connected with the conduct of a trade or business in the United States. This provision is intended to limit the ability of foreign persons to use foreign corporations to avoid the U.S. withholding tax on dividends. Under the existing treaty the United States cannot impose this tax on dividends paid by Norwegian companies. This creates a potential problem because a resident of a country that does not have an income tax treaty with the United States can form a Norwegian company to do business in the United States.

The provision in the proposed protocol would permit the United States to impose its withholding tax. The provision is more limited than the code provision in a significant respect. Under the code the 50 percent test compares gross income to gross income, while the proposed treaty rule is passed on a comparison of "profits" to gross income. The U.S. tax on dividends paid by a Norwegian company is limited to the 15-percent rate provided for dividends, but only if the recipient is a resident of Norway who is not a U.S. citizen. If paid to a resident of a third country, the full 30 percent U.S. statutory rate would apply.

Article V. Interest

The proposed protocol amends the treaty to provide that a country may tax interest paid at a rate of 10 percent or less. The article is also slightly revised and modernized.

The present treaty conforms to the United States position as expressed in the U.S. model by providing that interest will be exempt from tax at source.

The proposed protocol would amend the treaty to remove the exemption and would provide that interest may be taxed by both the country of source and the country of residence of the payee. The withholding tax would be limited to 10 percent generally. (In the absence of a treaty limitation, the United States generally imposes a 30-percent withholding tax on interest paid by U.S. debtors, other than on bank deposits, to foreign lenders.) However, interest will be exempt in the source country during any year in which the other country exempts similar interest derived from sources within it from taxation under its domestic law. At present, Norway does not impose a withholding tax on Norwegian source interest paid to foreigners and accordingly interest will remain free of tax at source.

The proposed protocol provides an exemption for interest in certain cases. Exempted is interest which is beneficially owned by or is paid by a contracting state, or a local government, or a tax-free subdivision or authority of a contracting state, interest that is beneficially owned by a resident of a country if paid on debt obligations guaranteed or insured by that government or a local government of that government, interest on commercial credit resulting from payments for goods and merchandise or services, bank interest, and interest on obligations which were outstanding on the date of signature of the protocol (September 19, 1980).

The proposed protocol would continue the broad definition of interest found in the existing treaty. Thus, it defines interest as income from bonds, debentures, government securities, notes, and debt plans of every kind, interest that the tax law of the country of source treats as interest income. The proposed protocol would continue the provision in the present treaty article that addresses the issue of a non-arm's-length interest charge between related parties by providing that the amount of interest for purposes of the treaty will be the amount of arm's-length interest that would normally be charged by an unrelated party. The amount of interest in excess of the arm's-length interest will be taxable according to the laws of each country, taking into account the other provisions of the 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 the dividend article (Article 8)).

The proposed protocol would also retain the provision in the present treaty that provides that the benefits of the interest article do not apply if the beneficial owner of the interest who is a resident of one country has a permanent establishment in the other country and the indebtedness giving rise to the interest is effectively connected with that permanent establishment. In that case, the interest will be treated as business profits of that permanent establishment under Article V (Business Profits), and taxed accordingly.

Finally, the proposed protocol also retains the provision in the treaty that interest paid by a resident of one country to a person who is not a resident of the other country will be exempt from tax by that other country. The rule would apply so that interest paid by a Norwegian company to a person other than a citizen of the United States will be exempt from tax by the United States. This rule does not apply if the interest is treated as from sources within the other country or if the recipient of the interest has a permanent establishment in the other country and the indebtedness giving rise to the interest is effectively connected with the permanent establishment.

Article VI. Capital Gains

The proposed protocol would permit a country to tax capital gain derived from the disposition of stock in a corporation or an interest in a partnership, trust or estate if the property of that entity consists principally of real property located in that country. In addition, a country would be permitted to tax gain derived by a resident of the other country from the disposition of stock in a corporation of that country if that individual owns a substantial amount of stock in the company and more than one-half of the business assets of the company are located in that country.

Under the treaty, capital gains derived by a resident of one country will generally be exempt from tax by the other country. Under the Code, capital gains derived from U.S. sources by foreign investors are generally exempt from tax. Under the present treaty, the exemption does not apply (and gain be taxed by both countries) in three situations: where the property sold is real property; where property is effectively connected with a permanent establishment that the transferor has in the source country; and where the property is effectively connected with a fixed base maintained by the individual in the source country or the individual is present in the source country for 183 days during the taxable year.

The proposed protocol would add two additional situations in which the exemption would not apply, and thus the gain would be taxable in both countries. First, gain from the sale, exchange or other disposition of stock of a corporation or an interest in a partnership, trust or estate where the property of the entity consists principally of real property located in one of the countries may be taxed in the country where the property is located. Real property would include stock of a corporation, or an interest in a partnership, trust or estate whose property consists principally of real property.

Under legislation enacted by the United States at the end of 1980 (sec. 897) the United States can tax a foreign person on his gain from the disposition of stock of a U.S. corporation if 50 percent of certain of its assets are U.S. real property. This provision would generally preserve this taxing jurisdiction for the United States. However, under the U.S. legislation, a Norwegian selling an interest in a partnership would be taxed on his proportionate share of the U.S. real property of the partnership. Under the treaty he would not be taxed unless real estate was more than 50 percent of the value of the partnership.

The second situation in which an exclusion would be denied is gain derived by a resident of one country from the sale, exchange or other disposition of stock of a corporation which is a resident of the other country if the transferor owns more than 25 percent of the stock of the corporation and more than 50 percent of the gross value of the business assets of the corporation are physically located in that other country on the last day of the three preceding taxable years of the corporation. This rule would permit a country to tax the gain on the sale of stock of a resident corporation doing most of its business in that country as business profits.

The protocol would provide that gains that a country may tax under the protocol will be treated as sourced in that country. In the case of the United States this provision has the effect of allowing under the treaty a foreign tax credit for any taxes imposed on these gains.

Article VII. Entertainers and Athletes

The protocol adopts the U.S. model rules for taxation of entertainers and athletes.

Under the present treaty a country can tax the entertainment personal service income of an entertainer or athlete who is a resident of the other country if the entertainer or athlete is present in that country for more than 90 days in the taxable year or he earns more than $3,000 or its equivalent in Norwegian kroner during the taxable year.

The protocol would raise the dollar threshold to $10,000 and would also add a new anti-abuse rule intended to prevent an entertainer or athlete from avoiding tax in the country in which he performs services by leasing his services to a foreign company that then contracts out his services in the United States or Norway and receives the income free of tax. The protocol provision would provide that where income for personal services performed by an entertainer or athlete is paid not to the individual but to another person or entity, that income may be taxed in the country in which the services are performed. The provision applies only if the entertainer or athlete, or a related person, participates in the profits of the other person in any manner. For this purpose, profit participation includes the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions, or other distributions.

Article VIII. Social Security

Under the treaty, social security payments are taxable only by the paying country. The proposed protocol would maintain this rule but extend it to payments to U.S. citizens who are not residents of the United States. Accordingly, social security payments by Norway to a nonresident U.S. citizen could not be taxed by the United States. This provision is an exception to the general provision in the treaty that the United States can tax its citizens on all of their income.

Article IX. General Rules of Taxation

The proposed protocol would amend the treaty to clarify that the United States retains its taxing jurisdiction over a former citizen for 10 years following loss of citizenship. Under the treaty, the United States retains the right to tax its citizens as if the treaty was not in effect. Accordingly, worldwide taxation of U.S. citizens is retained.

The proposed protocol would provide that a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of income tax will be treated as a citizen for 10 years following his loss of citizenship. This provision clarifies the right of the United States to apply its internal taxation rule that retains jurisdiction to tax former citizens on certain income for 10 years after they give up their citizenship (Code sec. 877). Even without this provision, the U.S. Internal Revenue Service takes the position that former citizens can be taxed. See Rev. Rul. 79–152, 1979–16.B.

Article X. Relief from Double Taxation

Under the existing treaty, Norway generally employs the exemption with progression method of providing relief from double taxation. Norway does, however, employ the credit method in certain cases such as dividends. In addition, where a Norwegian corporation owns 10 percent or more of the stock of a U.S. corporation, Norway allows a "deemed paid" credit against its tax for U.S. taxes imposed on the earnings out of which the dividend is paid. The proposed protocol would continue this regime, but would clarify it and provide that, for purposes of computing Norwegian tax on the dividend payment, the payment must be "grossed up" by the amount of tax deemed paid by the Norwegian recipient. As in the present treaty, the proposed protocol would also limit the credit to Norwegian taxes on U.S. source income. This regime is similar to that under U.S. law.

The proposed protocol would also require Norway to permit a resident of Norway who may be taxed by the United States under the Article dealing with offshore activities (Article 4(A)) to credit the U.S. tax against Norwegian tax imposed on that income. The credit is limited so that the U.S. tax can only offset Norwegian tax on income taxable by the United States under Article 4(A).

Article XI. Mutual Agreement Procedure

The existing treaty provides that when the competent authorities, upon request of a resident of one of the countries, reach an agreement to relieve him of double taxation then taxes may be imposed on the income in question and any refund or credit of taxes may be allowed in accordance with the agreement. The proposed protocol would amend this provision to clarify that the agreement can be implemented even if the statute of limitations provided by domestic laws has run. This rule would not open the statute of limitations for other items on the return except insofar as they are affected, directly or indirectly, by application of the provisions of the treaty. It also gives the competent authorities the right to agree to raise currency limits in the treaty to reflect economic developments.

Article XII. Exchange of Information

The proposed protocol would amend the exchange of information Article of the treaty to conform it to the U.S. model. The provision would provide that when information is requested by one country the requested country must use the same powers that it has under its domestic law to obtain information for its tax purposes. Also, if specifically requested, a country must supply information in authenticated form.

Article XIII. Entry into Force

The proposed protocol will enter into force on the date of exchange of instruments of ratification. Once in force, the provisions in Article I of the proposed protocol, dealing with the foreign tax credit, will apply retroactively to the 6 years preceding January 1 of the year in which the protocol enters into force. The other provisions apply only after the protocol has entered into force.

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