JOINT COMMITTEE ON TAXATION
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TESTIMONY OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION BEFORE THE SENATE COMMITTEE ON FOREIGN RELATIONS HEARING ON THE PROPOSED TAX TREATY WITH MALTA AND THE PROPOSED TAX PROTOCOLS WITH FRANCE AND NEW ZEALAND[1]

NOVEMBER 10, 2009

My name is Thomas A. Barthold. I am Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the staff of the Joint Committee on Taxation today concerning the proposed income tax treaty with Malta and the proposed tax protocols with France and New Zealand.

Overview

As in the past, the Joint Committee staff has prepared pamphlets covering the proposed treaty and protocols. The pamphlets provide detailed descriptions of the proposed treaty and protocols, including comparisons with the United States Model Income Tax Convention of November 15, 2006 ("U.S. Model treaty"), which reflects preferred U.S. tax treaty policy, and with other recent U.S. tax treaties.[2] The pamphlets also provide detailed discussions of issues raised by the proposed treaty and protocols. We consulted with the Treasury Department and with the staff of your committee in analyzing the proposed treaty and protocols and in preparing the pamphlets.

The principal purposes of the treaty and protocols 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 and

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[1] This document may be cited as follows: Joint Committee on Taxation, Testimony of the Staff of the Joint Committee on Taxation Before the Senate Committee on Foreign Relations Hearing on the Proposed Tax Treaty with Malta and the Proposed Tax Protocols with France and New Zealand (JCX-54-09), November 10, 2009. This publication can also be found at http://www.jct.gov/.

[2] Joint Committee on Taxation, *Explanation of Proposed Income Tax Treaty Between the United States and Malta* (JCX-50-09), November 6, 2009; Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and France* (JCX-49-09), November 6, 2009; Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and New Zealand* (JCX-51-09), November 6, 2009.

protocols also are intended to promote close economic cooperation between the treaty countries and to eliminate possible barriers to trade and investment caused by overlapping taxing jurisdictions of the treaty 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.

The proposed treaty with Malta would restore an income tax treaty relationship that the United States terminated with effect in 1997. The proposed protocol with France would amend an existing tax treaty that was signed in 1994 and that was amended by a previous protocol signed in 2004. The proposed protocol with New Zealand would amend an existing tax treaty that was signed in 1982.

My testimony today will highlight some of the key features of the proposed treaty and protocols and certain issues that those agreements raise.

U.S. Model treaty

As a general matter, U.S. model tax treaties provide a framework for U.S. tax treaty policy and a starting point for tax treaty negotiations with our treaty partners. These models provide helpful information to taxpayers, the Congress, and foreign governments about U.S. policies on tax treaty matters. The present U.S. Model treaty incorporates important developments in U.S. income tax treaty policy that had been reflected in U.S. income tax treaties signed in the years immediately preceding the Model's publication in 2006. Treaties that the United States has negotiated since 2006 in large part follow the U.S. Model treaty. The proposed treaty and protocols that are the subject of this hearing are, accordingly, generally consistent with the provisions found in the U.S. Model treaty. There are, however, some key differences from the U.S. Model treaty that I will discuss.

Malta: treaty shopping

Limitation-on-benefits provisions

Like the U.S. Model treaty, the proposed protocols with France and New Zealand and the proposed treaty with Malta include extensive limitation-on-benefits rules. Limitation-on-benefits provisions are intended to prevent third-country residents from benefitting inappropriately from a treaty that generally grants benefits only to residents of the two treaty countries. This practice is commonly referred to as "treaty shopping." A company may engage in treaty shopping by, for example, organizing a related treaty-country resident company that has no substantial presence in the treaty country. The third-country company may arrange, among other transactions, to have the related treaty-country company remove, or strip, income from the treaty country in a manner that reduces the overall tax burden on that income. Limitation-on-benefits rules may prevent these and other transactions by requiring that an individual or a company seeking treaty benefits have significant connections to a treaty country as a condition of eligibility for benefits.

The limitation-on-benefits rules of the proposed protocols with France and New Zealand are generally consistent with the rules of the U.S. Model treaty. The limitation-on-benefits rules of the proposed treaty with Malta, by contrast, depart in several significant respects from parallel rules of the U.S. Model treaty. These departures generally make the rules of the proposed treaty

with Malta more restrictive than the U.S. Model treaty's limitation-on-benefits provision. For example, the departures include more restrictive tests, first, for determining whether a publicly-traded company qualifies for treaty benefits and, second, for determining whether a non-publicly traded company is eligible for treaty benefits based on the extent to which the company pays its gross income to persons who are not residents of either treaty country.

Withholding tax rules

The proposed treaty with Malta also departs from the U.S. Model treaty in its withholding tax rules for interest, royalties, and other income not covered by particular articles of the treaty. The U.S. Model treaty provides an exemption from source-country withholding tax on most payments of interest, royalties, and other income to a resident of the other treaty country. By contrast, the proposed treaty with Malta permits withholding at a 10-percent rate on these payments.

The proposed treaty with Malta is consistent with the U.S. Model treaty in its rules for dividend withholding tax, but these rules are less favorable to taxpayers than the dividend provisions of other recent U.S. tax treaties. Like the U.S. Model treaty, the proposed treaty with Malta permits imposition of source-country withholding tax at a five-percent rate on dividends paid to a 10-percent-or-greater shareholder resident in the other treaty country and at a 15-percent rate on other dividends. The proposed protocol with France and many other recent U.S. tax treaties eliminate source-country withholding tax on dividends paid by an at least 80-percent-owned subsidiary to the parent corporation in the other treaty jurisdiction.

Malta's domestic law

The strict limitation-on-benefits rules and the less taxpayer-favorable withholding tax rules of the proposed treaty with Malta are intended to restrict treaty shopping that might otherwise be attractive because of features of Malta's internal tax laws. These features include, among others: (1) an exemption from Maltese corporate taxation for dividends received by a Malta corporation from certain foreign subsidiaries; (2) a corresponding exemption from Maltese corporate tax for gain from the sale of shares of these foreign subsidiaries; (3) the absence of Maltese withholding tax on dividend and interest payments to non-Maltese residents; and (4) an imputation system of corporate tax that has the effect of eliminating a shareholder-level tax on corporate profits.

Appropriateness of entering into new treaty with Malta

The previously mentioned U.S. termination of the prior income tax treaty with Malta was due in part to the Treasury Department's concern that Malta's internal tax law might have facilitated treaty shopping. At the time, Malta also did not generally permit sharing of bank information with foreign tax authorities. Malta has since joined the European Union ("E.U."), implemented E.U. directives assuring mutual administrative assistance and compliance with international transparency norms, and revised its domestic laws to allow Maltese tax authorities to share bank information with foreign tax authorities. By contrast, the Maltese internal taxation rules that might have facilitated treaty shopping remain largely unchanged. To prevent possible

treaty shopping, however, the proposed treaty includes the strict limitation-on-benefits and withholding tax provisions described above.

In light of the prior treaty history, your committee may wish to ask the Treasury Department about the factors that led it to conclude that it was now appropriate to enter into a new income tax treaty with Malta. Your committee may also wish to inquire whether the provisions of the proposed treaty and changes to Maltese domestic law, taken together, assuage the concerns that led the Treasury Department to terminate the prior treaty.

France: mandatory arbitration

The proposed protocol with France broadly follows the U.S. Model treaty. The proposed protocol does, however, differ from the U.S Model treaty in several provisions, including its requirement that disputes that the competent authorities of the two treaty countries are unable to resolve through consultation be settled by arbitration.

U.S. income tax treaties provide mutual agreement procedures authorizing the competent authorities of the treaty countries to cooperate to resolve disputes, clarify issues, and address cases of double taxation. The present tax treaty with France and other U.S. income tax treaties permit the competent authorities and the affected taxpayer to agree to voluntary arbitration of a case that the competent authorities cannot resolve by mutual agreement. The proposed protocol with France replaces this optional arbitration procedure with rules for mandatory arbitration of some unresolved disputes. Three U.S. tax treaties – those with Belgium, Canada, and Germany – now contain similar rules for mandatory arbitration. These rules are a departure from the U.S. Model treaty. The proposed treaty with Malta and the proposed protocol with New Zealand do not include provisions for mandatory arbitration of unresolved cases.

Although the mandatory arbitration provision of the proposed protocol with France is similar to the corresponding provisions of the U.S. tax treaties with Belgium, Canada, and Germany, there are two significant differences. First, by contrast with the U.S. tax treaties with Canada and Germany, but like the U.S.-Belgium treaty, the proposed protocol with France permits arbitration of any case involving the application of any article of the treaty so long as the competent authorities have not agreed that the case is not suitable for arbitration. The U.S. tax treaties with Canada and Germany provide mandatory arbitration of cases involving the application of only certain treaty articles. Second, by contrast with the treaties with Belgium, Canada, and Germany, the proposed protocol with France allows a taxpayer whose case is in mandatory arbitration to submit a position paper to the arbitration board. Your committee may wish to inquire about both the scope of mandatory arbitration and the opportunity for taxpayer participation.

More broadly, your committee may wish to ask about the Treasury Department's intentions for future U.S. income tax treaties and protocols. Does the Treasury Department expect that mandatory arbitration provisions following the proposed protocol and the treaties with Belgium, Canada, and Germany will become a standard feature of future U.S. tax treaties, or will the Treasury Department be selective in choosing the countries with which it negotiates those provisions? If the Treasury Department expects mandatory arbitration to become a standard feature in future U.S. tax treaties, will the Treasury Department revise the U.S. Model

treaty to include mandatory arbitration rules? If mandatory arbitration is not expected to be a part of all or most future U.S. income tax treaties, it may be useful to ask what criteria the Treasury Department will use to determine whether a particular treaty should include mandatory arbitration.

Your committee also is aware that as a condition of ratifying the U.S. protocol with Canada last year, the Senate required the Treasury Department to submit to the Joint Committee on Taxation and the Senate Finance Committee, among other information, a report describing the operation of the mandatory arbitration procedures of the treaties with Belgium, Canada, and Germany. This report must include information about the size and subject matter of cases before arbitration and the length of time of arbitration proceedings. This report must be provided within 60 days after a determination is reached in the tenth arbitration proceeding conducted under the U.S. treaty with Belgium, Canada, or Germany, and similar reports must be submitted annually for five years thereafter. These required reports will not include information about the operation of the mandatory arbitration procedures of the proposed protocol with France. Your committee may wish to consider whether the required Treasury reporting should be expanded to encompass arbitration proceedings under the proposed protocol with France.

Exchange of information

The U.S. Model treaty and U.S. income tax treaties generally provide exchange of information rules requiring the competent authorities of the two treaty countries to exchange information that may be relevant for carrying out the treaties or the domestic laws of the treaty countries concerning all taxes imposed by a treaty country. The exchange of information article of the proposed protocol with New Zealand closely follows the information exchange rules of the U.S. Model treaty. The exchange of information articles of the proposed treaty with Malta and the proposed protocol with France largely follow the corresponding rules of the U.S. Model treaty but do differ in certain respects. The Joint Committee staff's pamphlets describe these differences and provide detailed overviews of the information exchange articles of the two proposed protocols and the proposed treaty. Here I wish to highlight issues related to the proposed treaty relationship with Malta and related to the effectiveness of information exchange under income tax treaties generally.

Information exchange with Malta

As described previously, the United States terminated its prior income tax treaty with Malta with effect in 1997. At the time, Malta did not generally permit sharing of bank information with foreign tax authorities. Malta has since joined the European Union and implemented E.U. directives concerning transparency and legal assistance. Last year, Malta revised its banking law to grant Maltese tax authorities access to bank information for the purpose of exchanging the information with tax authorities of other countries under information exchange agreements. Malta has entered into 45 agreements that require exchange of information in compliance with standards set by the Organisation for Economic Co-operation and Development ("OECD"). Malta is now considered to have fully committed to the transparency standards of the OECD.

To the extent that there were perceived deficiencies in the former information exchange relationship with Malta that contributed to the decision to terminate the prior treaty, and to the extent that the United States may have little recent practical experience in cooperating with Malta on tax matters, your committee may wish to seek reassurances that any obstacles to effective information exchange have been eliminated.

The information exchange article of the proposed treaty with Malta includes one difference from the corresponding article of the U.S. Model treaty. The proposed treaty permits the recipient of information exchanged under the treaty to use that information for purposes sanctioned by the U.S.-Malta Treaty on Certain Aspects of Mutual Legal Assistance in Criminal Matters ("MLAT"). The Senate ratified that treaty last year, but it has not yet entered into effect. The extent to which this deviation from the U.S. Model treaty is intended to expand the scope of permitted exchange of information is not clear. The inclusion of a cross-reference to the MLAT in the proposed treaty is unique among U.S. income tax treaties, although it is consistent with both the OECD Convention on Mutual Assistance in Tax Matters (in Article 4) and the 2005 OECD Model Convention on Income and on Capital (in Article 26). Your committee may wish to explore how this new rule is to be reconciled with domestic restrictions on disclosure of return information if Malta requests permission to use the information for nontax purposes.

Effectiveness of information exchange

The Joint Committee staff's pamphlets describe in detail several practical issues related to information exchange under income tax treaties. I will briefly note two issues here. First, automatic and specific information exchange under tax treaties, two of three broad methods of exchange of information, may not always be fully useful.[3] Under automatic exchange, the parties to a tax treaty typically enter into a memorandum of understanding to share on an ongoing basis information that is deemed consistently relevant to the tax administration of the other treaty country; the treaty countries are not required to specifically request this information from one another. The United States, for example, provides to its treaty partners information about U.S.-source income received by residents of those treaty countries. Specific exchange occurs when one treaty country provides information to the other treaty country in response to a request by the latter country for information that is relevant to an ongoing investigation of a particular tax matter.

Problems with automatic exchange under U.S. tax treaties and the tax treaties of other countries have included that information has not been provided on a timely basis; treaty countries' tax reporting periods have differed from one another; the recipient country has had difficulty translating information into its own language; and information flows have been voluminous. Your committee may wish to inquire about whether there are any practical impediments to automatic information exchange with France, Malta, and New Zealand and the ease with which any impediments could be removed and the likelihood that they would be removed.

[3] The other method of information exchange is spontaneous exchange. Spontaneous exchange occurs when one treaty country determines that information in its possession may be relevant to the other treaty country's tax administration and thus transmits the information to the other country.

One problem with specific exchange has been that some treaty countries have declined to exchange information in response to specific requests intended to identify limited classes of persons.[4] Your committee may wish to seek assurances that, under the proposed treaty with Malta and the proposed protocols with France and New Zealand, treaty countries are required to exchange information in response to specific requests that are comparable to John Doe summonses under domestic law.[5]

Second, the United States has been criticized for Federal and State rules that may facilitate attempts by foreign persons to evade their home country tax laws. One criticism is that the U.S. "know-your-customer" rules for financial institutions may be less strict than other countries in their requirements for the determination of beneficial owners of financial accounts. A second criticism has been that the entity formation laws of some U.S. States make it difficult for government officials to ascertain the identities of owners of entities. Your committee may wish to ask about the extent to which it may be appropriate to consider policy changes to ensure that the United States is able to respond effectively to information requests from its treaty partners.

Article-by-article summaries

The Joint Committee staff's pamphlets provide detailed article-by-article explanations of the proposed treaty and the two proposed protocols. Below is a summary of significant features of each agreement.

Malta

Like other U.S. tax treaties, the proposed treaty with Malta includes rules that limit each country's right, in specified situations, 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 also provides that pensions and other similar remuneration paid to a resident of one country may be taxed only

[4] For example, a petition to enforce a John Doe summons served by the United States on UBS, AG was filed on February 21, 2009, accompanied by an affidavit of Barry B. Shott, the U.S. competent authority for the United States-Switzerland income tax treaty. Paragraph 16 of that affidavit notes that Switzerland had traditionally taken the position that a specific request must identify the taxpayer. See *United States v. UBS AG*, Civil No. 09-20423 (S.D. Fla.). On August 19, 2009, after extensive negotiations between the Swiss and U.S. governments, the United States and UBS announced that UBS had agreed to provide information on over 4,000 U.S. persons with accounts at UBS.

[5] Under a John Doe summons, the U.S. Internal Revenue Service ("IRS") asks for information to identify unnamed "John Doe" taxpayers. The IRS may issue a John Doe summons only with judicial approval, and judicial approval is given only if there is a reasonable basis to believe that taxes have been avoided and that the information sought pertains to an ascertainable group of taxpayers and is not otherwise available.

by that country and only at the time and to the extent that a pension distribution is made (Articles 17 and 18).

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 proposed treaty limits the rate of tax that the source country may impose on certain dividends paid to a resident of the other country. As described previously, these rules are consistent with the corresponding provisions of the U.S. Model treaty, but they represent a departure from the exemption from source-country withholding tax provided by several recent U.S. treaties and protocols for dividends paid by subsidiaries to parent corporations resident in the other treaty countries.

The proposed treaty's rule for Maltese taxation of Malta-source dividends paid to residents of the United States takes into account the Maltese imputation system of corporate tax. The rule provides that the tax that may be charged by Malta on dividends paid by a Maltese company to a U.S. resident is limited to the Maltese tax chargeable on the profits out of which the dividends are paid.

The proposed treaty generally limits the rate of source-country tax that may be imposed on interest arising in one treaty country (the source country) and beneficially owned by a resident of the other treaty so that it may not exceed 10 percent of the gross amount of the interest (Article 11). Similarly, the proposed treaty provides that a royalty payment arising in a treaty country and beneficially owned by a resident of the other treaty country may be subject to a source country tax of up to 10 percent of the gross amount of the royalty (Article 12). As described previously, these provisions differ from the corresponding rules of the U.S. Model treaty. The U.S. Model treaty provides an exemption from source-country tax for most interest and royalty payments beneficially owned by a resident of the other country.

Unlike the U.S. Model treaty, the proposed treaty permits limited source-country taxation of income not dealt with in other articles of the treaty. That income may be taxed by the source country at a rate not greater than 10 percent (Article 21). As described previously, the U.S. Model treaty, by contrast, exempts this income from source-country taxation.

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 (Article 20) generally provides that students and business trainees who are residents of one treaty country and who visit the other treaty country (the host country)

are exempt from host-country taxation on certain types of payments received from sources in their home country for their maintenance, education, or training.

The proposed treaty provides authority for the two countries to resolve disputes (Article 25) and exchange information (Article 26) in order to carry out the provisions of the proposed treaty. As noted above, unlike the U.S. Model treaty exchange of information rules, the proposed treaty permits the use of tax information received under the tax treaty for purposes that are consistent with the scope of the MLAT between the United States and Malta.

The proposed treaty also contains a detailed limitation-on-benefits provision to prevent the inappropriate use of the treaty by third-country residents (Article 22). This provision generally reflects the anti-treaty-shopping provisions included in the U.S. Model treaty and more recent U.S. income tax treaties, but, as was described previously, is more stringent in a number of respects.

The provisions of the proposed treaty generally take effect on or after the first day of January following the date that the proposed treaty enters into force. With respect to withholding taxes (principally on dividends, interest, and royalties), the provisions of the proposed treaty take effect 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.

France

The proposed protocol with France makes changes to Article 4 (Resident) of the present treaty that in general make the rules conform more closely to the rules of other recent U.S. income tax treaties and protocols. Among other changes, the proposed protocol provides a special rule for French qualified partnerships and includes rules for fiscally transparent entities, which are entities that are not subject to tax at the entity level, that are similar to rules found in other recent U.S. income tax treaties. One difference from recent U.S. treaties is the addition of a requirement that, when a fiscally transparent entity formed or organized outside the United States or France derives an item of income, profit, or gain from U.S. or French sources, the fiscally transparent entities rules apply only if the country in which the entity is organized has concluded with the treaty country from which the income, profit, or gain is derived an agreement including an exchange of information provision intended to prevent tax evasion.

The proposed protocol replaces Article 10 (Dividends) of the present treaty. The new article generally allows full residence-country taxation and limited source-country taxation of dividends. The proposed protocol retains both the generally applicable 15-percent maximum withholding rate and the reduced five-percent maximum rate for dividends received by a company owning at least 10 percent of the dividend-paying company. As described previously, like several other recent treaties and protocols, the proposed protocol 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. As in the present treaty, special rules apply to dividends received from a regulated investment company, a real estate investment trust, and a société d'investissement à capital variable; under the proposed protocol, these rules are extended to a "société d'investissement immobilier cotée" and a "société de placement à prépondérance immobilière à capital variable."

Article 12 (Royalties) of the present treaty is revised to provide that royalties arising in a treaty country (the source country) and beneficially owned by a resident of the other treaty country are exempt from taxation in the source country. Under the present treaty, the source country may impose up to a five-percent withholding tax on gross royalty payments.

The proposed protocol makes conforming changes to Article 13 (Capital Gains) to reflect revisions made to Article 12 (Royalties). It also updates Article 17 (Artistes and Sportsmen) to reflect the fact that the French currency is now the euro.

The proposed protocol clarifies that the exclusive source-country tax rule of Article 18 (Pensions) for payments arising under the social security legislation or similar legislation of one of the treaty countries to a resident of the other treaty country applies, in the case of payments arising under France's social security legislation, to payments made not only to residents of the United States, but also to citizens of the United States who are residents of France. Accordingly, notwithstanding the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions), the United States may not tax French social security payments made to a U.S. citizen resident in France.

Article 22 (Other Income) of the present treaty is replaced with a new article that conforms to the corresponding U.S. Model treaty provision. The article generally assigns taxing jurisdiction over income not dealt with in the other articles of the treaty to the residence country of the beneficial owner of the income.

The proposed protocol switches the order of two paragraphs of Article 24 (Relief from Double Taxation), clarifies that companies that are French residents may elect to be taxed on a worldwide basis subject to a credit in lieu of applying the general exemption system in France to foreign business income, and makes several conforming changes.

The proposed protocol changes cross-references that Article 25 (Non-Discrimination) makes to provisions of Articles 10 (Dividends) and 12 (Royalties). These changes in cross-references reflect the proposed protocol's renumbering of certain paragraphs of Articles 10 and 12.

As described previously, the proposed protocol changes the voluntary arbitration procedure of Article 26 (Mutual Agreement Procedure) of the treaty to a mandatory arbitration procedure 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 protocol, 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. A mandatory and binding arbitration procedure is included in the U.S. income tax treaties with Belgium, Canada, and Germany.

Mutual administrative assistance is modernized under the proposed protocol. The proposed protocol replaces Article 27 (Exchange of Information) of the present treaty with rules that conform closely to the U.S. Model treaty. The proposed rules generally provide that the two competent authorities will exchange such information as may be relevant in carrying out the

provisions of the domestic laws of the United States and France concerning taxes imposed at a national level, to the extent the taxation under those laws is not contrary to the treaty. The proposed protocol's information exchange article deviates from the U.S. Model treaty's article in its conditions under which entry into a treaty country's sovereign territory is permitted. The proposed protocol requires that a treaty country permit representatives of the other treaty country enter its territory to interview a taxpayer or to examine a taxpayer's books and records if the taxpayer has consented. This rule is narrower than the corresponding rules of the U.S. Model treaty because the proposed protocol's rule does not permit entry for interviewing or examining the books and records of consenting third parties.

Article 28 (Assistance in Collection) of the present treaty is modified to remove an obsolete reference to former paragraph 4 of Article 10 (Dividends).

The proposed protocol amends Article 29 (Miscellaneous Provisions) of the present treaty, updating the saving clause to provide that France may tax entities that have their place of effective management in France, and which are subject to tax in France, notwithstanding the new fiscally transparent entity provision in Article 4 (Resident). It also updates the definition of former citizen and long-term residents to conform with the changes to section 877 of the Code and makes conforming changes to other paragraphs in Article 29. The proposed protocol adds a new rule to Article 29 that payments made by French government agencies to lawful permanent residents of the United States will be taxable only in the United States.

As described previously, Article 30 (Limitation on Benefits) of the present treaty is replaced with a new article 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 indirect use of the treaty by persons who are not entitled to its benefits solely by reason of residence in France or the United States.

The proposed protocol modifies Article 32 (Provisions for Implementation) of the present treaty to delete obsolete references to former paragraph 4(i) of Article 10 (Dividends) and former paragraph 8 of Article 30 (Limitation on Benefits).

Finally, Article XVI of the proposed protocol provides for the entry into force of the proposed protocol. The treaty countries will notify each other in writing when their respective constitutional and statutory requirements for entry into force of the protocol have been satisfied. The proposed protocol will enter into force on the date of receipt of the latter of such notifications. For withholding taxes, the proposed protocol has effect with respect to amounts paid or credited on or after January 1st of the calendar year in which the proposed protocol enters into force. For all other taxes, the proposed protocol has effect for taxes imposed for tax periods beginning on or after January 1st of the year immediately after the date on which the proposed protocol enters into force. With respect to the binding arbitration rules of Article 26 (Mutual Agreement Procedures), the proposed protocol is effective for cases under consideration by the competent authorities as of the date the proposed protocol enters into force and cases that come under consideration thereafter.

New Zealand

Articles I (General Scope), II (Taxes Covered), III (General Definitions) and X (Independent Personal Services) of the proposed protocol with New Zealand generally update the provision of the present treaty to conform to the U.S. Model treaty.

The proposed protocol replaces the definition of "resident of a Contracting State" in Article 4 (Residence) of the present treaty with one that is identical to the definition in the U.S. Model treaty. The proposed protocol's definition of a resident of a Contracting State reverses an exclusion from the definition in the present treaty for a person who is subject to tax in a treaty country by reason of that person's citizenship but who is not a resident of that country. Consequently, under the proposed protocol, a nonresident citizen of the United States may (subject to the article's other rules) be treated as a resident of the United States. The proposed protocol also conforms to the U.S. Model treaty's two tie-breaker rules for determining the residence of an individual who otherwise would be a resident of both treaty countries. Accordingly, residence under these tie-breaker rules is determined based on the country of which the individual is a national, rather than, as under the present treaty, on the individual's country of citizenship.

The proposed protocol adds new paragraphs 8 and 9 to Article 7 (Business Profits) of the present treaty. New paragraph 8, like the U.S. Model treaty, provides that business profits 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 has ceased to exist. New paragraph 9 differs from the U.S. Model and OECD Model treaties, and specifically addresses New Zealand law relating to trusts. It provides that (1) if a fiscally transparent entity, or trustee, has a permanent establishment in one treaty country, and (2) a resident of the other treaty country is beneficially entitled to a share of profits from a business carried on by the entity or trustee through a permanent establishment in the first country, then the beneficial owner is treated as carrying on the business through the permanent establishment.

The proposed protocol replaces Article 10 (Dividends) of the present treaty with a new article that generally allows full residence-country taxation and limited source-country taxation of dividends. The proposed protocol retains the generally applicable maximum rate of withholding at source of 15 percent, but also adds a reduced five-percent maximum rate for dividends received by a company owning at least 10 percent of the voting power of dividend-paying company. Like several other recent treaties and protocols, the proposed protocol also 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 proposed protocol adds special rules that apply to dividends received from regulated investment companies and real estate investment trusts which are similar to provisions included in other recent treaties and protocols.

The proposed protocol replaces Article 11 (Interest) of the present treaty with a new article that retains source-country taxation of interest at a maximum withholding rate of 10 percent, but allows a special zero rate of withholding for certain financial institutions and governmental entities.

The proposed protocol revises Article 12 (Royalties) of the present treaty. It provides that royalties arising in a treaty country (the source country) and beneficially owned by a resident of the other treaty country may be subject to a source country tax of up to five percent. This is a reduction from the 10-percent rate provided in the present treaty, but any source-country taxation of royalties remains above the exemption provided in the U.S. Model treaty.

The proposed protocol makes two modifications to Article 13 (Alienation of Property). The proposed protocol makes a conforming change to reflect the elimination of Article 14 (Independent Personal Services) of the present treaty in a manner consistent with the OECD Model treaty. Additionally, to avoid double taxation, the proposed protocol updates the present treaty to allow U.S. individuals who expatriate to New Zealand (who are required to recognize taxable gain on a deemed sale of all of their property under section 877A of the Code) to get a step up in tax basis for New Zealand tax purposes by treating the property deemed sold as immediately repurchased at its fair market value.

The proposed protocol replaces Article 16 (Limitation on Benefits) of the present treaty with a new article 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 indirect use of the treaty by persons who are not entitled to its benefits solely by reason of residence in New Zealand or the United States.

The proposed protocol makes certain conforming changes to Article 22 (Relief from Double Taxation) of the present treaty to reflect changes by the proposed protocol to Article 2 (Taxes Covered). The proposed protocol also deletes the last sentence of paragraph 2 of Article 22 of the present treaty. The deleted sentence provides that dividends received from a U.S. company by a New Zealand company that owns at least 10 percent of the paid-up share capital of the U.S. company (being dividends that would be exempt from New Zealand tax under New Zealand law at the time of the signing of the present treaty) are exempt from New Zealand tax.

The proposed protocol replaces the nondiscrimination rules of Article 23 of the present treaty with new rules that are similar to the nondiscrimination provisions of the U.S. Model treaty and other recent U.S. income tax treaties. These rules generally forbid each treaty country from discriminating against nationals of the other country by imposing on those nationals more burdensome taxes than it would impose on its own comparably situated nationals in the same circumstances. Similarly, neither treaty 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. The nondiscrimination provision does not include the U.S. Model treaty rule which provides that the nondiscrimination rules apply to taxes of every kind and description imposed by a treaty country or by a political subdivision or local authority of that treaty country. Accordingly, the nondiscrimination rules apply only to taxes covered by the present treaty (as modified by the proposed protocol) and not, for example, to U.S. state and local taxes.

The proposed protocol does not change the provisions of Article 24 (Mutual Agreement Procedure) of the treaty. Thus, the treaty, as modified by the proposed protocol, does not include a mandatory arbitration procedure similar to the rules of the proposed protocol with France and the treaties with Belgium, Canada, and Germany.

The proposed protocol replaces Article 25 (Exchange of Information) of the present treaty with rules that conform closely to the U.S. Model treaty. The proposed rules generally provide that the two competent authorities will exchange such information as may be relevant in carrying out the provisions of the domestic laws of the United States and New Zealand concerning taxes imposed at a national level, to the extent the taxation under those laws is not contrary to the treaty, as modified by the proposed protocol. It provides – for the first time – for mutual assistance in the collection of tax debts between the United States and New Zealand. Such assistance is limited to tax debts that arise from improperly granted treaty benefits.

The proposed protocol replaces paragraph 1 of the protocol to the present treaty, which was signed on the same day as the treaty. Under the proposed protocol, New Zealand is required to consult with the United States for purposes of providing the same treatment on a reciprocal basis if (1) it enters into a double taxation treaty with any country (and not just with an OECD member) and (2) that treaty limits the withholding tax rates on interest or royalties (but not dividends) to a rate lower than the one provided for in the treaty with the United States.

Under the provisions of Article XVI, the proposed protocol enters into force on the date of the later of the notifications. The relevant date is the date on the second of the notification documents, and not the date on which the second notification is delivered to the other treaty country. Generally, the proposed protocol is effective on a prospective basis. However, the competent authority provisions under Article 26 (Exchange of Information) are effective retroactively to taxable periods preceding the entry into force of the proposed protocol.

Conclusion

These provisions and issues are all discussed in more detail in the Joint Committee staff pamphlets on the proposed treaty and protocols. I am happy to answer any questions that your committee may have at this time or in the future.